



INDIAN CONTRACT ACT, 1872



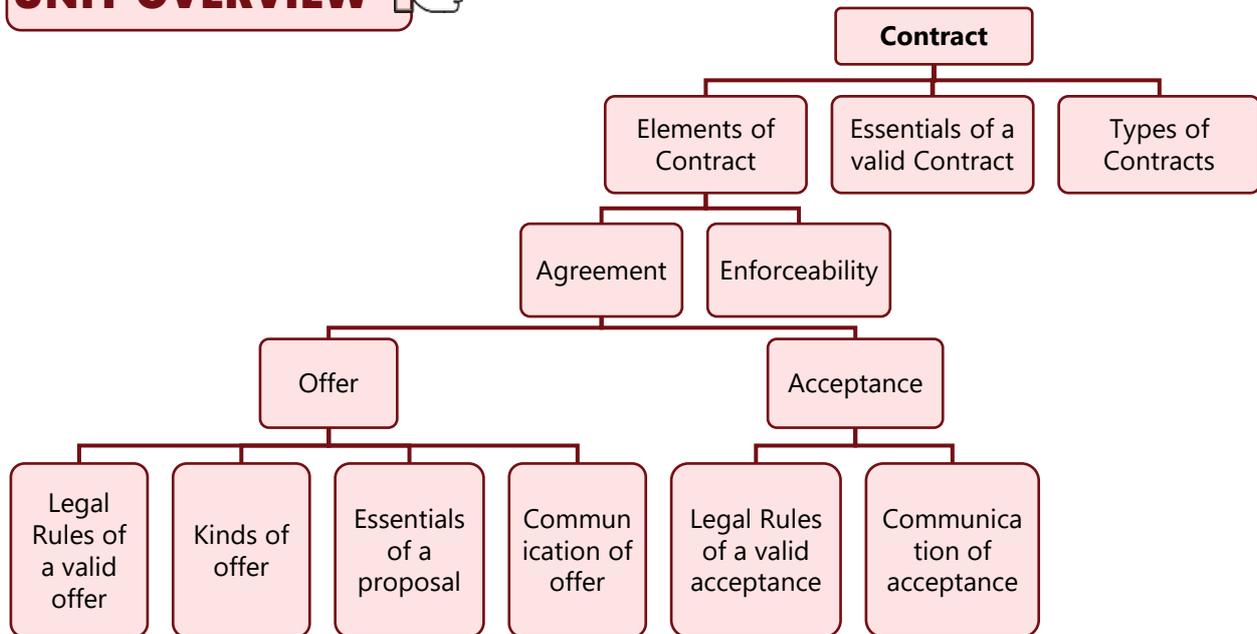
UNIT – 1: NATURE OF CONTRACTS

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ The meaning of the terms 'agreement' and 'contract' and note the distinction between the two.
- ◆ The essential elements of a contract.
- ◆ About various types of contract.
- ◆ The concept of offer and acceptance and rules of communication and revocation thereof.

UNIT OVERVIEW



Contract Law before Indian Contract Act, 1872

To understand the Contract Law before the Indian Contract Act, 1872, we should understand the journey of contract law during different time periods. In the ancient and medieval time, there was no specific law for contracts. For this purpose, generally, different sources of Hindu law like; Vedas, Dharam shastras, Smritis, Shrutis etc. were referred which gave a vivid description of the law similar to contracts in those times. During the period of Mauryas, contracts were in the form of "bilateral transactions" which were based on free consent on all the terms and conditions involved.

During the Mughal rule in India, contracts were governed by Mohammedan Law of Contract. In this law, the Arabic word 'Aqd' is known for contract which means a conjunction. In the same way, word 'Ijab' was used for proposal and 'Qabul' was used for acceptance. The formation of a contract according to Islamic law does not require any kind of formality; the only requirement is the express consent of both parties on the same thing in the same sense.

Hindu law is basically different from that of English law. Hindu law is actually the compilation of numerous customs and works of Smritikaras, who interpreted and analysed Vedas to develop the various aspect of Hindu law. According to Hindu law, minor, intoxicated person, old man or handicapped cannot enter into a valid contract. According to Narada smriti, someone of age upto 8 years is considered as an infant. Age from 8 years to 16 years is considered as boyhood and after 16 years the person is competent to enter into a contract.

During British period; before the advent of the Indian Contract Act, the English Law was applied in the Presidency Towns of Madras, Bombay and Calcutta under the Charter of 1726 issued by king George to the East India Company. If one of the parties of contract is from either of the religion and other is from other religion then the law of the defendant is to be used. This was followed in the presidency towns, but in cities outside the presidency towns, the matters were solved on the basis of justice, equity and good conscience. This procedure was followed till the Indian Contract Act was implemented in India.

The Law of contract: Introduction

The Law of Contract constitutes the most important branch of mercantile or commercial law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world. The law relating to contract is governed by the Indian Contract Act, 1872. It was formed on April 25, 1872 and came into force on September 01, 1872. The preamble to the Act says that it is an Act "to define and amend certain parts of the law relating to contract". It extends to the whole of India including the state of Jammu and Kashmir after removal of Article – 370 of Indian Constitution.

The Act mostly deals with the general principles and rules governing contracts. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, e.g., Indemnity and guarantee, bailment, pledge, and agency.

As a result of increasing complexities of business environment, innumerable contracts are entered into by the parties in the usual course of carrying on their business. 'Contract' is the most usual method of defining the rights and duties in a business transaction. This branch of law is different from other branches of law in a very important aspect. It does not prescribe so many rights and duties, which the law will protect or enforce; instead it contains a number of limiting principles subject to which the parties may create rights and duties for themselves. The Indian Contract Act, 1872 codifies the legal principles that govern 'contracts'. The Act basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with certain special type of contractual relationships like indemnity, guarantee, bailment, pledge, quasi contracts, contingent contracts etc. It basically defines the circumstances in which promises made by the parties to a contract shall be legally binding on them.



This unit refers to the essentials of a legally enforceable agreement or contract. It sets out rules for the offer and acceptance and revocation thereof. It states the circumstances when an agreement is voidable or enforceable by one party only, and when the agreements are void, i.e. not enforceable at all.

1.1 WHAT IS A CONTRACT?

The term contract is defined under section 2(h) of the Indian Contract Act, 1872 as-

“an agreement enforceable by law”.

The contract consists of two essential elements:

- (i) an agreement, and
- (ii) its enforceability by law.

- (i) Agreement** - The term 'agreement' **given in Section 2(e)** of the Act is defined as- “every promise and every set of promises, forming the consideration for each other”.

To have an insight into the definition of agreement, we need to understand promise.

Section 2 (b) defines promise as- “when the person to whom the proposal is made signifies his assent there to, the proposal is said to be accepted. Proposal when accepted, becomes a promise”.

The following points emerge from the above definition:

1. when the person to whom the proposal is made
2. signifies his assent on that proposal which is made to him
3. the proposal becomes accepted
4. accepted proposal becomes promise

Thus, we say that an agreement is the result of the proposal made by one party to the other party and that other party gives his acceptance thereto of course for mutual consideration.

Agreement = Offer/Proposal + Acceptance + Consideration

- (ii) Enforceability by law** – An agreement to become a contract must give rise to a legal obligation which means a duly enforceable by law.

Thus, from above definitions it can be concluded that –

Contract = Agreement + Enforceability by law

On elaborating the above two concepts, it is obvious that contract comprises of an agreement which is a promise or a set of reciprocal promises, that a promise is the acceptance of a proposal giving rise to a binding contract. Further, section 2(h) requires an agreement capable of being enforceable by law before it is called 'contract'. Where parties have made a binding contract, they created rights and obligations between themselves.

Example 1: A agrees with B to sell car for ₹ 2 lacs to B. Here A is under an obligation to give car to B and B has the right to receive the car on payment of ₹ 2 lacs and also B is under an obligation to pay ₹ 2 lacs to A and A has a right to receive ₹ 2 lacs.

Example 2: Father promises his son to pay him pocket allowance of Rs. 500 every month. But he refuses to pay later. The son cannot recover the same in court of law as this is a social agreement. This is not created with an intention to create legal relationship and hence it is not a contract.

So, Law of Contract deals with only such legal obligations which has resulted from agreements. Such obligation must be contractual in nature. However, some obligations are outside the purview of the law of contract.

Example 3: An obligation to maintain wife and children, an order of the court of law etc. These are status obligations and so out of the scope of the Contract Act.

Difference between Agreement and Contract

| Basis of differences | Agreement | Contract |
|-------------------------|--------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| Meaning | Every promise and every set of promises, forming the consideration for each other. (Promise + Consideration) | Agreement enforceable by law. (Agreement + Legal enforceability) |
| Scope | It's a wider term including both legal and social agreement. | It is used in a narrow sense with the specification that contract is only legally enforceable agreement. |
| Legal obligation | It may not create legal obligation. An agreement does not always grant rights to the parties | Necessarily creates a legal obligation. A contract always grants certain rights to every party. |
| Nature | All agreement are not contracts. | All contracts are agreements. |

 **1.2 ESSENTIALS OF A VALID CONTRACT**

Essentials of a valid contract

| | As given by Section 10 of Indian Contract Act, 1872 | | Not given by Section 10 but are also considered essential |
|---|-----------------------------------------------------|---|-----------------------------------------------------------|
| 1 | Agreement | 1 | Two parties |
| 2 | Free consent | 2 | Intention to create legal relationship |

| | | | |
|---|--------------------------------------------------------------------|---|----------------------------------|
| 3 | Competency of the parties | 3 | Fulfilments of legal formalities |
| 4 | Lawful consideration | 4 | Certainty of meaning |
| 5 | Legal object | 5 | Possibility of performance |
| 6 | Not expressly declared to be void [as per Section 24 to 30 and 56] | 6 | - |

In terms of Section 10 of the Act, “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 expressly declared to be void”.

Since section 10 is not complete and exhaustive, so there are certain other sections which also contains requirements for an agreement to be enforceable. Thus, in order to create a valid contract, the following elements should be present:

1. **Two Parties:** One cannot contract with himself. A contract involves at least two parties- one party making the offer and the other party accepting it. A contract may be made by natural persons and by other persons having legal existence e.g. companies, universities etc. It is necessary to remember that identity of the parties be ascertainable.

Example 4: To constitute a contract of sale, there must be two parties- seller and buyer. The seller and buyer must be two different persons, because a person cannot buy his own goods.

In **State of Gujarat vs. Ramanlal S & Co.** when on dissolution of a partnership, the assets of the firm were divided among the partners, the sales tax officer wanted to tax this transaction. It was held that it was not a sale. The partners being joint owner of those assets cannot be both buyer and seller.

2. **Parties must intend to create legal obligations:** There must be an intention on the part of the parties to create legal relationship between them. Social or domestic type of agreements are not enforceable in court of law and hence they do not result into contracts.

Example 5: A husband agreed to pay to his wife certain amount as maintenance every month while he was abroad. Husband failed to pay the promised amount. Wife sued him for the recovery of the amount. Here, in this case, wife could not recover as it was a social agreement and the parties did not intend to create any legal relations. (**Balfour v. Balfour**)

Example 6: Mr. Lekhpal promises to pay ₹ 5 lakhs to his son if the son passes the CA exams. On passing the exams, the son claims the money. Here, the son could not recover as it was a social agreement.

Example 7: A sold goods to B on a condition that he must pay for the amount of goods within 30 days. Here A intended to create legal relationship with B. Hence the same is contract. On failure by B for making a payment on due date, A can sue him in the court of law.

3. **Other Formalities to be complied with in certain cases:** A contract may be written or spoken. As to legal effects, there is no difference between a written contract and contract made by word of mouth. But in the interest of the parties the contract must be written. In case of certain contracts some other formalities have to be complied with to make an agreement legally enforceable.

For e.g. Contract of Insurance is not valid except as a written contract. Further, in case of certain contracts, registration of contract under the laws which is in force at the time, is essential for it to be valid, e.g. in the case of immovable property.

Thus, where there is any statutory requirement that any contract is to be made in writing or in the presence of witness, or any law relating to the registration of documents must be complied with.

4. **Certainty of meaning:** The agreement must be certain and not vague or indefinite.

Example 8: A agrees to sell to B a hundred tons of oil. There is nothing certain in order to show what kind of oil was intended for.

Example 9: XYZ Ltd. agreed to lease the land to Mr. A for indefinite years. The contract is not valid as the period of lease is not mentioned.

5. **Possibility of performance of an agreement:** The terms of agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced.

Example 10: A agrees with B to discover treasure by magic. The agreement cannot be enforced as it is not possible to be performed

Now, according to Section 10 of the Indian Contract Act, 1872, the following are the essential elements of a Valid Contract:

- I. **Offer and Acceptance or an agreement:** An agreement is the first essential element of a valid contract. According to Section 2(e) of the Indian Contract Act, 1872, "Every promise and every set of promises, forming consideration for each other, is an agreement" and according to Section 2(b) "A proposal when accepted, becomes a promise". An agreement is an outcome of offer and acceptance for consideration.
- II. **Free Consent:** Two or more persons are said to consent when they agree upon the same thing in the same sense. This can also be understood as identity of minds in understanding the terms viz consensus ad idem. Further such consent must be free.

Consent would be considered as free consent if it is not caused by coercion, undue influence, fraud, misrepresentation or mistake.

Example 11: A, who owns two cars is selling red car to B. B thinks he is purchasing the black car. There is no *consensus ad idem* and hence no contract.

To determine *consensus ad idem* the language of the contract should be clearly drafted. Thus, if A says B "Will you buy my red car for ₹ 3,00,000?". B says "yes" to it. There is said to be *consensus ad idem* i.e. the meaning is taken in same sense by both the parties.

Example 12: A threatened to shoot B if he (B) does not lend him ₹ 2,00,000 and B agreed to it. Here the agreement is entered into under coercion and hence not a valid contract.

(Students may note that the terms coercion, undue influence, fraud, misrepresentation, mistake are explained in the Unit-3)

III. Capacity of the parties: Capacity to contract means the legal ability of a person to enter into a valid contract. Section 11 of the Indian Contract Act specifies that every person is competent to contract who

- (a) is of the age of majority according to the law to which he is subject and
- (b) is of sound mind and
- (c) is not otherwise disqualified from contracting by any law to which he is subject.

A person for being competent to contract must fulfil all the above three qualifications.

Qualification (a) refers to the age of the contracting person i.e. the person entering into contract must be of 18 years of age. Persons below 18 years of age are considered minor, therefore, incompetent to contract.

Qualification (b) requires a person to be of sound mind i.e. he should be in his senses so that he understands the implications of the contract at the time of entering into a contract. A lunatic, an idiot, a drunken person or under the influence of some intoxicant is not supposed to be a person of sound mind.

Qualification (c) requires that a person entering into a contract should not be disqualified by his status, in entering into such contracts. Such persons are an alien enemy, foreign sovereigns, convicts etc. They are disqualified unless they fulfil certain formalities required by law.

Contracts entered by persons not competent to contract are not valid.

IV. Consideration: It is referred to as '*quid pro quo*' i.e. 'something in return'. A valuable consideration in the sense of law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

Example 13: A agrees to sell his books to B for ₹ 100.

B's promise to pay ₹ 100 is the consideration for A's promise to sell his books.

A's promise to sell the books is the consideration for B's promise to pay ₹ 100.

V. Lawful Consideration and Object: The consideration and object of the agreement must be lawful.

Section 23 states that consideration or object is not lawful if it is prohibited by law, or it is such as would defeat the provisions of law, if it is fraudulent or involves injury to the person or property of another or court regards it as immoral or opposed to public policy.

Example 14: 'A' promises to drop prosecution 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.

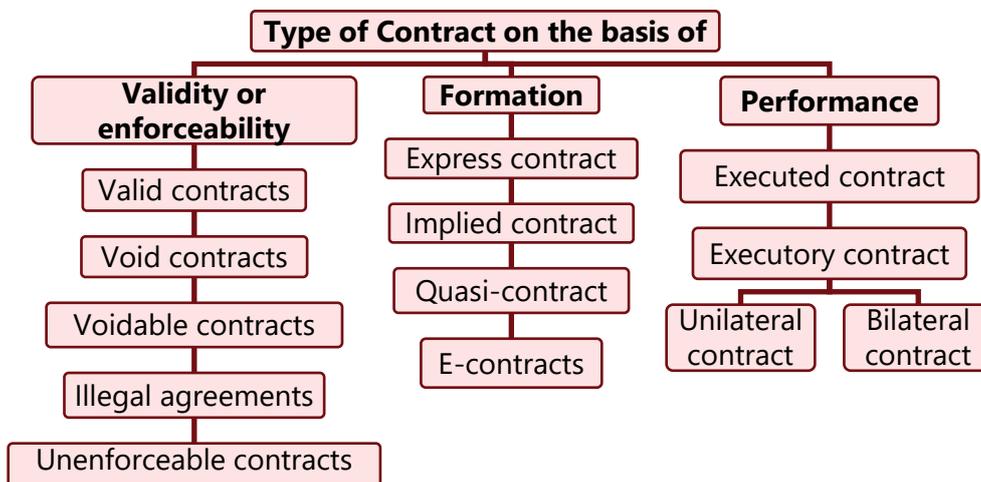
Example 15: A agrees to sell his house to B against 100 kgs of cocaine (drugs). Such agreement is illegal as the consideration is unlawful.

VI. Not expressly declared to be void: The agreement entered into must not be which the law declares to be either illegal or void. An illegal agreement is an agreement expressly or impliedly prohibited by law. A void agreement is one without any legal effects.

Example 16: Threat to commit murder or making/publishing defamatory statements or entering into agreements which are opposed to public policy are illegal in nature. Similarly, any agreement in restraint of trade, marriage, legal proceedings, etc. are classic examples of void agreements.

1.3 TYPES OF CONTRACTS

Now let us discuss various types of contracts.



I. On the basis of the validity

1. **Valid Contract:** An agreement which is binding and enforceable is a valid contract. It contains all the essential elements of a valid contract.

Example 17: A asks B if he wants to buy his bike for ₹ 50,000. B agrees to buy the bike. It is an agreement which is enforceable by law. Hence, it is a valid contract.

2. **Void Contract: Section 2 (j) states as follows:** "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable". Thus, a void contract is one which cannot be enforced by a court of law.

Example 18: Mr. X agrees to write a book with a publisher. Such a contract is valid. But after a few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract. Thus, a valid contract which cannot be performed because of some uncalled happening becomes void.

Example 19: A contracts with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is effected, a fire is caught in the factory and everything is destroyed. Here the contract becomes void.

It may be added by way of clarification here that when a contract is void, it is not a contract at all but for the purpose of identifying it, it has to be called a [void] contract.

3. **Voidable Contract:** Section 2(i) defines that "an agreement which is enforceable by law at the option of one or more parties thereto, but not at the option of the other or others is a voidable contract".

This in fact means where one of the parties to the agreement is in a position or is legally entitled or authorized to avoid performing his part, then the agreement is treated and becomes voidable.

Following are the situations where a contract is voidable:

- (i) When the consent of a party is not free, it is caused by coercion, undue influence, misrepresentation or fraud.

Example 20: X promises to sell his scooter to Y for ₹ 1 Lac. However, the consent of X has been procured by Y at a gun point. X is an aggrieved party, and the contract is voidable at his option but not on the option of Y. It means if X accepts the contract, the contract becomes a valid contract then Y has no option of rescinding the contract.

- (ii) When a person promises to do something for another person, but the other person prevents him from performing his promise, the contract becomes voidable at the option of first person.

Example 21: There is a contract between A and B to sell car of A to B for ₹ 2,00,000. On due date of performance, A asks B that he does not want to sell his car. Here contract is voidable at the option of B.

- (iii) When a party to a contract promise to perform a work within a specified time, could not perform within that time, the contract is voidable at the option of promisee.

Example 22: A agrees to construct a house for B upto 31-3-2022 but A could not complete the house on that date. Here contract is voidable at the option of B.

At this juncture it would be desirable to know **the distinction between a Void Contract and a Voidable Contract**. These are elaborated hereunder:

| S. No. | Basis | Void Contract | Voidable Contract |
|--------|-----------------------|--------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Meaning | A Contract ceases to be enforceable by law becomes void when it ceases to be enforceable. | An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract. |
| 2 | Enforceability | A void contract cannot be enforced at all. | It is enforceable only at the option of aggrieved party and not at the option of other party. |
| 3 | Cause | A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties. | A contract becomes a voidable contract if the consent of a party was not free. |

| | | | |
|---|--------------------------------|---------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4 | Performance of contract | A void contract cannot be performed. | If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract. |
| 5 | Rights | A void contract does not grant any legal remedy to any party. | The party whose consent was not free has the right to rescind the contract within a reasonable time. If so rescinded, it becomes a void contract. If it is not rescinded it becomes a valid contract. |

4. **Illegal Contract:** It is a contract which the law forbids to be made. The court will not enforce such a contract but also the connected contracts. All illegal agreements are void but all void agreements are not necessarily illegal. Despite this, there is similarity between them is that in both cases they are void ab initio and cannot be enforced by law.

Example 23: Contract that is immoral or opposed to public policy are illegal in nature. Similarly, if R agrees with S, to purchase brown sugar, it is an illegal agreement.

According to Section 2(g) of the Indian Contract Act, "an agreement not enforceable by law is void". The Act has specified various factors due to which an agreement may be considered as void agreement. One of these factors is unlawfulness of object and consideration of the contract i.e. illegality of the contract which makes it void. The illegal and void agreement differ from each other in the following respects:

| Basis of difference | Void agreement | Illegal agreement |
|----------------------------|----------------------------------------------------------|----------------------------------------------------------|
| Scope | A void agreement is not necessarily illegal. | An illegal agreement is always void. |
| Nature | Not forbidden under law. | Are forbidden under law. |
| Punishment | Parties are not liable for any punishment under the law. | Parties to illegal agreements are liable for punishment. |

| | | |
|-----------------------------|----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|
| Collateral Agreement | It's not necessary that agreements collateral to void agreements may also be void. It may be valid also. | Agreements collateral to illegal agreements are always void. |
|-----------------------------|----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|

5. **Unenforceable Contract:** Where a contract is good in substance but because of some technical defect i.e. absence in writing, barred by limitation etc. one or both the parties cannot sue upon it, it is described as an unenforceable contract.

Example 24: A bought goods from B in 2018. But no payment was made till 2022. B cannot sue A for the payment in 2022 as it has crossed three years and barred by Limitation Act. A good debt becomes unenforceable after the period of three years as barred by Limitation Act.

Similarly, an agreement for transfer of immovable property should be written for being enforceable.

II. On the basis of the formation of contract

1. **Express Contracts:** A contract would be an express contract if the terms are expressed by words or in writing. Section 9 of the Act provides that if a proposal or acceptance of any promise is made in words, the promise is said to be express.

Example 25: A tells B on telephone that he offers to sell his house for ₹ 20 lacs and B in reply informs A that he accepts the offer, this is an express contract.

2. **Implied Contracts:** Implied contracts in contrast come into existence by implication. Most often the implication is by action or conduct of parties or course of dealings between them. Section 9 of the Act contemplates such implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.

Example 26: Where a coolie in uniform picks up the luggage of A to be carried out of the railway station without being asked by A and A allows him to do so, it is an implied contract and A must pay for the services of the coolie detailed by him.

Example 27: A drinks a coffee in restaurant. There is an implied contract that he should pay for the price of coffee.

Tacit Contracts: The word Tacit means silent. Tacit contracts are those that are inferred through the conduct of parties without any words spoken or written. A classic example of tacit contract would be when cash is withdrawn by a

customer of a bank from the automatic teller machine [ATM]. Another example of tacit contract is where a contract is assumed to have been entered when a sale is given effect to at the fall of hammer in an auction sale. It is not a separate form of contract but falls within the scope of implied contracts.

- 3. Quasi-Contract:** A quasi-contract is not an actual contract, but it resembles a contract. It is created by law under certain circumstances. The law creates and enforces legal rights and obligations when no real contract exists. Such obligations are known as quasi-contracts. In other words, it is a contract in which there is no intention on part of either party to make a contract but law imposes a contract upon the parties.

Example 28: Obligation of finder of lost goods to return them to the true owner or liability of person to whom money is paid under mistake to repay it back cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent. These are said to be quasi-contracts.

Example 29: T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

- 4. E-Contracts:** When a contract is entered into by two or more parties using electronics means, such as e-mails is known as e-commerce contracts. In electronic commerce, different parties/persons create networks which are linked to other networks through EDI - Electronic Data Inter change. This helps in doing business transactions using electronic mode. These are known as EDI contracts or Cyber contracts or mouse click contracts.

III. On the basis of the performance of the contract

- 1. Executed Contract:** The consideration in a given contract could be an act or forbearance. When the act is done or executed or the forbearance is brought on record, then the contract is an executed contract.

Example 30: When a grocer sells a sugar on cash payment it is an executed contract because both the parties have done what they were to do under the contract.

- 2. Executory Contract:** In an executory contract the consideration is reciprocal promise or obligation. Such consideration is to be performed in future only and therefore these contracts are described as executory contracts.

Example 31: Where G agrees to take the tuition of H, a pre-engineering student, from the next month and H in consideration promises to pay G ₹ 1,000 per month, the contract is executory because it is yet to be carried out.

Unilateral or Bilateral are kinds of Executory Contracts and are not separate kinds.

- (a) **Unilateral Contract:** Unilateral contract is a one sided contract in which one party has performed his duty or obligation and the other party's obligation is outstanding.

Example 32: M advertises payment of award of ₹ 50,000 to any one who finds his missing boy and brings him. As soon as B traces the boy, there comes into existence an executed contract because B has performed his share of obligation and it remains for M to pay the amount of reward to B. This type of Executory contract is also called unilateral contract.

- (b) **Bilateral Contract:** A Bilateral contract is one where the obligation or promise is outstanding on the part of both the parties.

Example 33: A promises to sell his plot to B for ₹10 lacs cash down, but B pays only ₹ 2,50,000 as earnest money and promises to pay the balance on next Sunday. On the other hand, A gives the possession of plot to B and promises to execute a sale deed on the receipt of the whole amount. The contract between the A and B is executory because there remains something to be done on both sides. Such Executory contracts are also known as Bilateral contracts.



1.4 PROPOSAL / OFFER [SECTION 2(a) OF THE INDIAN CONTRACT ACT, 1872]

Definition of Offer/Proposal:

According to Section 2(a) of the Indian Contract Act, 1872, "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".

Essentials of a proposal/offer are-

1. **The person making the proposal or offer is called the 'promisor' or 'offeror':** The person to whom the offer is made is called the 'offeree' and the person accepting the offer is called the 'promisee' or 'acceptor'.
2. **For a valid offer, the party making it must express his willingness 'to do' or 'not to do' something:** There must be an expression of willingness to do or not to do some act by the offeror.

Example 34: A willing to sell his good at certain price to B.

Example 35: A is willing to not to dance in a competition if B pays him certain sum of money.

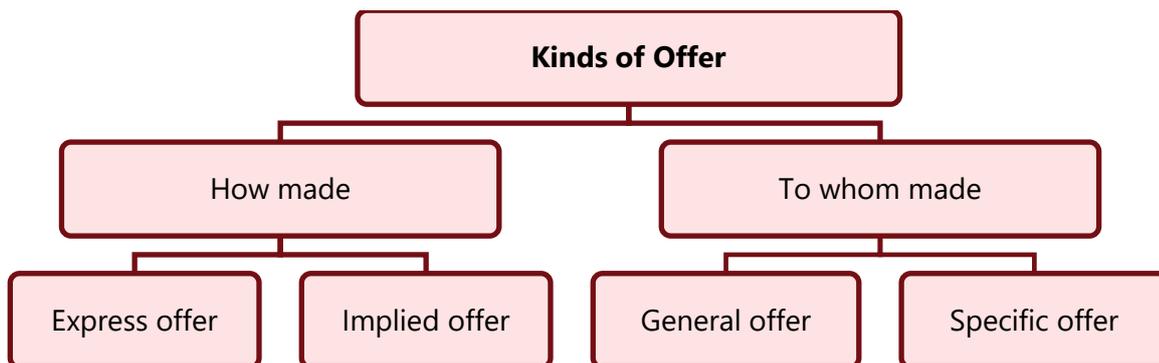
3. The willingness must be expressed with a view to obtain the assent of the other party to whom the offer is made.

Example 36: Where 'A' tells 'B' that he desires to marry by the end of 2022, it does not constitute an offer of marriage by 'A' to 'B'. Therefore, to constitute a valid offer expression of willingness must be made to obtain the assent (acceptance) of the other. Thus, if in the above **example**, 'A' further adds, 'Will you marry me', it will constitute an offer.

4. An offer can be positive as well as negative: Thus "doing" is a positive act and "not doing", or "abstinence" is a negative act; nonetheless both these acts have the same effect in the eyes of law.

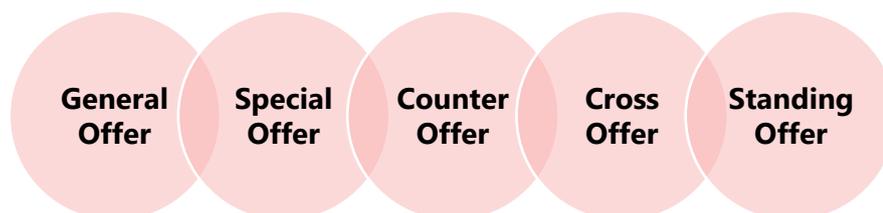
Example 37: A offers to sell his car to B for ₹ 3 lacs is an act of doing. So in this case, A is making an offer to B.

Example 38: When A ask B after his car meets with an accident with B's scooter not to go to Court and he will pay the repair charges to B for the damage to B's scooter; it is an act of not doing or abstinence.



Classification of offer

An offer can be classified as general offer, special/specific offer, cross offer, counter offer, standing/ open/ continuing offer.



Now let us examine each one of them.

- (a) **General offer:** It is an offer made to public at large and hence anyone can accept and do the desired act (***Carlill Vs. Carbolic Smoke Ball Co.***). In terms of Section 8 of the Act, anyone performing the conditions of the offer can be considered to have accepted the offer. Until the general offer is retracted or withdrawn, it can be accepted by anyone at any time as it is a continuing offer.

Case Law: *Carlill Vs. Carbolic Smoke Ball Co. (1893)*

Facts: In this famous case, Carbolic smoke Ball Co. advertised in several newspapers that a reward of £100 would be given to any person who contracted influenza after using the smoke balls produced by the Carbolic Smoke Ball Co. according to printed directions. One lady, Mrs. Carlill, used the smoke balls as per the directions of company and even then, suffered from influenza. Held, she could recover the amount as by using the smoke balls she had accepted the offer.

- (b) **Special/specific offer:** When the offer is made to a specific or an ascertained person, it is known as a specific offer. Specific offer can be accepted only by that specified person to whom the offer has been made. [***Boulton Vs. Jones***]

Example 39: 'A' offers to sell his car to 'B' at a certain cost. This is a specific offer.

- (c) **Cross offer:** When two parties exchange identical offers in ignorance at the time of each other's offer, the offers are called cross offers. There is no binding contract in such a case because offer made by a person cannot be construed as acceptance of the another's offer.

Example 40: If A makes a proposal to B to sell his car for ₹ 2 lacs and B, without knowing the proposal of A, makes an offer to purchase the same car at ₹ 2 lacs from A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer). And when two persons make offer to each other, it cannot be treated as mutual acceptance. There is no binding contract in such a case.

- (d) **Counter offer:** When the offeree offers to qualified acceptance of the offer subject to modifications and variations in the terms of original offer, he is said to have made a counter offer. Counter-offer amounts to rejection of the original offer. It is also called as Conditional Acceptance.

Example 41: 'A' offers to sell his plot to 'B' for ₹10 lakhs. 'B' agrees to buy it for ₹ 8 lakhs. It amounts to counter offer. It will result in the termination of the offer of 'A'. If later on 'B' agrees to buy the plot for ₹ 10 lakhs, 'A' may refuse.

- (e) **Standing or continuing or open offer:** An offer which is allowed to remain open for acceptance over a period of time is known as standing or continuing or open offer. Tenders that are invited for supply of goods is a kind of standing offer.

Essential of a valid offer

1. **It must be capable of creating legal relations:** Offer must be such as in law is capable of being accepted and giving rise to legal relationship. If the offer does not intend to give rise to legal consequences and creating legal relations, it is not considered as a valid offer in the eye of law. A social invitation, even if it is accepted, does not create legal relations because it is not so intended.

Example 42: A invited B on his birthday party. B accepted the proposal but when B reached the venue, he (B) found that A was not there. He filed the suit against A for recovery of travelling expenses incurred by him to join the birthday party. Held, such an invitation did not create a legal relationship. It is a social activity. Hence, B could not succeed.

2. **It must be certain, definite and not vague:** If the terms of an offer are vague or indefinite, its acceptance cannot create any contractual relationship.

Example 43: A offers to sell B 100 quintals of oil, there is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.

If in the above example, A is a dealer in mustard oil only, it shall constitute a valid offer.

3. **It must be communicated to the offeree:** An offer, to be complete, must be communicated to the person to whom it is made, otherwise there can be no acceptance of it. Unless an offer is communicated, there can be no acceptance by it. An acceptance of an offer, in ignorance of the offer, is not acceptance and does not confer any right on the acceptor.

This can be illustrated by the landmark case of **Lalman Shukla v. GauriDutt**

Facts: G (Gauridutt) sent his servant L (Lalman) to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. L traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. **Held,** he was not entitled to the reward, as he did not know the offer.

4. **It must be made with a view to obtaining the assent of the other party:** Offer must be made with a view to obtaining the assent of the other party addressed and not merely with a view to disclosing the intention of making an offer.

5. **It may be conditional:** An offer can be made subject to any terms and conditions by the offeror.

Example 44: Offeror may ask for payment by RTGS, NEFT etc. The offeree will have to accept all the terms of the offer otherwise the contract will be treated as invalid.

6. **Offer should not contain a term the non-compliance of which would amount to acceptance:** Thus, one cannot say that if acceptance is not communicated by a certain time the offer would be considered as accepted.

Example 45: A proposes B to purchase his android mobile for ₹5000 and if no reply by him in a week, it would be assumed that B had accepted the proposal. This would not result into contract.

7. **The offer may be either specific or general:** Any offer can be made to either public at large or to the any specific person. (Already explained in the heading-types of the offer)

8. **The offer may be express or implied:** An offer may be made either by words or by conduct.

Example 46: A boy starts cleaning the car as it stops on the traffic signal without being asked to do so, in such circumstances any reasonable man could guess that he expects to be paid for this, here boy makes an implied offer.

9. **Offer is Different from a mere statement of intention, an invitation to offer, a mere communication of information, A prospectus and Advertisement.**

- (i) **A statement of intention and announcement.**

Example 47: A father wrote his son about his wish of making him the owner of all his property is mere a statement of intention.

Example 48: An announcement to give scholarships to children scoring more than 95% in 12th board is not an offer.

- (ii) **Offer must be distinguished from an answer to a question.**

Case Law: Harvey vs. Face [1893] AC 552

In this case, Privy Council succinctly explained the distinction between an offer and an invitation to offer. In the given case, the plaintiffs through a telegram asked the defendants two questions namely,

- (i) Will you sell us Bumper Hall Pen? and
(ii) Telegraph lowest cash price.

The defendants replied through telegram that the "lowest price for Bumper Hall Pen is £ 900". The plaintiffs sent another telegram stating "we agree to buy Bumper Hall Pen at £ 900". However, the defendants refused to sell the property at the price.

The plaintiffs sued the defendants contending that they had made an offer to sell the property at £ 900 and therefore they are bound by the offer.

However, the Privy Council did not agree with the plaintiffs on the ground that while plaintiffs had asked two questions, the defendant replied only to the second question by quoting the price but reserved their answer with regard to their willingness to sell. Thus, they made no offer at all. Their Lordships held that the mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.

The above decision was followed in *Mac Pherson vs Appanna [1951] A.S.C. 184* where the owner of the property had said that he would not accept less than £ 6000/- for it. This statement did not indicate any offer but indicated only an invitation to offer.

- (iii) **A statement of price is not an offer:** Quoting the price of a product does not constitute it as offer. (refer case of ***Harvey Vs. Facie*** as discussed above)

Example 49: The price list of goods does not constitute an offer for sale of certain goods on the listed prices. It is an invitation to offer.

- (iv) **An invitation to make an offer or do business.** In case of "an invitation to make an offer", the person making the invitation does not make an offer rather invites the other party to make an offer. His objective is to send out the invitation that he is willing to deal with any person who, on the basis of such invitation, is ready to enter into contract with him subject to final terms and conditions.

Example 50: An advertisement for sale of goods by auction is an invitation to the offer. It merely invites offers/bids made at the auction.

When goods are sold through auction, the auctioneer does not contract with anyone who attends the sale. The auction is only an advertisement to sell but the items are not put for sale though persons who have come to the auction may have the intention to purchase. Similar decision was given in the case of ***Harris vs. Nickerson (1873)***.

Similarly, Prospectus issued by a company, is only an invitation to the public to make an offer to subscribe to the securities of the company.

10. A statement of price is not an offer**What is invitation to offer?**

An offer should be distinguished from an invitation to offer. An offer is definite and capable of converting an intention into a contract. Whereas an invitation to an offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer. An invitation to offer is an act precedent to making an offer. Acceptance of an invitation to an offer does not result in the contract and only an offer emerges in the process of negotiation.

When a person advertises that he has stock of books to sell or houses to let, there is no offer to be bound by any contract. Such advertisements are offers to negotiate-offers to receive offers. In order to ascertain whether a particular statement amounts to an 'offer' or an 'invitation to offer', the test would be intention with which such statement is made. Does the person who made the statement intend to be bound by it as soon as it is accepted by the other or he intends to do some further act, before he becomes bound by it. In the former case, it amounts to an offer and in the latter case, it is an invitation to offer.

Difference between offer and invitation to make an offer:

In terms of Section 2(a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other party chooses to accept it. On the other hand, offers made with the intention to negotiate or offers to receive offers are known as invitation to offer. Thus, where a party without expressing his final willingness proposes certain terms on which he is willing to negotiate he does not make an offer, but only invites the other party to make an offer on those terms. Hence the only thing that is required is the willingness of the offeree to abide by the terms of offer.

In order to ascertain whether a particular statement amounts to an offer or an invitation to offer, the test would be intention with which such statement is made. The mere statement of the lowest price which the vendor would sell contains no implied contract to sell at that price to the person making the inquiry.

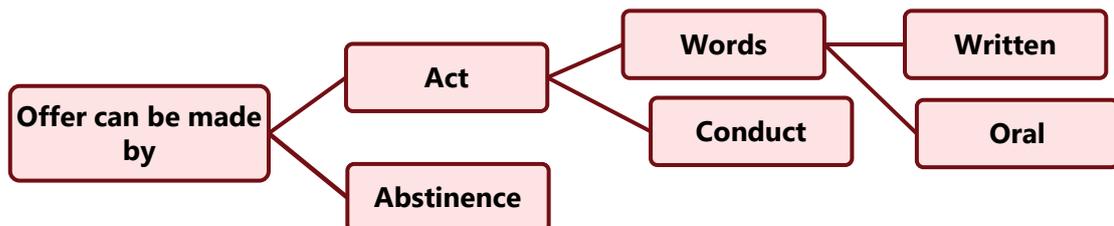
If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. Thus, the intention to be bound is important factor to be considered in deciding whether a statement is an 'offer' or 'invitation to offer.'

Following are instances of invitation to offer to buy or sell:

- (i) A Prospectus by a company to the public to subscribe for its shares.
- (ii) Display of goods for sale in shop windows.

- (iii) Advertising auction sales and
 (iv) Quotation of prices sent in reply to a query regarding price.

| Basis | Offer | Invitation to offer |
|---------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Meaning | Section 2(a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other party chooses to accept it. | Where a party without expressing his final willingness proposes certain terms on which he is willing to negotiate he does not make an offer, but only invites the other party to make an offer on those terms. |
| Intention of the parties | If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. | If a person has the intention of negotiating on terms it is called invitation to offer. |
| Sequence | An offer cannot be an act precedent to invitation to offer. | An invitation to offer is always an act precedent to offer. |



1.5 ACCEPTANCE

Definition of Acceptance: In terms of Section 2(b) of the Act, 'the term acceptance' is defined as follows:

"When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal, when accepted, becomes a promise".

Analysis of the above definition

- When the person to whom proposal is made - for example if A offers to sell his car to B for ₹ 2,00,000. Here, proposal is made to B.
- The person to whom proposal is made i.e. B in the above example and if B signifies his consent on that proposal, then we can say that B has signified his consent on the proposal made by A.

3. When B has signified his consent on that proposal, we can say that the proposal has been accepted.
4. Accepted proposal becomes promise.

Relationship between offer and acceptance: According to Sir William Anson "Acceptance is to offer what a lighted match is to a train of gun powder". The effect of this observation is that what acceptance triggers cannot be recalled or undone. But there is a choice to the person who had the train to remove it before the match is applied. It in effect means that the offer can be withdrawn just before it is accepted. Acceptance converts the offer into a promise and then it is too late to revoke it. This means as soon as the train of gun powder is lighted it would explode. Train of Gun powder [offer] in itself is inert, but it is the lighted match [the acceptance] which causes the gun powder to explode. The significance of this is an offer in itself cannot create any legal relationship but it is the acceptance by the offeree which creates a legal relationship. Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked. An offer remains an offer so long as it is not accepted but becomes a contract as soon as it is accepted.

Legal Rules regarding a valid acceptance

- (1) **Acceptance can be given only by the person to whom offer is made:** In case of a specific offer, it can be accepted only by the person to whom it is made. [**Boulton vs. Jones (1857)**]

Case Law: Boulton vs. Jones (1857)

Facts: Boulton bought a business from Brocklehurst. Jones, who was Brocklehurst's creditor, placed an order with Brocklehurst for the supply of certain goods. Boulton supplied the goods even though the order was not in his name. Jones refused to pay Boulton for the goods because by entering into the contract with Brocklehurst, he intended to set off his debt against Brocklehurst. **Held,** as the offer was not made to Boulton, therefore, there was no contract between Boulton and Jones.

In case of a general offer, it can be accepted by any person who has the knowledge of the offer. [**Carlill vs. Carbolic Smoke Ball Co. (1893)**]

- (2) **Acceptance must be absolute and unqualified:** As per section 7 of the Act, acceptance is valid only when it is absolute and unqualified and is also expressed in some usual and reasonable manner unless the proposal prescribes the manner in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be accepted accordingly.

M offered to sell his land to N for £280. N replied purporting to accept the offer but enclosed a cheque for £ 80 only. He promised to pay the balance of £ 200 by monthly

instalments of £ 50 each. It was held that N could not enforce his acceptance because it was not an unqualified one. **[Neale vs. Merret [1930] W. N. 189].**

A offers to sell his house to B for ₹ 30,00,000/-. B replied that, "I can pay ₹ 24,00,000 for it. The offer of 'A' is rejected by 'B' as the acceptance is not unqualified. B however changes his mind and is prepared to pay ₹ 30,00,000/-. This is also treated as counter offer and it is upto A whether to accept it or not. **[Union of India vs. Bahul AIR 1968 Bombay 294].**

Example 51: 'A' enquires from 'B', "Will you purchase my car for ₹ 2 lakhs?" If 'B' replies "I shall purchase your car for ₹ 2 lakhs, if you buy my motorcycle for ₹ 50,000/-, here 'B' cannot be considered to have accepted the proposal. If on the other hand 'B' agrees to purchase the car from 'A' as per his proposal subject to availability of valid Registration Certificate / book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore, the acceptance in this case is unconditional.

- (3) **The acceptance must be communicated:** To conclude a contract between the parties, the acceptance must be communicated in some perceptible form. Any conditional acceptance or acceptance with varying or too deviant conditions is no acceptance. Such conditional acceptance is a counter proposal and has to be accepted by the proposer, if the original proposal has to materialize into a contract. Further when a proposal is accepted, the offeree must have the knowledge of the offer made to him. If he does not have the knowledge, there can be no acceptance. The acceptance must relate specifically to the offer made. Then only it can materialize into a contract. The above points will be clearer from the following examples:

Brogden vs. Metropolitan Railway Co. (1877)

Facts: B a supplier, sent a draft agreement relating to the supply of coal to the manager of railway Co. viz, Metropolitan railway for his acceptance. The manager wrote the word "Approved" on the same and put the draft agreement in the drawer of the table intending to send it to the company's solicitors for a formal contract to be drawn up. By an over sight the draft agreement remained in drawer. Held, that there was no contract as the manager had not communicated his acceptance to the supplier, B.

Where an offer made by the intended offeree without the knowledge that an offer has been made to him cannot be deemed as an acceptance thereto. **(Bhagwandas v. Girdharilal)**

A mere variation in the language not involving any difference in substance would not make the acceptance ineffective. **[Heyworth vs. Knight [1864] 144 ER 120].**

Example 52: A proposed B to marry him. B informed A's sister that she is ready to marry him. But his sister didn't inform A about the acceptance of proposal. There is no contract as acceptance was not communicated to A.

- (4) **Acceptance must be in the prescribed mode:** Where the mode of acceptance is prescribed in the proposal, it must be accepted in that manner. But if the proposer does not insist on the proposal being accepted in the manner prescribed after it has been accepted otherwise, i.e., not in the prescribed manner, the proposer is presumed to have consented to the acceptance.

Example 53: If the offeror prescribes acceptance through messenger and offeree sends acceptance by email, there is no acceptance of the offer if the offeror informs the offeree that the acceptance is not according to the mode prescribed. But if the offeror fails to do so, it will be presumed that he has accepted the acceptance and a valid contract will arise.

- (5) **Time:** Acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within the reasonable time and before the offer lapses. What is reasonable time is nowhere defined in the law and thus would depend on facts and circumstances of the particular case.

Example 54: A offered to sell B 50 kgs of bananas at Rs. 500. B communicated the acceptance after four days. Such is not a valid contract as bananas being perishable items could not stay for a period of week. Four days is not a reasonable time in this case.

Example 55: A offers B to sell his house at Rs. 20,00,000. B accepted the offer and communicated to A after 4 days. Held the contract is valid as four days can be considered as reasonable time in case of sell of house.

- (6) **Mere silence is not acceptance:** The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer, unless the offeree has in any previous conduct indicated that his silence is the evidence of acceptance.

Case Law: Felthouse vs. Bindley (1862)

Facts: F (Uncle) offered to buy his nephew's horse for £30 saying "If I hear no more about it I shall consider the horse mine at £30." The nephew did not reply to F at all. He told his auctioneer, B to keep the particular horse out of sale of his farm stock as he intended to reserve it for his uncle. By mistake the auctioneer sold the horse. F sued him for conversion of his property. **Held,** F could not succeed as his nephew had not communicated the acceptance to him.

Example 56: 'A' subscribed for the weekly magazine for one year. Even after expiry of his subscription, the magazine company continued to send him magazine for five years. And also 'A' continued to use the magazine but denied to pay the bills sent to him. 'A' would be liable to pay as his continued use of the magazine was his acceptance of the offer.

- (7) **Acceptance by conduct/Implied Acceptance:** Section 8 of the Act lays down that "the performance of the conditions of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, constitutes an acceptance of the proposal. This section provides the acceptance of the proposal by conduct as against other modes of acceptance i.e. verbal or written communication.

Therefore, when a person performs the act intended by the proposer as the consideration for the promise offered by him, the performance of the act constitutes acceptance.

Example 57: when a tradesman receives an order from a customer and executes the order by sending the goods, the customer's order for goods constitutes the offer, which has been accepted by the trades man subsequently by sending the goods. It is a case of acceptance by conduct.

1.6 COMMUNICATION OF OFFER AND ACCEPTANCE

The importance of 'offer' and 'acceptance' in giving effect to a valid contract was explained in the previous paragraphs. One important common requirement for both 'offer' and 'acceptance' is their effective communication. Effective and proper communication prevents avoidable revocation and misunderstanding between parties.

When the contracting parties are face-to-face, there is no problem of communication because there is instantaneous communication of offer and acceptance. In such a case the question of revocation does not arise since the offer and its acceptance are made instantly.

The difficulty arises when the contracting parties are at a distance from one another and they utilise the services of the post office or telephone or email (internet). In such cases, it is very much relevant for us to know the exact time when the offer or acceptance is made or complete.

The Indian Contract Act, 1872 gives a lot of importance to "time" element in deciding when the offer and acceptance is complete.

Communication of offer: In terms of Section 4 of the Act, "the communication of offer is complete when it comes to the knowledge of the person to whom it is made".

Example 58: Where 'A' makes a proposal to 'B' by post to sell his house for ₹ 5 lakhs and if the letter containing the offer is posted on 10th March and if that letter reaches 'B' on 12th March the offer is said to have been communicated on 12th March when B received the letter.

Thus, it can be summed up that when a proposal is made by post, its communication will be complete when the letter containing the proposal reaches the person to whom it is made.

Mere receiving of the letter is not sufficient, he must receive or read the message contained in the letter.

He receives the letter on 12th March, but he reads it on 15th of March. In this case offer is communicated on 15th of March, and not 12th of March.

Communication of acceptance: There are two issues for discussion and understanding. They are: The modes of acceptance and when is acceptance complete?

Let us, first consider the **modes of acceptance**. Section 3 of the Act prescribes in general terms two modes of communication namely, (a) by any act and (b) by omission, intending thereby, to communicate to the other or which has the effect of communicating it to the other.

Communication by act would include any expression of words whether written or oral. Written words will include letters, telegrams, faxes, emails and even advertisements. Oral words will include telephone messages. Again communication would include any conduct intended to communicate like positive acts or signs so that the other person understands what the person 'acting' or 'making signs' means to say or convey.

Communication of acceptance by 'omission' to do something. Such omission is conveyed by a conduct or by forbearance on the part of one person to convey his willingness or assent. However, silence would not be treated as communication by 'omission'.

Example 59: A offers ₹ 50,000 to B if he does not arrive before the court of law as an evidence to the case. B does not arrive on the date of hearing to the court. Here omission of doing an act amounts to acceptance.

Communication of acceptance by conduct. For instance, delivery of goods at a price by a seller to a willing buyer will be understood as a communication by conduct to convey acceptance. Similarly, one need not explain why one boards a public bus or drop a coin in a weighing machine. The first act is a conduct of acceptance against its communication to the offer by the public transport authority to carry any passenger. The second act is again a conduct conveying acceptance to use the weighing machine kept by the vending company as an offer to render that service for a consideration.

The other issue in communication of acceptance is about the effect of act or omission or conduct. These indirect efforts must result in effectively communicating its acceptance or non acceptance. If it has no such effect, there is no communication regardless of which the acceptor thinks about the offer within himself. Thus, a mere mental unilateral assent in one's

own mind would not amount to communication. Where a resolution passed by a bank to sell land to 'A' remained uncommunicated to 'A', it was held that there was no communication and hence no contract. [**Central Bank Yeotmal vs Vyankatesh (1949) A. Nag. 286**].

Let us now come to the issue of when communication of acceptance is complete. In terms of Section 4 of the Act, it is complete,

- (i) **As against the proposer**, when it is put in the course of transmission to him so as to be out of the power of the acceptor to withdraw the same;
- (ii) **As against the acceptor**, when it comes to the knowledge of the proposer.

Where a proposal is accepted by a letter sent by the post, the communication of acceptance will be complete as against the proposer when the letter of acceptance is posted and as against the acceptor when the letter reaches the proposer.

For instance in the above *example*, if 'B' accepts, A's proposal and sends his acceptance by post on 14th, the communication of acceptance as against 'A' is complete on 14th, i.e. when the letter is posted. As against 'B' acceptance will be complete, when the letter reaches 'A'.

Here 'A' the proposer will be bound by B's acceptance, even if the letter of acceptance is delayed in post or lost in transit. The golden rule is proposer becomes bound by the contract, the moment acceptor has posted the letter of acceptance. But it is necessary that the letter is correctly addressed, adequately stamped and duly posted. In such an event the loss of letter in transit, wrong delivery, non delivery etc., will not affect the validity of the contract.

However, from the view point of acceptor, he will be bound by his acceptance only when the letter of acceptance has reached the proposer. So, it is crucial in this case that the letter reaches the proposer. If there is no delivery of the letter, the acceptance could be treated as having been completed from the viewpoint of proposer but not from the viewpoint of acceptor. Of course this will give rise to an awkward situation of only one party to the contract, being treated as bound by the contract though no one would be sure as to where the letter of acceptance had gone.

Acceptance over telephone or telex or fax: When an offer is made of instantaneous communication like telex, telephone, fax or through e-mail, the contract is only complete when the acceptance is received by the offeree, and the contract is made at the place where the acceptance is received (**Entores Ltd. v. Miles Far East Corporation**). However, in case of a call drops and disturbances in the line, there may not be a valid contract.

Communication of special conditions: Sometimes there are situations where there are contracts with special conditions. These special conditions are conveyed tacitly and the acceptance of these conditions are also conveyed by the offeree again tacitly or without him even realizing it.

Example 60: Where a passenger undertakes a travel, the conditions of travel are printed at the back of the tickets, sometimes these special conditions are brought to the notice of the passenger, sometimes not. In any event, the passenger is treated as having accepted the special condition the moment he bought his ticket.

When someone travels from one place to another by air, it could be seen that special conditions are printed at the back of the air ticket in small letters [in a non-computerized train ticket even these are not printed] Sometimes these conditions are found to have been displayed at the notice board of the Airlines office, which passengers may not have cared to read. The question here is whether these conditions can be considered to have been communicated to the passengers of the Airlines and can the passengers be treated as having accepted the conditions. The answer to the question is in the affirmative and was so held in ***Mukul Datta vs. Indian Airlines [1962] AIR cal. 314*** where the plaintiff had travelled from Delhi to Kolkata by air and the ticket bore conditions in fine print. But such terms and condition should be reasonable.

Example 61: Where a launderer gives his customer a receipt for clothes received for washing. The receipt carries special conditions and are to be treated as having been duly communicated to the customer and therein a tacit acceptance of these conditions is implied by the customer's acceptance of the receipt [***Lily White vs. R. Mannuswamy [1966] A. Mad. 13***].

CASE LAW: Lily White vs. Mannuswamy (1970)

Facts: P delivered some clothes to drycleaner for which she received a laundry receipt containing a condition that in case of loss, customer would be entitled to claim 15% of the market price of value of the article, P lost her new saree. Held, the terms were unreasonable and P was entitled to recover full value of the saree from the drycleaner.

In the cases referred above, the respective documents have been accepted without a protest and hence amounted to tacit acceptance.

Standard forms of contracts: It is well established that a standard form of contract may be enforced on another who is subjectively unaware of the contents of the document, provided the party wanting to enforce the contract has given notice which, in the circumstances of a case, is sufficiently reasonable. But the acceptor will not incur any contractual obligation, if the document is so printed and delivered to him in such a state that it does not give reasonable notice on its face that it contains certain special conditions. In this connection, let us consider a converse situation. A transport carrier accepted the goods for transport without any conditions. Subsequently, he issued a circular to the owners of goods limiting his liability for the goods. In such a case, since the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods [***Raipur transport Co. vs. Ghanshyam [1956] A. Nag.145***].

1.7 COMMUNICATION OF PERFORMANCE

We have already discussed that in terms of Section 4 of the Act, communication of a proposal is complete when it comes to the knowledge of the person to whom it is meant. As regards acceptance of the proposal, the same would be viewed from two angles. These are:

- (i) **from the viewpoint of proposer and**
- (ii) **the other from the viewpoint of acceptor himself**

From the viewpoint of proposer, when the acceptance is put into a course of transmission, when it would be out of the power of acceptor. From the viewpoint of acceptor, it would be complete when it comes to the knowledge of the proposer.

At times the offeree may be required to communicate the performance (or act) by way of acceptance. In this case, it is not enough if the offeree merely performs the act but he should also communicate his performance unless the offer includes a term that a mere performance will constitute acceptance. The position was clearly explained in the famous case of **Carlill Vs Carbolic & Smokeball Co.** In this case the defendant a sole proprietary concern manufacturing a medicine which was a carbolic ball whose smoke could be inhaled through the nose to cure influenza, cold and other connected ailments issued an advertisement for sale of this medicine. The advertisement also included a reward of \$100 to any person who contracted influenza, after using the medicine (which was described as 'carbolic smoke ball'). Mrs. Carlill bought these smoke balls and used them as directed but contracted influenza. It was held that Mrs. Carlill was entitled to a reward of \$100 as she had performed the condition for acceptance. Further as the advertisement did not require any communication of compliance of the condition, it was not necessary to communicate the same. The court thus in the process laid down the following three important principles:

- (i) an offer, to be capable of acceptance, must contain a definite promise by the offeror that he would be bound provided the terms specified by him are accepted;
- (ii) an offer may be made either to a particular person or to the public at large, and
- (iii) if an offer is made in the form of a promise in return for an act, the performance of that act, even without any communication thereof, is to be treated as an acceptance of the offer.

1.8 REVOCATION OF OFFER AND ACCEPTANCE

If there are specific requirements governing the making of an offer and the acceptance of that offer, we also have specific law governing their revocation.

In term of **Section 4**, communication of revocation (of the proposal or its acceptance) is complete.

- (i) **as against the person who makes it** when it is put into a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it, and
- (ii) as against the person to whom it is made, when it comes to his knowledge.

The above law can be illustrated as follows: If you revoke your proposal made to me by a telegram, the revocation will be complete, as far as you are concerned when you have dispatched the telegram. But as far as I am concerned, it will be complete only when I receive the telegram.

As regards revocation of acceptance, if you go by the above example, I can revoke my acceptance (of your offer) by a telegram. This revocation of acceptance by me will be complete when I dispatch the telegram and against you, it will be complete when it reaches you.

But the important question for consideration is when a proposal can be revoked? And when can an acceptance be revoked? These questions are more important than the question when the revocation (of proposal and acceptance) is complete.

Ordinarily, the offeror can revoke his offer before it is accepted. If he does so, the offeree cannot create a contract by accepting the revoked offer.

Example 62: the bidder at an auction sale may withdraw (revoke) his bid (offer) before it is accepted by the auctioneer by fall of hammer.

An offer may be revoked by the offeror before its acceptance, even though he had originally agreed to hold it open for a definite period of time. So long as it is a mere offer, it can be withdrawn whenever the offeror desires.

Example 63: X offered to sell 50 bales of cotton at a certain price and promised to keep it open for acceptance by Y till 6 pm of that day. Before that time X sold them to Z. Y accepted before 6 p.m., but after the revocation by X. In this case it was held that the offer was already revoked.

In terms of **Section 5** of the Act a proposal can be revoked at any time before the communication of its acceptance is complete as against the proposer. An acceptance may be revoked at any time before the communication of acceptance is complete as against the acceptor.

Example 64: A proposes, by a letter sent by post, to sell his house to B. B accepts the proposal by a letter sent by post. A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards. Whereas B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches A, but not afterwards.

An acceptance to an offer must be made before that offer lapses or is revoked.

The law relating to the revocation of offer is the same in India as in England, but the law relating to the revocation of acceptance is different.

In English law, the moment a person expresses his acceptance of an offer, that moment the contract is concluded, and such an acceptance becomes irrevocable, whether it is made orally or through the post. In Indian law, the position is different as regards contract through post.

Contract through post- As acceptance, in English law, cannot be revoked, so that once the letter of acceptance is properly posted the contract is concluded. In Indian law, the acceptor or can revoke his acceptance any time before the letter of acceptance reaches the offeror, if the revocation telegram arrives before or at the same time with the letter of acceptance, the revocation is absolute.

Contract over Telephone- A contract can be made over telephone. The rules regarding offer and acceptance as well as their communication by telephone or telex are the same as for the contract made by the mutual meeting of the parties. The contract is formed as soon as the offer is accepted but the offeree must make it sure that his acceptance is received by the offeror, otherwise there will be no contract, as communication of acceptance is not complete. If telephone unexpectedly goes dead during conversation, the acceptor must confirm again that the words of acceptance were duly heard by the offeror.

Revocation of proposal otherwise than by communication: When a proposal is made, the proposer may not wait indefinitely for its acceptance. The offer can be revoked otherwise than by communication or sometimes by lapse.

Modes of revocation of offer

(i) **By notice of revocation:**

Example 65: A offered B to sell goods at Rs. 5,000 through a post but before B could accept the offer A received highest bid for the goods from C. So, A revoked the offer to B by informing B over the telephone and sold goods to C.

(ii) **By lapse of time:** The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely. It was held in **Ramsgate Victoria Hotel Co. Vs Montefiore (1866 L.R.Z. Ex 109)**, that a person who applied for shares in June was not bound by an allotment made in November. This decision was also followed in **India Cooperative Navigation and Trading Co. Ltd. Vs Padamsey Prem Ji**. However, these decisions now will have no relevance in the context of allotment of shares since the Companies Act, 2013 has several provisions specifically covering these issues.

- (iii) **By non-fulfilment of condition precedent:** Where the acceptor fails to fulfill a condition precedent to acceptance the proposal gets revoked. This principle is laid down in Section 6 of the Act. The offeror for instance may impose certain conditions such as executing a certain document or depositing certain amount as earnest money. Failure to satisfy any condition will result in lapse of the proposal. As stated earlier 'condition precedent' to acceptance prevents an obligation from coming into existence until the condition is satisfied. Suppose where 'A' proposes to sell his house to be 'B' for ₹ 5 lakhs provided 'B' leases his land to 'A'. If 'B' refuses to lease the land, the offer of 'A' is revoked automatically.
- (iv) **By death or insanity:** Death or insanity of the proposer would result in automatic revocation of the proposal but only if the fact of death or insanity comes to the knowledge of the acceptor.
- (v) By counter offer
- (vi) By the non-acceptance of the offer according to the prescribed or usual mode
- (vii) By subsequent illegality.

SUMMARY

Contract: A Contract is an agreement enforceable by law [Section 2(h)]. An agreement is enforceable by law, if it is made by the free consent of the parties who are competent to contract and the agreement is made with a lawful object and is for a lawful consideration and is not hereby expressly declared to be void [Section 10]. All contracts are agreements, but all agreements are not contracts. Agreements lacking any of the above said characteristics are not contracts. A contract that ceases to be enforceable by law is called 'void contract', [Section 2(i)], but an agreement which is enforceable by law at the option of one party thereto, but not at the option of the other is called 'voidable contract' [(Section 2(i)].

Offer and Acceptance: Offeror undertakes to do or to abstain from doing a certain act if the offer is properly accepted by the offeree. Offer may be expressly made or may even be implied by the conduct of the offeror, but it must have intention and be capable of creating legal relations. The terms of offer must be certain or at least be capable of being made certain.

Acceptance of offer must be absolute and unqualified and must be according to the prescribed or usual mode. If the offer has been made to a specific person, it must be accepted by that person only, but a general offer may be accepted by any person.

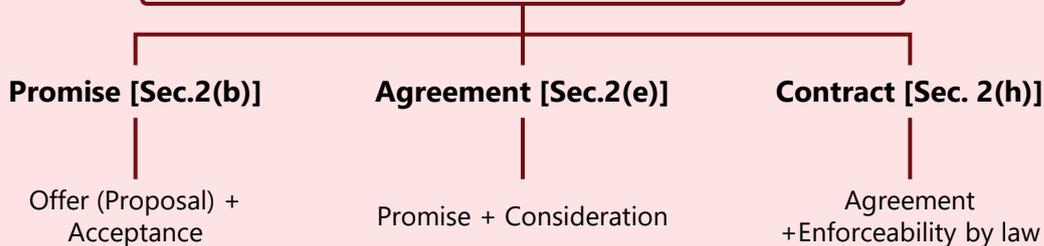
Communication of offer and acceptance, and revocation thereof-

- (a) Communication of an offer is complete when it comes to the knowledge of the offeree.
- (b) Communication of an acceptance is complete: As against the offeror when it is put in the course of transmission to him and as against the acceptor, when it comes to the knowledge of the offeror.
- (c) Communication of revocation of an offer or acceptance is complete: It is complete as against the person making it, when it is put into a course of transmission so as to be out of power of the person making it and as against the person to whom it is made, when it comes to his knowledge.

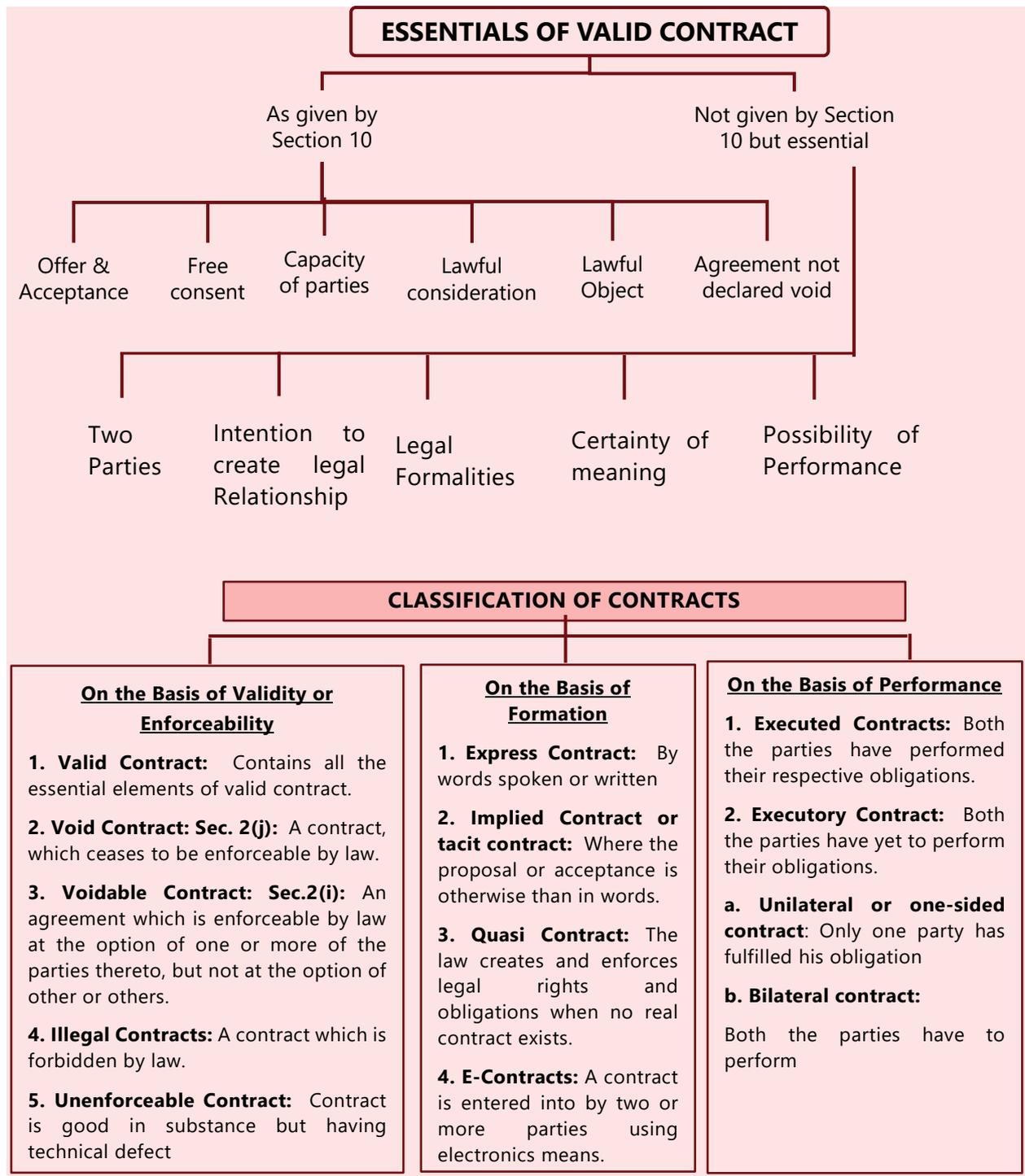
| Meaning of certain terms | |
|----------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Proposal [(i.e., offer) Section 2(a)] | <ul style="list-style-type: none"> ◆ 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 either to- • such act; or • abstinence, ◆ he is said to make a proposal (i.e. offer). |
| Promise [Section 2 (b)] | <ul style="list-style-type: none"> ◆ 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. |
| Agreement [Section 2(e)] | <ul style="list-style-type: none"> ◆ Every promise and every set of promises, ◆ forming consideration for each other, ◆ is an agreement. |
| Contract [Section 2(h)] | <ul style="list-style-type: none"> ◆ An agreement enforceable by law is a contract. |
| Promisor and Promisee [Section 2(c)] | <p>When the proposal is accepted-</p> <ul style="list-style-type: none"> ◆ the person making the proposal is called as 'promisor'; and ◆ the person accepting the proposal is called as 'promisee'. |

| | |
|------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Consideration [Section 2(d)]</p> | <p>When, at the desire of the promisor, the promisee</p> <ul style="list-style-type: none"> ◆ has done or abstained from doing something; or ◆ does or abstains from doing something; or any other person ◆ promises to do or abstain from doing something, <p>Such act, abstinence or promise is called a consideration for the promise.</p> |
| <p>Void agreement [Section 2(g)]</p> | <p>An agreement not enforceable by law is said to be void. A void agreement is not enforceable from the very beginning, i.e. it is void ab initio.</p> |
| <p>Voidable Contract [Section 2(i)]</p> | <p>An agreement is a voidable contract if-</p> <ul style="list-style-type: none"> ◆ it is enforceable by law at the option of one or more of the parties thereto, ◆ it is not enforceable by law at the option of the other or others. |
| <p>Void contract [Section 2 (j)]</p> | <ul style="list-style-type: none"> ◆ A contract ◆ which ceases to be enforceable by law ◆ becomes void when it ceases to be enforceable. |

Indian Contract Act, 1872 (1st September 1872)



Note: Agreement may be social or legal. Social Agreement is not enforceable by law.



PROPOSAL OR OFFER Sec.2(a)

"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".

Classification of Offer

- (a) General Offer:** Offer to the world at large.
- (b) Specific Offer:** Offer made to a definite person
- (c) Cross Offer:** When two parties make identical offers to each other
- (d) Counter Offer:** When offeree imposes conditions which have the effect of modifying or varying the offer.
- (e) Standing or continue or open offer:** Offer to public at large for acceptance for certain period of time

Essentials of A Valid Offer

1. Must be with intent to create legal relationship
2. Terms of the offer must be certain, definite & unambiguous.
3. Must be communicated to the offeree.
4. Must be made with a view to obtaining the assent of the other party.
5. May be conditional.
6. Must not contain a term the non-compliance of which amount acceptance.
7. May be general or specific or express or implied.
8. An offer must be distinguished from an invitation to offer.

ACCEPTANCE Sec 2(b)

"When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal when accepted, becomes a promise".

Legal Rules

1. Given only by the person to whom offer is made.
2. Must be absolute and unqualified.
3. Must be communicated.
4. Must be in the prescribed mode.
5. Mere silence is not acceptance.
6. May be by conduct/implied Acceptance

COMMUNICATION OF OFFER AND ACCEPTANCE

Mode of Communication: By Act, By Omission, By Conduct

Communication of Offer: (Sec.4)

The communication of offer is completed when it comes to the knowledge of person to whom it is made.

Communication of Acceptance: (Sec.4)

The communication of acceptance is complete-

- as against the proposer when it is put into a course of transmission to him, so as to be out of the power of acceptor to withdraw the same.
- as against the acceptor when it comes to the knowledge of proposer.

REVOCATION OF OFFER AND ACCEPTANCE

Time for revocation

Proposal: Before the communication of its acceptance is complete as against the proposer.

Acceptance: Before communication of the acceptance is complete as against the acceptor

Mode of Revocation

1. By communication of notice.
2. By lapse of time it is not accepted within the prescribed time.
3. By non-fulfillment by the offeree of a condition precedent to acceptance.
4. By death or insanity of the offer or provided the offeree comes to know of it before acceptance.
5. If a counter-offer is made to it.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. An agreement enforceable by law is a
 - (a) Promise
 - (b) Contract
 - (c) Obligation
 - (d) Lawful promise
2. A void agreement is one which is -
 - (a) Valid but not enforceable
 - (b) Enforceable at the option of both the parties
 - (c) Enforceable at the option of one party
 - (d) Not enforceable in a court of law.
3. 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
 - (a) Valid Contract
 - (b) Void contract

- (c) Voidable contract
 - (d) Illegal contract
4. When the consent of a party is not free, the contract is
- (a) Void
 - (b) Voidable
 - (c) Valid
 - (d) Illegal
5. In case of illegal agreements, the collateral agreements are:
- (a) Valid
 - (b) Void
 - (c) Voidable
 - (d) None of these
6. An offer may lapse by:
- (a) Revocation
 - (b) Counter Offer
 - (c) Rejection of offer by offeree
 - (d) All of these
7. A proposal when accepted becomes a
- (a) Promise
 - (b) Contract
 - (c) Offer
 - (d) Acceptance
8. If A says to B "I offer to sell my house to you for ₹ 40,00,000" and B accepts the offer by saying clearly "I accept your offer", it is a/an
- (a) Implied offer
 - (b) Express offer
 - (c) General offer
 - (d) None of the above

9. 'A' offered a reward of ₹ 1,00,000 for recovery of some valuable missing articles. 'B' who did not know of this offer, found the missing articles. Which one of the following is the correct solution to this problem?
- (a) Giving delivery of articles to 'A' amounts to an acceptance and hence 'B' is entitled to get the reward of ₹ 1,00,000
 - (b) Giving delivery of articles to 'A' amounts to performance of a condition precedent to an offer and hence there is valid acceptance. So 'B' must get the reward of ₹ 1,00,000
 - (c) As there is no acceptance of an offer due to want of Knowledge, 'B', is not entitled to get the reward of ₹ 1,00,000
 - (d) In the absence of any legal obligation on 'A', no claim for reward of ₹ 1,00,000 is maintainable by 'B'.
10. Arun has two cars- one of white colour and another of red colour. He offers to sell one of the cars to Basu thinking that he is selling the car which has white colour. Basu agrees to buy the car thinking that Arun is selling the car which has red colour. Will this agreement become a valid contract?
- (a) Yes
 - (b) No
 - (c) Insufficient information
 - (d) None of the above.
11. A dress is displayed in the showroom with a price tag attached to the dress. A buyer interested in the dress and ready to pay the price mentioned in the tag approached the shopkeeper for purchasing the dress.
- (a) The shopkeeper can refuse to sell the dress as display of dress is just an invitation to offer.
 - (b) The shopkeeper cannot refuse to sell the dress as the buyer has accepted the offer
 - (c) In case of refusal, the shopkeeper will be liable for breach of contract
 - (d) The shopkeeper cannot refuse to sell the dress but may charge higher price
12. A agrees to pay ₹ 1,000 to B if a certain ship returns within a year. However, the ship sinks within the year. In this case, the contract becomes
- (a) Valid
 - (b) Void

- (c) Voidable
(d) Illegal
13. A notice in the newspaper inviting tenders is
- (a) a proposal
(b) An invitation to proposal
(c) A promise
(d) An invitation for negotiation
14. A telephonic acceptance is complete when the offer is
- (a) spoken into the telephone
(b) heard but not understood by the offeror
(c) heard and understood by the offeror
(d) is received, heard and understood by some person in the offeror's house
15. A and B agree to deal in smuggled goods and share the profits. A refuses to give B's share of profit. In this case:
- (a) B can enforce the agreement in the court
(b) B can only claim damages
(c) B has no remedy as the contract is illegal
(d) B can enforce the contract and claim damages
16. Which one of the following statements is correct?
- (a) Void agreements are always illegal
(b) Illegal agreements are voidable
(c) Illegal agreement can be ratified by the parties
(d) Illegal agreements are always void
17. A voidable contract is one which
- (a) Can be enforced at the option of aggrieved party
(b) Can be enforced at the option of both the parties
(c) Cannot be enforced in a court of law
(d) Courts prohibit

18. When offer is made to a definite person, it is known as
- (a) General Offer
 - (b) Cross Offer
 - (c) Counter offer
 - (d) Special offer
19. On the face of a ticket, it is mentioned that to look for the terms and conditions look behind. Mr. A bought the ticket but didn't read the terms and conditions. He:
- (a) is not bound by the terms and condition
 - (b) may decide to bound by certain terms and ignore others
 - (c) is bound by all the terms and conditions whether he read it or not
 - (d) none of the above
20. It does not effect the free consent of the parties,
- (a) Fraud
 - (b) Coercion
 - (c) Incompetency of parties
 - (d) Undue Influence
21. _____ contract is made without intention of parties.
- (a) Express
 - (b) Implied
 - (c) Quasi
 - (d) Executory
22. A offers B to supply Books at Rs. 500 each. B accepts the same with condition of 30% discount. It is _____
- (a) Counter Offer
 - (b) Cross Offer
 - (c) Specific Offer
 - (d) General Offer

Descriptive Questions

1. *"All contracts are agreements, but all agreements are not contracts". Comment.*
2. *A sends an offer to B to sell his second-car for ₹ 1,40,000 with a condition that if B does not reply within a week, he (A) shall treat the offer as accepted. Is A correct in his proposition?*
3. *Explain the type of contracts in the following agreements under the Indian Contract Act, 1872:*
 - (i) *A coolie in uniform picks up the luggage of A to be carried out of the railway station without being asked by A and A allows him to do so.*
 - (ii) *Obligation of finder of lost goods to return them to the true owner.*
 - (iii) *A contracts with B (owner of the factory) for the supply of 10 tons of sugar, but before the supply is effected, the fire caught in the factory and everything was destroyed.*
4. *Shambhu Dayal started "self service" system in his shop. Smt. Prakash entered the shop, took a basket and after taking articles of her choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can Shambhu Dayal be compelled to sell the said articles to Smt. Prakash? Decide as per the provisions of the Indian Contract Act, 1872.*
5. *State whether there is any contract in following cases:*
 - (a) *A engages B to do certain work and remuneration to be paid as fixed by C.*
 - (b) *A and B promise to pay for the studies of their maid's son*
 - (c) *A takes a seat in public bus.*
 - (d) *A, a chartered accountant promises to help his friend to file his return.*
6. *Miss Shakuntala puts an application to be a teacher in the school. She was appointed by the trust of the school. Her friend who works in the same school informs her about her appointment informally. But later due to some internal reasons her appointment was cancelled. Can Miss Shakuntala claim for damages?*

ANSWER/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 1. | (b) | 2. | (d) | 3. | (c) | 4. | (b) | 5. | (b) | 6. | (d) |
| 7. | (a) | 8. | (b) | 9. | (c) | 10. | (b) | 11. | (a) | 12. | (b) |
| 13. | (b) | 14. | (c) | 15. | (c) | 16. | (d) | 17. | (a) | 18. | (d) |
| 19. | (c) | 20 | (c) | 21 | (c) | 22 | (a) | | | | |

Answers to the Descriptive Questions

- An agreement comes into existence when one party makes a proposal or offer to the other party and that other party gives his acceptance to it. A contract is an agreement enforceable by law. It means that to become a contract an agreement must give rise to a legal obligation i.e. duty enforceable by law. If an agreement is incapable of creating a duty enforceable by law, it is not a contract. There can be agreements which are not enforceable by law, such as social, moral or religious agreements. The agreement is a wider term than the contract. All agreements need not necessarily become contracts but all contracts shall always be agreements.

All agreements are not contracts: When there is an agreement between the parties and they do not intend to create a legal relationship, it is not a contract.

All contracts are agreements: For a contract there must be two things (a) an agreement and (b) enforceability by law. Thus, existence of an agreement is a pre-requisite existence of a contract. Therefore, it is true to say that all contracts are agreements.

Thus, we can say that there can be an agreement without it becoming a contract, but we can't have a contract without an agreement.

- Acceptance to an offer cannot be implied merely from the silence of the offeree, even if it is expressly stated in the offer itself. Unless the offeree has by his previous conduct indicated that his silence amount to acceptance, it cannot be taken as valid acceptance. So, in the given problem, if B remains silent, it does not amount to acceptance.

The acceptance must be made within the time limit prescribed by the offer. The acceptance of an offer after the time prescribed by the offeror has elapsed will not avail to turn the offer into a contract.

- (i) It is an implied contract and A must pay for the services of the coolie detailed by him.

Implied Contracts: Implied contracts come into existence by implication. Most often the implication is by law and or by action. Section 9 of the Act

contemplates such implied contracts when it lays down that in so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.

- (ii) Obligation of finder of lost goods to return them to the true owner cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent. These are said to be quasi-contracts.

Quasi-Contract: A quasi-contract is not an actual contract but it resembles a contract. It is created by law under certain circumstances. The law creates and enforces legal rights and obligations when no real contract exists. Such obligations are known as quasi-contracts. In other words, it is a contract in which there is no intention on part of either party to make a contract but law imposes a contract upon the parties.

- (iii) The above contract is a void contract.

Void Contract: Section 2 (j) states as follows: "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable". Thus, a void contract is one which cannot be enforced by a court of law.

4. **Invitation to offer:** The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

The display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, Smt. Prakash by selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by her. If the cashier does not accept the price, the interested buyer cannot compel him to sell.

5. (a) It is a valid express contract
(b) It is not a contract as it is a social agreement
(c) It is an implied contract. A is bound to pay for the bus fare.
(d) It is a social agreement without any intention to create a legal relationship.
6. No, Miss Shakuntala cannot claim damages. As per Section 4, communication of acceptance is complete as against proposer when it is put in the course of transmission to him.

In the present case, school authorities have not put any offer letter in transmission. Her information from a third person will not form part of contract.

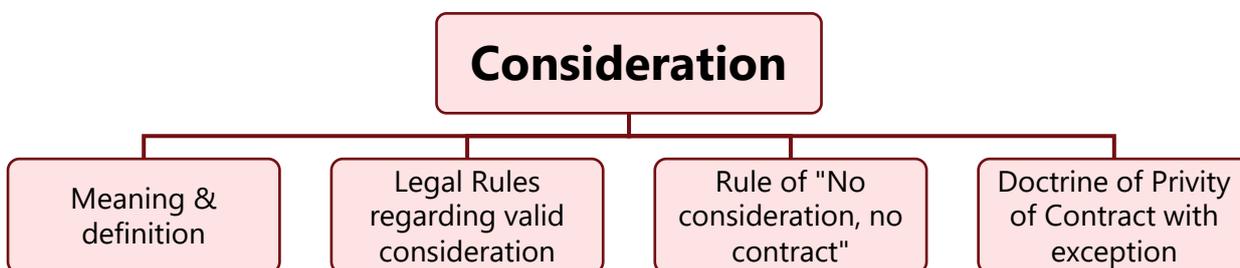
UNIT-2: CONSIDERATION

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ The concept of consideration, its importance for a contract and its double aspect.
- ◆ How consideration may move from a third party and how this makes the contract valid.
- ◆ The peculiar circumstances when a contract is valid even without consideration.
- ◆ The rule 'A stranger to a contract cannot sue' and exceptions thereof.

UNIT OVERVIEW



Consideration is an essential element of a valid contract without which no single promise will be enforceable. It is a term used in the sense of *quid pro quo*, i.e., 'something in return'. Having a double aspect of a benefit to the promisor and a detriment to the promisee, it has to be really understood in the sense of some detriment as envisaged by English Law. In this Unit, we shall try to understand the concept of consideration and also the legal requirements regarding consideration.

2.1 WHAT IS CONSIDERATION?

Consideration is the price agreed to be paid by the promisee for the obligation of the promisor. The word consideration was described in a very popular English case of **Misa v. Currie** as:

“A valuable consideration in the sense of law may consist either in some right, interest, profit or benefit accruing to one party (i.e. promisor) or forbearance, detriment, loss or responsibility given, suffered or undertaken by the other (i.e. the promisee).”

Section 2(d) defines consideration as follows:

“When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or abstain from doing something, such an act or abstinence or promise is called consideration for the promise”.

(1) Consideration is an act- doing something.

Example 1: Ajay guarantees Bhuvan for payment of price of the goods which Bhuvan wanted to sell on one month credit to Chaitanya. Here selling of goods on credit by Bhuvan to Chaitanya is consideration for A’s promise.

Example 2: A college promises students, who will score above 95% for the job in MNC. Consideration need not to be monetary. Here the promise for recruitment of candidate will be considered as consideration for the act of students scoring above 95%.

(2) Consideration is abstinence- abstain from doing something.

Example 3: Abhishek promises Bharti not to file a suit against him if she (Bharti) would pay him (Abhishek) ₹ 1,00,000. Here abstinence on the part of Abhishek would constitute consideration against Bharti’s payment of ₹ 1,00,000 in favor of Abhishek.

Example 4: ABC has a shop of electric items. XYZ wishes to open another electric shop next to his shop. ABC offers Rs 2,00,000 to XYZ for shifting the same away from 1 km of ABC’s shop. Here, consideration is given for abstaining XYZ from opening his shop nearby.

(3) Consideration must be at the desire of the promisor.

(4) Consideration may move from promisee or any other person.

(5) Consideration may be past, present or future.

Thus, from above it can be concluded that:

Consideration = Promise / Performance that parties exchange with each other.

Form of consideration = Some benefit, right or profit to one party / some detriment, loss, or forbearance to the other.

2.2 LEGAL RULES REGARDING CONSIDERATION

- (i) **Consideration must move at the desire of the promisor:** Consideration must be offered by the promisee or the third party at the desire or request of the promisor. This implies "return" element of consideration. Contract of marriage in consideration of promise of settlement is enforceable.

An act done at the desire of a third party is not a consideration.

In *Durga Prasad v. Baldeo*, D (defendant) promised to pay to P (plaintiff) a certain commission on articles which would be sold through their agency in a market. Market was constructed by P at the desire of the C (Collector), and not at the desire of the D. D was not bound to pay as it was without consideration and hence void.

Example 5: R saves S's goods from fire without being asked to do so. R cannot demand any reward for his services, as the act being done voluntary.

- (ii) **Consideration may move from promisee or any other person:** In India, consideration may proceed from the promisee or any other person who is not a party to the contract. The definition of consideration as given in Section 2(d) makes that proposition clear. According to the definition, when at the desire of the promisor, the promisee or any other person does something such an act is consideration. In other words, there can be a stranger to a consideration but not stranger to a contract.

Example 6: An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the brother agreeing to pay annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter. [*Chinnayya vs. Ramayya (1882)*]

- (iii) **Executed and executory consideration:** A consideration which consists in the performance of an act is said to be executed. When it consists in a promise, it is said to be executory. The promise by one party may be the consideration for an act by some other party, and vice versa.

Example 7: A pays ₹ 5,000 to B and B promises to deliver to him a certain quantity of wheat within a month. In this case, A pays the amount, whereas B merely makes a

promise. Therefore, the consideration paid by A is executed, whereas the consideration promised by B is executory.

- (iv) **Consideration may be past, present or future:** The words “has done or abstained from doing” [as contained in Section 2(d)] are a recognition of the doctrine of past consideration. In order to support a promise, a past consideration must move by a previous request. It is a general principle that consideration is given and accepted in exchange for the promise. The consideration, if past, may be the motive but cannot be the real consideration of a subsequent promise. But in the event of the services being rendered in the past at the request or the desire of the promisor, the subsequent promise is regarded as an admission that the past consideration was not gratuitous.

Example 8: ‘A’ performed some services to ‘B’ at his desire. After a week, ‘B’ promises to compensate ‘A’ for the work done by him. It is said to be past consideration and A can sue B for recovering the promised money.

Example 9: A cash sale of goods is an example of present consideration. The consideration is immediately made against delivery of goods.

- (v) **Consideration need not be adequate:** Consideration need not to be of any particular value. It need not be approximately of equal value with the promise for which it is exchanged but it must be something which the law would regard as having some value. Something in return need not be equal to something given. It can be considered a bad bargain of the party.

It may be noted in this context that Explanation 2 to Section 25 states that an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate.

But as an exception if it is shockingly less and the other party alleges that his consent was not free than this inadequate consideration can be taken as an evidence in support of this allegation.

Example 10: X promises to sell a house worth ₹60 lacs for ₹10 lacs only, the adequacy of the price in itself shall not render the transaction void, unless the party pleads that transaction takes place under coercion, undue influence or fraud.

- (vi) **Performance of what one is legally bound to perform:** The performance of an act by a person who is legally bound to perform the same cannot be consideration for a contract. Hence, a promise to pay money to a witness is void, for it is without consideration. Hence, such a contract is void for want of consideration. Similarly, an agreement by a client to pay to his counsel after the latter has been engaged, a

certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

Example 11: A promise to pay ₹ 2,000 to a doctor over the fees is invalid as it is the duty of a doctor to give a treatment for his normal fees.

But where a person promises to do more that he is legally bound to do or such a promise provided it is not opposed to public policy, is a good consideration. It should not be vague or uncertain.

- (vii) **Consideration must be real and not illusory:** Consideration must be real and must not be illusory. It must be something to which the law attaches some value. If it is legally or physically impossible it is not considered valid consideration.

Examples 12: A man promises to discover treasure by magic, bringing the dead person to live again. This transaction can be said to be void as it is illusory.

- (viii) **Consideration must not be unlawful, immoral, or opposed to public policy.** Only presence of consideration is not sufficient it must be lawful. Anything which is immoral or opposed to public policy also cannot be valued as valid consideration.

Example 13: ABC Ltd. promises to give job to Mr. X in a Government bank against payment of ₹ 50,000 is void as the promise is opposed to public policy.

2.3 SUIT BY A THIRD PARTY TO A CONTRACT

Though under the Indian Contract Act, 1872, the consideration for an agreement may proceed from a third party, the third party cannot sue on contract. Only a person who is party to a contract can sue on it.

Thus, the concept of stranger to consideration is a valid and is different from stranger to a contract.

Example 14: P who is indebted to Q, sells his property to R and R promises to pay off the debt amount to Q. If R fails to pay, then in such situation Q has no right to sue, as R is a stranger to contract.

The aforesaid rule, that **stranger to a contract cannot sue is known as a “doctrine of privity of contract”**, is however, subject to certain exceptions. In other words, even a stranger to a contract may enforce a claim in the following cases:

- (1) **In the case of trust,** a beneficiary can enforce his right under the trust, though he was not a party to the contract between the settler and the trustee.

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

Example 15: Two brothers X and Y agreed to pay an allowance of ₹ 20,000 to mother on partition of joint properties. But later they denied to abide by it. Held their mother although stranger to contract can require their sons for such allowance in the court of law.

- (3) **In the case of certain marriage contracts/arrangements**, a provision may be made for the benefit of a person, he may file the suit though he is not a party to the agreement.

Example 16: Mr. X's wife deserted him for ill-treating her. Mr. X promised his wife's father Mr. Puri that he will treat her properly or else pay her monthly allowance. But she was again ill-treated by her husband. Held, she has all right to sue Mr. X against the contract made between Mr. X and Mr. Puri even though she was stranger to contract.

- (4) **In the case of assignment of a contract**, when the benefit under a contract has been assigned, the assignee can enforce the contract but such assignment should not involve any personal skill.

Example 17: Mr. Ankit Sharma has assigned his insurance policy to his son. Now son can claim even if he was not a party to contract.

- (5) **Acknowledgement or estoppel** – where the promisor by his conduct acknowledges himself as an agent of the third party, it would result into a binding obligation towards third party.

Example 18: If L gives to M ₹20,000 to be given to N, and M informs N that he is holding the money for him, but afterwards M refuses to pay the money. N will be entitled to recover the same from the former i.e. M.

- (6) **In the case of covenant running with the land**, the person who purchases land with notice that the owner of land is bound by certain duties affecting land, the covenant affecting the land may be enforced by the successor of the seller.

Example 19: One owner of the land having two land adjacent to each other. One was agricultural land. He sold the other land containing a condition that it can never be used for Industrial purpose so as to protect the other agricultural land from pollution. Such condition is attached with the land so who so ever is the successor of land has to abide by it. Such are called restrictive covenants and all successor are bind to it.

- (7) **Contracts entered into through an agent:** The principal can enforce the contracts entered by his agent where the agent has acted within the scope of his authority and in the name of the principal.

Example 20: Prashant appoints Abhinav as his agent to sell his house. Abhinav sells house to Tarun. Now Prashant has right to recover the price from Tarun.

2.4 VALIDITY OF AN AGREEMENT WITHOUT CONSIDERATION

The general rule is that an agreement made without consideration is void (Section 25). In every valid contract, consideration is very important. A contract may only be enforceable when consideration is there. However, the Indian Contract Act contains certain exceptions to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

1. **Natural Love and Affection:** Conditions to be fulfilled under section 25(1)

- (i) It must be made out of natural love and affection between the parties.
- (ii) Parties must stand in near relationship to each other.
- (iii) It must be in writing.
- (iv) It must also be registered under the law.

A written and registered agreement based on natural love and affection between the parties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration.

Example 21: A husband, by a registered agreement promised to pay his earnings to his wife. Held the agreement though without consideration, was valid.

Example 22: A out of natural love and affection promises to give his newly wedded daughter- in -law a golden necklace worth ₹ 5,00,000. 'A' made the promise in writing and signed it and registered. The agreement is valid.

2. **Compensation for past voluntary services:** A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under Section 25(2). In order that a promise to pay for the past voluntary services be binding, the following essential factors must exist:

- (i) The services should have been rendered voluntarily.
- (ii) The services must have been rendered for the promisor.
- (iii) The promisor must be in existence at the time when services were rendered.

(iv) The promisor must have intended to compensate the promisee.

Example 23: P finds R's wallet and gives it to him. R promises to give P ₹10,000. This is a valid contract.

Example 24: Mr. X had helped his nephew Mr. Y to fight a case in the court of law using his knowledge and intellect. After Mr. Y won the case, he promised Mr. X to pay Rs. 10,000. Held, this is a valid contract as it is compensation to past services.

3. **Promise to pay time barred debt:** Where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation it is valid without consideration [Section 25(3)].

Example 25: A is indebted to C for ₹60,000 but the debt is barred by the Limitation Act. A sign a written promise now to pay ₹50,000 in final settlement of the debt. This is a contract without consideration, but enforceable for ₹50,000 only.

4. **Agency:** According to Section 185 of the Indian Contract Act, 1872, no consideration is necessary to create an agency.
5. **Completed gift:** In case of completed gifts, the rule no consideration no contract does not apply. Explanation (1) to Section 25 states "nothing in this section shall affect the validity as between the donor and donee, of any gift actually made." Thus, gifts do not require any consideration.
6. **Bailment:** No consideration is required to affect the contract of bailment. Section 148 of the Indian Contract Act, 1872, defines bailment as the delivery of goods from one person to another for some purpose. This delivery is made upon a contract that post accomplishment of the purpose, the goods will either be returned or disposed of, according to the directions of the person delivering them. No consideration is required to affect a contract of bailment.

Example 26: Mr. A hand over the keys of his godown to Mr. Y as Mr. Y had deposited his goods in the same. Mr. Y gets possession of godown but not the ownership. As soon as Mr. Y lifts his goods from godown he is liable to hand over the keys back to Mr. A.

7. **Charity:** If a promisee undertakes the liability on the promise of the person to contribute to charity, there the contract shall be valid. (**Kadarnath v. Gorie Mohammad**)

Example 27: Mr. G promised Mr. K, the secretary of committee of temple to donate ₹ 1,00,000 for renovation of that temple. On the faith of his promise, secretary has incurred some cost for renovation. Now secretary can claim from Mr. G even the contract was without consideration.

SUMMARY

The students may note that:

- (a) Consideration is a price for the promise of the other party and it may either be in the form of 'benefit' or some 'detriment' to the parties.
- (b) Consideration must move at the desire of the promisor.
- (c) It may be executed or executory.
- (d) Past consideration is valid provided it moved at the previous request of the promisor.
- (e) It must not be something which the promisor is already legally bound to do.
- (f) It may move from the promisee or any third party.
- (g) Inadequacy of consideration is not relevant.
- (h) Consideration must be legal.
- (i) The general rule of law is "No Consideration, No Contract" but there are a few exceptional cases where a contract, even though without consideration is valid.
- (j) "Stranger to a contract can't sue but in some exceptional cases the contract may be enforced by a person who is not a party to the contract.

CONSIDERATION Sec.2(d)

"When at the desire of the promisor, the promisee or any other person has done or abstained from doing, something, such act or abstinence or promise is called a consideration for the promise."

Legal Rules

- (i) move at the desire of the promisor.
- (ii) move from the promisee or any other person.
- (iii) may be executed and executory.
- (iv) May be past, present or future.
- (v) need not be adequate.
- (vi) must be something which the promisor is not already bound to do.
- (vii) must be real, not illusory.
- (viii) must not be unlawful, immoral or opposed to public policy.

Suit by a Third Party to any Agreement

- (i) Trust
- (ii) Family Settlement
- (iii) Marriage contracts
- (iv) Assignment of contract
- (v) Acknowledgement or estoppel
- (vi) Covenants running with land
- (viii) Agency

Contract is Valid even without Consideration in following situations:

- (i) A written and registered agreement based on natural love and affection between near relatives
- (ii) A promise to pay for a past voluntary service is binding
- (iii) A written promise to pay time-barred debt.
- (iv) Agency.
- (v) Completed gifts
- (vi) Bailment (sec.148).
- (vii) Charity

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Which of the following statement is false? Consideration:
 - (a) Must move at the desire of the promisor.
 - (b) May move from any person
 - (c) Must be illusory
 - (d) Must be of some value
2. Consideration must move at the desire of
 - (a) Promisor
 - (b) Promisee
 - (c) Any other person
 - (d) Any of these
3. Consideration may be
 - (a) Past
 - (b) Present
 - (c) Future
 - (d) All of the above
4. Consideration in simple term means:
 - (a) Anything in return
 - (b) Something in return
 - (c) Everything in return
 - (d) Nothing in return
5. Which of the following is not an exception to the rule - No consideration, No Contract
 - (a) Compensation for involuntary services
 - (b) Love & Affection
 - (c) Contract of Agency
 - (d) Gift

6. *Past consideration means*
- Consideration and promise should move together*
 - Executed consideration*
 - Consideration is provided prior to the making of the contract*
 - Invalid consideration*
7. *A contract without consideration under Section 25 is:*
- void*
 - voidable*
 - valid*
 - illegal*

Descriptive Questions

- "To form a valid contract, consideration must be adequate". Comment.*
- Mr. Sohanlal sold 10 acres of his agricultural land to Mr. Mohanlal on 25th September 2022 for ₹ 25 Lakhs. The Property papers mentioned a condition, amongst other details, that whosoever purchases the land is free to use 9 acres as per his choice but the remaining 1 acre has to be allowed to be used by Mr. Chotelal, son of the seller for carrying out farming or other activity of his choice. On 12th October, 2022, Mr. Sohanlal died leaving behind his son and life. On 15th October, 2022 purchaser started construction of an auditorium on the whole 10 acres of land and denied any land to the son.*

Now Mr. Chotelal wants to file a case against the purchaser and get a suitable redressal. Discuss the above in light of provisions of Indian Contract Act, 1872 and decide upon Mr. Chotelal's plan of action?

ANSWER/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|----|-----|----|-----|----|-----|----|-----|----|-----|----|-----|
| 1. | (c) | 2. | (a) | 3. | (d) | 4. | (b) | 5. | (a) | 6. | (c) |
| 7. | (c) | | | | | | | | | | |

Answers to the Descriptive Questions

1. The law provides that a contract should be supported by consideration. So long as consideration exists, the Courts are not concerned to its adequacy, provided it is of some value. The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the Court when it is sought to be enforced (**Bolton v. Modden**). Consideration must however, be something to which the law attaches value though it need not be equivalent in value to the promise made.

According to Explanation 2 to Section 25 of the Indian Contract Act, 1872, an agreement to which the consent of the promisor 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.

2. Problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 2(d) and on the principle 'privity of consideration'. Consideration is one of the essential elements to make a contract valid and it can flow from the promisee or any other person. In view of the clear language used in definition of 'consideration' in Section 2(d), it is not necessary that consideration should be furnished by the promisee only. A promise is enforceable if there is some consideration for it and it is quite immaterial whether it moves from the promisee or any other person.

The leading authority in the decision of the **Chinnaya Vs. Ramayya**, held that the consideration can legitimately move from a third party and it is an accepted principle of law in India.

In the given problem, Mr. Sohanlal has entered into a contract with Mr. Mohanlal, but Mr. Chotelal has not given any consideration to Mr. Mohanlal but the consideration did flow from Mr. Sohanlal to Mr. Mohanlal on the behalf of Mr. Chotelal and such consideration from third party is sufficient to enforce the promise of Mr. Mohanlal to allow Mr. Chotelal to use 1 acre of land. Further the deed of sale and the promise made by Mr. Mohanlal to Mr. Chotelal to allow the use of 1 acre of land were executed simultaneously and therefore they should be regarded as one transaction and there was sufficient consideration for it.

Moreover, it is provided in the law that "in case covenant running with the land, where a person purchases land with notice that the owner of the land is bound by certain duties affecting land, the covenant affecting the land may be enforced by the successor of the seller."

In such a case, third party to a contract can file the suit although it has not moved the consideration.

Hence, Mr. Chotelal is entitled to file a petition against Mr. Mohanlal for execution of contract.

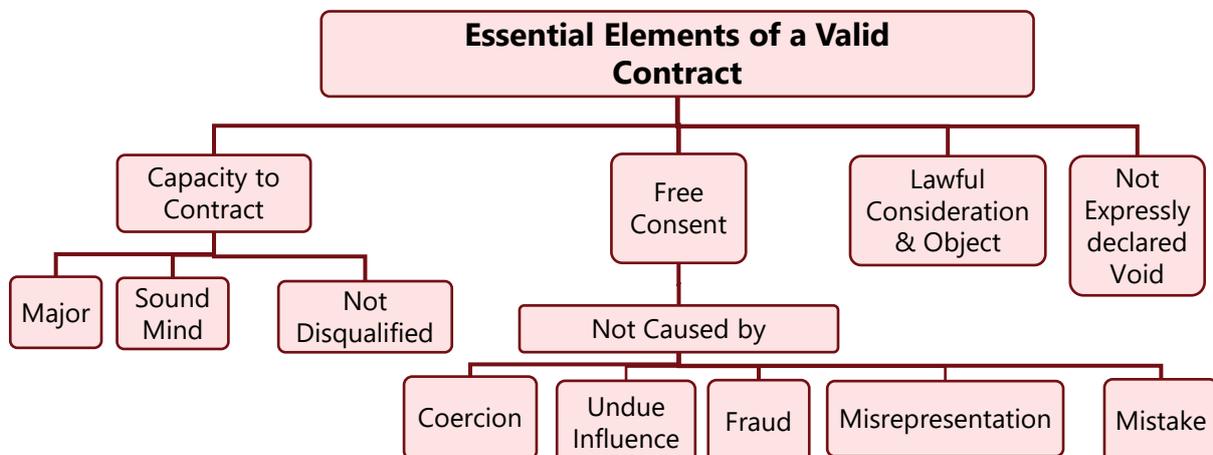
UNIT-3: OTHER ESSENTIAL ELEMENTS OF A CONTRACT

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ The various ingredients of incapacity to contract.
- ◆ The legal consequence of contracting with a minor.
- ◆ The concept of 'consensus ad idem' i.e. parties agreeing upon the same thing in the same sense.
- ◆ The characteristics of different elements vitiating free consent and particularly to distinguish amongst fraud, misrepresentation and mistake.
- ◆ The circumstances when object and consideration become unlawful.
- ◆ Agreements opposed to public policy.

UNIT OVERVIEW



It has already been discussed that an agreement results from a proposal by one party and its acceptance by the other party. We have already discussed offer, acceptance and consideration in detail. We shall now discuss in detail the elements which constitute a valid contract enforceable in law.

Section 10 of the Indian Contract Act, 1872 provides that an agreement in order to be a contract, must satisfy the following conditions:

- (1) the parties must be competent to contract;
- (2) it must be made by the free consent of the parties;
- (3) it must be made for a lawful consideration and with a lawful object;
- (4) it should not have been expressly declared as void by law.

3.1 CAPACITY TO CONTRACT

Meaning: Capacity refers to the competence of the parties to make a contract. It is one of the essential elements to form a valid contract.

Who is competent to contract (Section 11)

Every person is competent to contract who-

- (A) has attained the age of majority,
- (B) is of sound mind and
- (C) is not disqualified from contracting by any law to which he is subject.

(A) Age of Majority: In India, the age of majority is regulated by the Indian Majority Act, 1875.

Every person domiciled in India shall attain the age of majority on the completion of 18 years of age and not before. The age of majority being 18 years, a person less than that age even by a day would be minor for the purpose of contracting.

Law relating to Minor's agreement/Position of Minor

1. **A contract made with or by a minor is void ab-initio:** A minor is not competent to contract and any agreement with or by a minor is void from the very beginning.

In the leading case of ***Mohori Bibi vs. Dharmo Das Ghose (1903)***, "Mr. D a minor, mortgaged his house for Rs. 20,000 to money lender, but the mortgagee i.e. money lender has paid him Rs. 8,000. Subsequently the minor

had filed a suit for cancellation of contract. Held the contract is void as Mr. D is minor and therefore he is not liable to pay anything to lender.”

- 2. No ratification after attaining majority:** A minor cannot ratify the agreement on attaining majority as the original agreement is void ab initio and a void agreement can never be ratified.

Example 1: X, a minor makes a promissory note in favour of Y. On attaining majority, he cannot ratify it and if he makes a new promissory note in place of old one, here the new promissory note which he executed after attaining majority is also void being without consideration.

- 3. Minor can be a beneficiary or can take benefit out of a contract:** Though a minor is not competent to contract, nothing in the Contract Act prevents the minor from making the other party bound to him. Thus, a promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.

A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).

Example 2: A mortgage was executed in favour of a minor. Held, he can get a decree for the enforcement of the mortgage.

- 4. A minor can always plead minority:** A minor can always plead minority and is not stopped to do so even where he has taken any loan or entered into any contract by falsely representing that he was major. Rule of estoppel cannot be applied against a minor. It means he can be allowed to plea his minority in defence.

Example 3: A, a minor has falsely induced himself as major and contracted with Mr. X for loan of ₹ 20,000. When Mr. X asked for the repayment A denied to pay. He pleaded that he was a minor so cannot enter into any contract. Held, A cannot be held liable for repayment of amount. However, if he has not spent the same, he may be asked to repay it but the minor shall not be liable for any amount which he has already spent even though he received the same by fraud. Thus, a minor can always plead minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

- 5. Liability for necessaries:** The case of necessaries supplied to a minor or to any other person whom such minor is legally bound to support is governed by

section 68 of the Indian Contract Act. A claim for necessities supplied to a minor is enforceable by law. But a minor is not liable for any price that he may promise and never for more than the value of the necessities. There is no personal liability of the minor, but only his property is liable.

To render minor's estate liable for necessities two conditions must be satisfied.

- (i) The contract must be for the goods reasonably necessary for his support in the station in life.
- (ii) The minor must not have already a sufficient supply of these necessities.

Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles. Necessaries extend to all such things as reasonable persons would supply to an infant in that class of society to which the infant belongs. Expenses on minor's education, on funeral ceremonies come within the scope of the word 'necessaries'.

The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.

Example 4: Shruti being a minor purchased a laptop for her online classes of ₹ 70,000 on credit from a shop. But her assets could pay only ₹ 20,000. The shop keeper could not hold Shruti personally liable and could recover only amount recoverable through her assets i.e. upto ₹ 20,000.

6. **Contract by guardian - how far enforceable:** Though a minor's agreement is void, his guardian can, under certain circumstances enter into a valid contract on minor's behalf. Where the guardian makes a contract for the minor, which is within his competence and which is for the benefit of the minor, there will be valid contract which the minor can enforce.

But all contracts made by 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. But a contract entered into by a certified guardian (appointed by the Court) of a minor, with the sanction of the court for the sale of the minor's property, may be enforced by either party to the contract.

7. **No specific performance:** A minor's agreement being absolutely void, there can be no question of the specific performance of such an agreement.

8. **No insolvency:** A minor cannot be declared insolvent as he is incapable of contracting debts and dues are payable from the personal properties of minor and he shall never be held personally liable.
9. **Partnership:** A minor being incompetent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the benefits of partnership.
10. **Minor can be an agent:** A minor can act as an agent. But he will not be liable to his principal for his acts. A minor can draw, deliver and endorse negotiable instruments without himself being liable.

Example 5: A minor can have an account in the bank. He can draw a cheque for his purchases. But he shall not be liable for cheque bounces nor can he be sued under court of law for any fraud done from his account.

11. **Minor cannot bind parent or guardian:** In the absence of authority, express or implied, an infant is not capable of binding his parent or guardian, even for necessities. The parents will be held liable only when the child is acting as an agent for parents.

Example 6: Richa a minor entered into contract of buying a scooty from the dealer and mentioned that her parents will be liable for the payment of scooty. The dealer sent a letter to her parents for money. The parents will not be liable for such payment as the contract was entered by a minor in their absence and out of their knowledge.

12. **Joint contract by minor and adult:** In such a case, the adult will be liable on the contract and not the minor. *In Sain Das vs. Ram Chand*, where there was a joint purchase by two purchasers, one of them was a minor, it was held that the vendor could enforce the contract against the major purchaser and not the minor.
13. **Surety (Guarantor) for a minor:** In a contract of guarantee when an adult stands surety for a minor then he (adult) is liable to third party as there is direct contract between the surety and the third party.

Example 7: Mr. X guaranteed for the purchase of a mobile phone by Krish, a minor. In case of failure for payment by Krish, Mr. X will be liable to make the payment.

14. **Minor as Shareholder:** A minor, being incompetent to contract cannot be a shareholder of the company. If by mistake he becomes a member, the company can rescind the transaction and remove his name from register. But,

a minor may, acting through his lawful guardian become a shareholder by transfer or transmission of fully paid shares to him.

15. **Liability for torts:** A tort is a civil wrong. A minor is liable in tort unless the tort in reality is a breach of contract. Thus, where a minor borrowed a horse for riding only, he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend.

- (B) **Person of sound mind:** According to Section 12 of Indian Contract Act, "a person is said to be of sound mind for the purposes of making a contract if, at the time when he makes it is capable of understanding it and of forming a rational judgement as to its effect upon his interests."

A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.

A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

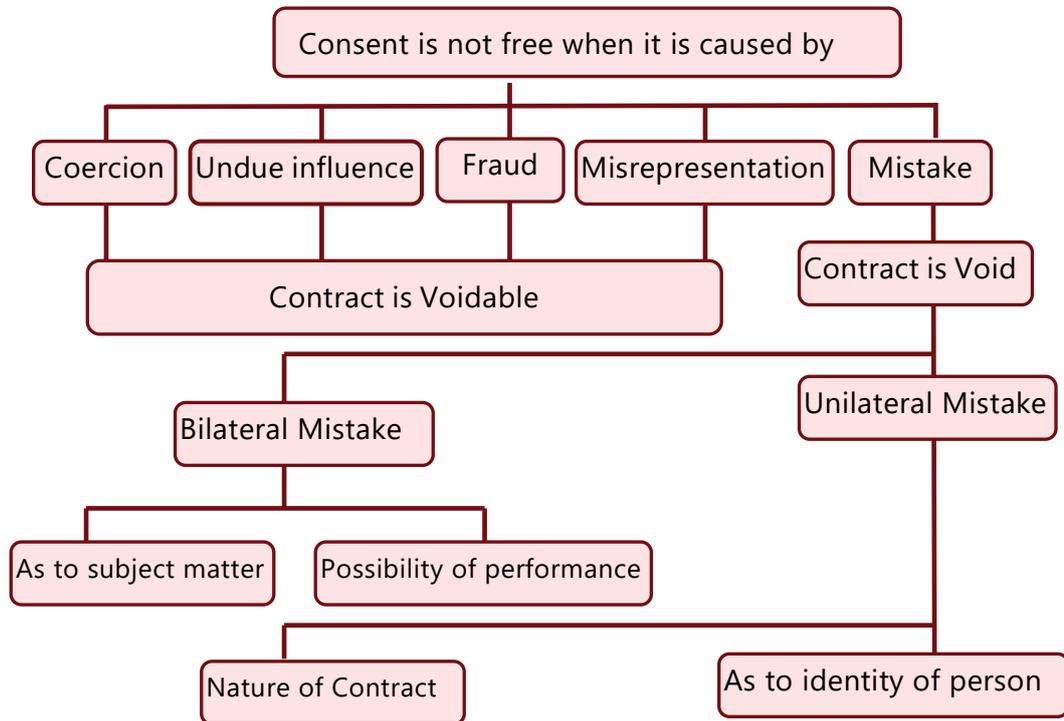
Example 8: A patient in a lunatic asylum, who is at intervals, of sound mind, may contract during those intervals.

Example 9: 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 interests, cannot contract whilst such delirium or drunkenness lasts.

Position of unsound mind person making a contract: A contract by a person who is not of sound mind is void.

- (C) **Contract by disqualified persons:** Besides minors and persons of unsound mind, there are also other persons who are disqualified from contracting, partially or wholly, so that the contracts by such person are void. Incompetency to contract may arise from political status, corporate status, legal status, etc. The following persons fall in this category: Foreign Sovereigns and Ambassadors, Alien enemy, Corporations, Convicts, Insolvent etc.

3.2 FREE CONSENT



Definition of Consent according to Section 13:

“two or more persons are said to consent when they agree upon the same thing in the same sense.”

Parties are said to have consented when they not only agreed upon the same thing but also agreed upon that thing in the same sense. ‘Same thing’ must be understood as the whole content of the agreement. Consequently, when parties to a contract make some fundamental error as to the nature of the transaction, or as to the person dealt with or as to the subject-matter of the agreement, it cannot be said that they have agreed upon the same thing in the same sense. And if they do not agree in the same sense, there cannot be consent. A contract cannot arise in the absence of consent.

If two persons enter into an apparent contract concerning a particular person or ship, and it turns out that each of them, misled by similarity of name, had a different person or ship in his mind, no contract would exist between them as they were not *ad idem*, i.e., of the same mind. Again, ambiguity in the terms of an agreement, or an error as to the nature of any transaction or as to the subject-matter of any agreement may prevent the formation of any contract on the ground of absence of consent. In the case of fundamental error, there is really no consent whereas, in the case of mistake, there is no real consent.

As has been said already, one of the essential elements of a contract is consent and there cannot be a contract without consent. Consent may be free or not free. Only free consent is necessary for the validity of a contract.

Definition of 'Free Consent' (Section 14)

Consent is said to be free when it is not caused by:

1. Coercion, as defined in Section 15; or
2. Undue Influence, as defined in Section 16; or
3. Fraud, as defined in Section 17; or
4. Misrepresentation, as defined in Section 18 or
5. Mistake, subject to the provisions of Sections 20, 21, and 22.

When consent to an agreement is caused by coercion, fraud, misrepresentation, or undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. When the consent is vitiated by mistake, the contract becomes void.

3.3 ELEMENTS VITIATING FREE CONSENT

We shall now explain these elements one by one.

I Coercion (Section 15)

"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."

It is to be noted that the section does not require that coercion must proceed from a party to the contract; nor is it necessary that subject of the coercion must be the other contracting party, it may be directed against any third person whatever.

Effects of coercion under section 19 of Indian Contract Act, 1872

- (i) Contract induced by coercion is voidable at the option of the party whose consent was so obtained.
- (ii) A person to whom money has been paid or anything delivered under coercion must repay or return it. (Section 72)

Threat to commit suicide – Whether is it coercion?

Suicide though forbidden by Indian Penal Code is not punishable, as a dead man cannot be punished. But Section 15 declares that committing or threatening to commit any act

forbidden by Indian Penal Code is coercion. Hence, a threat to commit suicide will be regarded as coercion.

Example 10: Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code.

Example 11: An agent refused to give books of accounts to the principal unless he frees him from all his liabilities. The principal had to give the release deed. Held, the contract was under coercion by unlawful detaining of the principal's property.

II Undue influence (Section 16)

According to section 16 of the Indian Contract Act, 1872, "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 he uses that position to obtain an unfair advantage over the other".

Example 12: A having advanced money to his son, B, during his minority, upon B's coming of age obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employs undue influence.

The essential ingredients under this provision are:

- (1) **Relation between the parties:** A person can be influenced by the other when a near relation between the two exists.
- (2) **Position to dominate the will:** Relation between the parties exist in such a manner that one of them is in a position to dominate the will of the other. A person is deemed to be in such position in the following circumstances:
 - (a) **Real and apparent authority:** Where a person holds a real authority over the other as in the case of master and servant, doctor and patient and etc.

Example 13: A father, by reason of his authority over the son can dominate the will of the son.

- (b) **Fiduciary relationship:** Where relation of trust and confidence exists between the parties to a contract. Such type of relationship exists between father and son, solicitor and client, husband and wife, creditor and debtor, etc.

Example 14: By reason of fiduciary relationship, a solicitor can dominate the will of his client and a trustee can dominate the will of the beneficiary.

Example 15: A spiritual guru induced his devotee to gift to him the whole of his property in return of a promise of salvation of the devotee. Held, the consent of the devotee was given under undue influence. Here, the

relationship was fiduciary relationship between Guru and devotee and Guru was in a position to dominate the will of devotee.

- (c) **Mental distress:** An undue influence can be used against a person to get his consent on a contract where the mental capacity of the person is temporarily or permanently affected by the reason of mental or bodily distress, illness or of old age.

Example 16: A doctor is deemed to be in a position to dominate the will of his patient enfeebled by protracted illness.

- (d) **Unconscionable bargains:** Where one of the parties to a contract is in a position to dominate the will of the other and the contract is apparently unconscionable i.e., unfair, it is presumed by law that consent must have been obtained by undue influence. Unconscionable bargains are witnessed mostly in money-lending transactions and in gifts.

Example 17: 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.

Example 18: A applies to a banker for a loan at a time when there is a stringency in money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.

- (3) **The object must be to take undue advantage:** Where the person is in a position to influence the will of the other in getting consent, must have the object to take advantage of the other.

Example 19: A teacher asks her daughter to get marry to one of his brilliant students. Both the girl and boy were smart, settled and intelligent. Here the teacher had a relation which can have influence on both of them. But as no undue advantage of such influence was taken such contract of marriage is said to be made by free consent.

- (4) **Burden of proof:** When a party to contract decides to avoid the contract on the ground of undue influence, he has to prove that-
- (a) The other party is in position to dominate his will,
 - (b) the other party actually used his position to obtain his consent,
 - (c) transaction is unfair or unconscionable.

Effect of undue influence- (Section 19A)

- (i) 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.
- (ii) Any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, upon such terms and conditions as to the Court may seem just.

Example 20: A, a money lender advances ₹ 1,00,000 to B, an agriculturist, and by undue influence induces B to execute a bond for ₹ 2,00,000 with interest at 6 percent per month. The court may set aside the bond, ordering B to repay ₹ 1,00,000 with such interest as may seem just.

III Fraud (Section 17)

Definition of Fraud under Section 17: 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with an intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

- (1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
- (2) the active concealment of a fact by one having knowledge or belief of the fact;
- (3) a promise made without any intention of performing it;
- (4) any other act fitted to deceive;
- (5) any such act or omission as the law specially declares to be fraudulent.

The following are the essential elements of the fraud:

- (1) There must be a representation or assertion and it must be false. However, silence may amount to fraud or an active concealment may amount to fraud.

Whether Silence is fraud or not?

As per explanation of section 17, silence is fraud in following situations:

- (a) There is duty to speak.

Example 21: A sell, by auction, to B, a horse which A knows to be unsound, A says nothing to B about the unsoundness of the horse. This is not fraud by A.

Example 22: In the above example, B is A's daughter. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

- (b) When silence is equal to speech.

Example 23: B says to A –“If you do not deny it, I shall assume that the horse is sound”. A says nothing. Here A’s silence is equivalent to speech.

- (2) The representation must be related to a fact.

Example 24: ‘A’ who is about to sell goods says that goods cost him Rs. 50,000. This is statement of fact. But if he says the goods are worth Rs. 50,000, it is a statement of opinion.

- (3) The representation should be made before the conclusion of the contract with the intention to induce the other party to act upon it.
- (4) The representation or statement should be made with a knowledge of its falsity or without belief in its truth or recklessly not caring whether it is true or false.
- (5) The other party must have been induced to act upon the representation or assertion.

Example 25: ‘A’ bought shares in a company on the faith of a prospectus which contained an untrue statement that ‘B’ was a director of the company. ‘A’ had never heard of ‘B’ and, therefore, the statement was immaterial from his point of view. A’s claim for damages in this case was dismissed because the untrue statement had not induced ‘A’ to buy the shares.

- (6) The other party must have relied upon the representation and must have been deceived.
- (7) The other party acting on the representation must have consequently suffered a loss.

Effect of Fraud upon validity of a contract: When the consent to an agreement is caused by the fraud, the contract is voidable at option of the party defrauded and he has the following remedies:

- (1) He can rescind the contract within a reasonable time.
- (2) He can sue for damages.
- (3) He can insist on the performance of the contract on the condition that he shall be put in the position in which he would have been had the representation made been true.

Exception: In the following cases, contract is not voidable:

- (i) If the party whose consent was caused by silence which amounting to fraud, had the means of discovering the truth with ordinary diligence.
- (ii) A fraud which did not cause the consent of the party to agreement.

IV Misrepresentation (Section 18)

According to Section 18, there is misrepresentation:

- (1) Statement of fact, which of false, would constitute misrepresentation if the maker believes it to be true but which is not justified by the information he possesses;
- (2) When there is a breach of duty by a person without any intention to deceive which brings an advantage to him;
- (3) When a party causes, even though done innocently, the other party to the agreement to make a mistake as to the subject matter.

Example 26: A makes a positive statement to B that C will be made the director of a company. A makes the statement on information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B.

Example 27: 'A' believed the engine of his motor cycle to be in an excellent condition. 'A' without getting it checked in a workshop, told to 'B' that the motor cycle was in excellent condition. On this statement, 'B' bought the motor cycle, whose engine proved to be defective. Here, 'A's statement is misrepresentation as the statement turns out to be false.

Example 28: A while selling his mare to B, tells him that the mare is thoroughly sound. A genuinely believes the mare to be sound although he has no sufficient ground for the belief. Later on, B finds the mare to be unsound. The representation made by A is a misrepresentation.

Example 29: A buy an article thinking that it is worth ₹ 1000 when in fact it is worth only ₹ 500. There has been no misrepresentation on the part of the seller. The contract is valid.

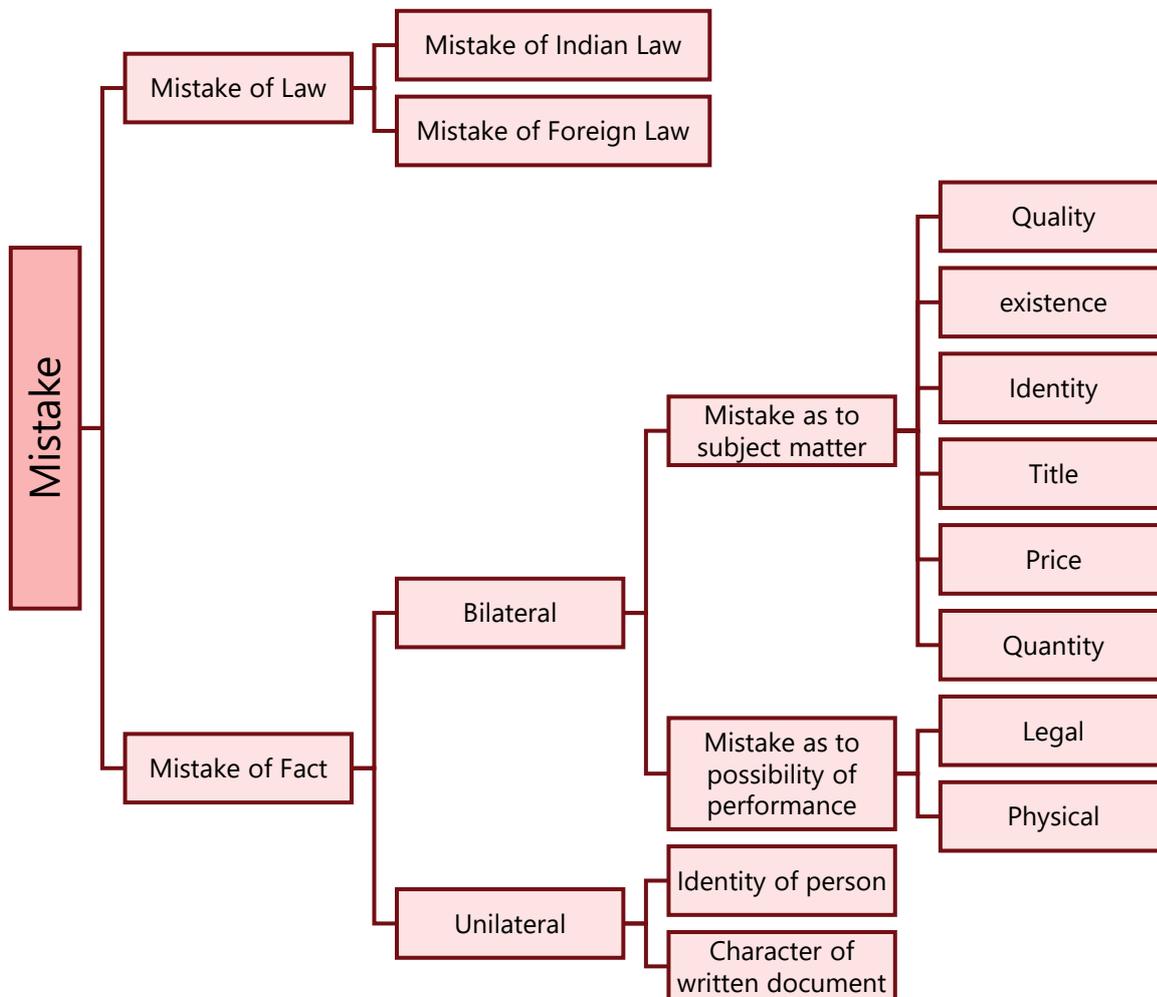
Difference between Coercion and Undue influence:

| Basis of difference | Coercion | Undue Influence |
|---------------------------------------|-------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------|
| Nature of action | It involves the physical force or threat. The aggrieved party is compelled to make the contract against its will. | It involves moral or mental pressure. |
| Involvement of criminal action | It involves committing or threatening to commit and act forbidden by Indian Penal Code or detaining or | No such illegal act is committed or a threat is given. |

| | | |
|--------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| | threatening to detain property unlawfully. | |
| Relationship between parties | It is not necessary that there must be some sort of relationship between the parties. | Some sort of relationship between the parties is absolutely necessary. |
| Exercised by whom | Coercion need not proceed from the promisor nor need it be the directed against the promisor. It can be used even by a stranger to the contract. | Undue influence is always exercised between parties to the contract. |
| Enforceability | The contract is voidable at the option of the party whose consent has been obtained by the coercion. | Where the consent is induced by undue influence, the contract is either voidable or the court may set it aside or enforce it in a modified form. |
| Position of benefits received | In case of coercion where the contract is rescinded by the aggrieved party, as per Section 64, any benefit received has to be restored back to the other party. | The court has the discretion to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions. |

Distinction between fraud and misrepresentation:

| Basis of difference | Fraud | Misrepresentation |
|---------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Intention | To deceive the other party by hiding the truth. | There is no such intention to deceive the other party. |
| Knowledge of truth | The person making the suggestion believes that the statement as untrue. | The person making the statement believes it to be true, although it is not true. |
| Rescission of the contract and claim for damages | The injured party can repudiate the contract and claim damages. | The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages. |
| Means to discover the truth | The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth. | Party can always plead that the injured party had the means to discover the truth. |



Mistake: Mistake may be defined as innocent or erroneous belief which leads the party to misunderstand the others. Mistake may be either mistake of law or mistake of fact.

Mistake of Law: Mistake of law is further classified as mistake of Indian law or mistake of foreign law.

(i) **Mistake of Indian Law:** A person cannot be allowed to get any relief on the ground that it had done a particular act in ignorance of law.

Example 30: A and B enter into a contract on the erroneous belief that a particular debt is barred by the Indian Law of Limitation. This contract is not voidable.

(ii) **Mistake of foreign law:** Such a mistake is treated as mistake of fact and the agreement in such a case is void.

Mistake of fact: Mistake of fact are of two types – (i) Bilateral Mistake, (ii) Unilateral Mistake

(i) Bilateral mistake: Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, there is a bilateral mistake. In such a case, the agreement is void (Section 20).

Cases of Bilateral Mistakes

- (i) Mistake as to the quality of the subject-matter.
- (ii) Mistake as to the existence of the subject-matter.
- (iii) Mistake as to the identity of the subject-matter.
- (iv) Mistake as to the title of the subject-matter.
- (v) Mistake as to the price of the subject-matter.
- (vi) Mistake as to the quantity of the subject-matter.

(ii) Unilateral Mistake: 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.

3.4 LEGALITY OF OBJECT AND CONSIDERATION

Which considerations and objects are lawful, and those which are not (Section 23):

Under Section 23 of the Indian Contract Act, in each of the following cases the consideration or object of an agreement is said to be unlawful:

(i) When consideration or object is forbidden by law: Acts forbidden by law are those which are punishable under any statute as well as those prohibited by regulations or orders made in exercise of the authority conferred by the legislature.

Example 31: A father had arranged for marriage of his 17 years boy and took dowry from the girl's parents. Such marriage contract cannot take place as in India the minimum age for boy marriage is 21 years and dowry is not permissible in Indian law. Such is not a valid contract as the consideration and object both are forbidden by law.

(ii) When consideration or object are of such a nature that if permitted it would defeats the provisions of law:

If the consideration or the object of an agreement is of such a nature that not directly but indirectly, it would defeat the provisions of the law, the agreement is void.

Example 32: 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 an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him 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.

- (iii) **When it is fraudulent:** Agreements which are entered into to promote fraud are void.

Example 33: 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, viz., acquisition of gains by fraud is unlawful.

- (iv) The general term "injury" means criminal or wrongful harm. In the following examples, the object or consideration is unlawful as it involves injury to the person or property of another.

Example 34: An agreement to print a book in violation of another's copyright is void, as the object is to cause injury to the property of another. It is also void as the object of the agreement is forbidden by the law relating to copyright.

Example 35: A promises to repay his debt by doing manual labour daily for a special period and agrees to pay interest at an exorbitant rate in case of default. Here A's promise to repay by manual labour is the consideration for the loan, and this consideration is illegal as it imposes what, in substance, amounts to slavery on the part of A. In other words, as the consideration involves injury to the person A, the consideration is illegal. Here, the object too is illegal, as it seeks to impose slavery which is opposed to public policy. Hence, the agreement is void.

- (v) **When consideration is immoral:** The following are the examples of agreements where the object or consideration is unlawful, being immoral.

Example 36: Where P had advanced money to D, a married woman to enable her to obtain a divorce from her husband and D had agreed to marry him as soon as she could obtain the divorce, it was held that P was not entitled to recover the amount, since the agreement had for its object the divorce of D from her husband and the promise of marriage given under these circumstances was against good morals.

Example 37: A asks B, "If you arrange a girl for marriage with me, I will give ₹ 50,000." Here contract is void as it is immoral.

- (vi) **When consideration is opposed to public policy:** The expression 'public policy' can be interpreted either in a wide or in a narrow sense. The freedom to contract may

become illusory, unless the scope of 'public policy' is restricted. In the name of public policy, freedom of contract is restricted by law only for the good for the community.

Some of the agreements which are held to be opposed to public policy are-

- (1) **Trading with enemy:** Any trade with person owing allegiance to a Government at war with India without the licence of the Government of India is void, as the object is opposed to public policy. Here, the agreement to trade offends against the public policy by tending to prejudice the interest of the State in times of war.

Example 38: India entered in war like situation with China. Mr. A from India entered into contract with China for import of toys. Such contract is void as China is alien enemy of India. The contract if made before such war like situation may be suspended or dissolved. Like India felt apps like tik tok and PUBG will provide some internal information of the country, hence such apps were banned and any contract with them were dissolved.

- (2) **Stifling Prosecution:** An agreement to stifle prosecution i.e. "an agreement to prevent proceedings already instituted from running their normal course using force" tends to be a perversion or an abuse of justice; therefore, such an agreement is void. The principle is that one should not make a trade of felony. The compromise of any public offence is generally illegal.

Under the Indian Criminal Procedure Code, there is, however, a statutory list of compoundable offences and an agreement to drop proceeding relating to such offences with or without the permission of the Court, as the case may be, in consideration the accused promising to do something for the complainant, is not opposed to public policy. Thus, where A agrees to sell certain land to B in consideration of B abstaining from taking criminal proceeding against A with respect to an offence which is compoundable, the agreement is not opposed to public policy. But, it is otherwise, if the offence is uncompoundable.

- (3) **Maintenance and Champerty:** *Maintenance* is an agreement in which a person promises to maintain suit in which he has no interest.

Example 39: A offer B ₹ 2000, if he sues C for a case which they could have settled mutually under provisions of law, just to annoy C. Such agreement is maintenance agreement.

Champerty is an agreement in which a person agrees to assist another in litigation in exchange of a promise to hand over a portion of the proceeds of the action.

Example 40: A agrees to pay expenses to B if he sues C and B agrees to pay half of the amount received from result of such suit. This is an agreement of champerty. The agreement for supplying funds by way of Maintenance or Champerty is valid unless

- (a) It is unreasonable so as to be unjust to other party or
- (b) It is made by a malicious motive like that of gambling in litigation or oppressing other party by encouraging unrighteous suits and not with the bonafide object of assisting a claim believed to be just.

(4) Trafficking relating to Public Offices and titles: An agreement to trafficking in public office is opposed to public policy, as it interferes with the appointment of a person best qualified for the service of the public. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested. The following are the examples of agreements that are void; since they are tantamount to sale of public offices.

- (1) An agreement to pay money to a public servant in order to induce him to retire from his office so that another person may secure the appointment is void.
- (2) An agreement to procure a public recognition like Padma Vibhushan for reward is void.

Example 41: Harish paid ₹ 15000 to the officer to give his son the job in the Forest department of India. On failure by officer he couldn't recover the amount as such contract amounts to trafficking in public office which is opposed to public policy.

(5) Agreements tending to create monopolies: Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void.

Example 42: XYZ and ABC were only the manufactures of oxygen cylinders in West Bengal. They both entered into contract of supplying the same at very high rates and enjoy the monopoly rates during the covid period in the country. Such contract is opposed to public policy as they intended to create monopolies.

(6) Marriage brokerage agreements: An agreement to negotiate marriage for reward, which is known as a marriage brokerage contract, is void, as it is opposed to public policy. For instance, an agreement to pay money to a person hired to procure a wife is opposed to public policy and therefore void.

Note: Marriage bureau only provides information and doesn't negotiate marriage for reward, therefore, it is not covered under this point.

(7) Interference with the course of justice: An agreement whose object is to induce any judicial officer of the State to act partially or corruptly is void, as it is opposed to

public policy; so also is an agreement by A to reward B, who is an intended witness in a suit against A in consideration of B's absencing himself from the trial. For the same reasons, an agreement which contemplates the use of under-hand means to influence legislation is void.

(8) Interest against obligation: The following are examples of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy.

- (1) An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.
- (2) A, who is the manager of a firm, agrees to pass a contract to X if X pays to A ₹ 200,000 privately; the agreement is void.

(9) Consideration Unlawful in Part: By virtue of Section 24, 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."

This section is an obvious consequence of the general principle of Section 23. There is no promise for a lawful consideration if there is anything illegal in a consideration which must be taken as a whole. The general rule is that where the legal part of a contract can be severed from the illegal part, the bad part may be rejected and the good one can be retained. But where the illegal part cannot be severed, the contract is altogether void.

3.5 VOID AGREEMENTS

Expressly declared Void Agreements

| | | | |
|----|----------------------------------------------------------------------------------|----|----------------------------------------------------------|
| 1. | Made by incompetent parties (Section 11) | 6. | Agreement in restraint of marriage (Section 26) |
| 2. | Agreements made under Bilateral mistake of fact (Section 20) | 7. | Agreements in restraint of trade (Section 27) |
| 3. | Agreements the consideration or object of which is unlawful (Section 23) | 8. | Agreement in restraint of legal proceedings (Section 28) |
| 4. | Agreement the consideration or object of which is unlawful in parts (Section 24) | 9. | Agreement the meaning of which is uncertain (Section 29) |

| | | | |
|----|----------------------------------------------------|-----|-----------------------------------------------|
| 5. | Agreements made without consideration (Section 25) | 10. | Wagering Agreement (Section 30) |
| | [Refer Unit 2] | 11. | Agreements to do impossible Acts (Section 56) |

(1) **Agreement in restraint of marriage (Section 26):** Every agreement in restraint of marriage of any person other than a minor, is void. So, if a person, being a major, agrees for good consideration not to marry, the promise is not binding and considered as void agreement.

(2) **Agreement in restraint of trade (Section 27):** An agreement by which any person is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. But this rule is subject to the following exceptions, namely, where a person sells the goodwill of a business and agrees with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or his successor in interest carries on a like business therein, such an agreement is valid (goodwill is the advantage enjoyed by a business on account of public patronage and encouragement from habitual customers). The local limits within which the seller of the goodwill agrees not to carry on similar business must be reasonable. Under Section 36 of the Indian Partnership Act, 1932 if an outgoing partner makes an agreement with the continuing partners that he will not carry on any business similar to that of the firm within a specified period or within specified local limits, such an agreement, thought in restraint of trade, will be valid, if the restrictions imposed are reasonable. Similarly, under Section 11 of that Act an agreement between partners not to carry on competing business during the continuance of partnership is valid.

But an agreement of service by which an employee binds himself, during the term of his agreement, not to compete with his employer is not in restraint of trade.

Example 43: B, a physician and surgeon, employs A as an assistant for a term of three years and A agrees not to practice as a surgeon and physician during these three years. The agreement is valid and A can be restrained by an injunction if he starts independent practice during this period.

Example 44: An agreement by a manufacturer to sell during a certain period his entire production to a wholesale merchant is not in restraint of trade.

Example 45: Agreement among the sellers of a particular commodity not to sell the commodity for less than a fixed price to maintain the quality of the product, is not an agreement in restraint of trade.

(3) **Agreement in restraint of legal proceedings (Section 28):** An agreement in restraint of legal proceeding is the one by which any party thereto is restricted

absolutely from enforcing his rights under a contract through a Court or which abridges the usual period for starting legal proceedings. A contract of this nature is void.

However, there are certain exceptions to the above rule:

- (i) A contract by which the parties agree that any dispute between them in respect of any subject shall be referred to arbitration and that only the amount awarded in such arbitration shall be recoverable is a valid contract.
- (ii) Similarly, a contract by which the parties agree to refer to arbitration any question between them which has already arisen or which may arise in future, is valid; but such a contract must be in writing.

- (4) **Agreement - the meaning of which is uncertain (Section 29):** An agreement, the meaning of which is not certain, is void, but where the meaning thereof is capable of being made certain, the agreement is valid.

Example 46: A agrees to sell B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. But the agreement would be valid if A was dealer only in coconut oil; because in such a case its meaning would be capable of being made certain.

- (5) **Wagering agreement (Section 30):** An agreement by way of a wager is void. It is an agreement involving payment of a sum of money upon the determination of an uncertain event. The essence of a wager is that each side should stand to win or lose, depending on the way an uncertain event takes place in reference to which the chance is taken and in the occurrence of which neither of the parties has legitimate interest.

Example 47: A agrees to pay ₹ 50,000 to B if it rains, and B promises to pay a like amount to A if it does not rain, the agreement will be by way of wager. But if one of the parties has control over the event, agreement is not a wager.

Essentials of a Wager

1. There must be a promise to pay money or money's worth.
2. Promise must be conditional on an event happening or not happening.
3. There must be uncertainty of event.
4. There must be two parties, each party must stand to win or lose.
5. There must be common intention to bet at the timing of making such agreement.
6. Parties should have no interest in the event except for stake.

Transactions similar to Wager (Gambling)

- (i) **Lottery transactions:** A lottery is a game of chance and not of skill or knowledge. Where the prime motive of participant is gambling, the transaction amounts to a wager. Even if the lottery is sanctioned by the Government of India it is a wagering transaction. The only effect of such sanction is that the person responsible for running the lottery will not be punished under the Indian Penal Code. Lotteries are illegal and even collateral transactions to it are tainted with illegality (Section 294A of Indian Penal Code).
- (ii) **Crossword Puzzles and Competitions:** Crossword puzzles in which prizes depend upon the correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction.

Case Law: State of Bombay vs. R.M.D. Chamarbawala AIR (1957)

Facts: A crossword puzzle was given in magazine. Abovementioned clause was stated in the magazine. A solved his crossword puzzle and his solution corresponded with previously prepared solution kept with the editor. Held, this was a game of chance and therefore a lottery (wagering transaction).

Crossword puzzles, picture competitions and athletic competitions where prizes are awarded on the basis of skill and intelligence are the games of skill and hence such competitions are valid. According to the Prize Competition Act, 1955 prize competitions in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.

- (iii) **Speculative transactions:** an agreement or a share market transaction where the parties intend to settle the difference between the contract price and the market price of certain goods or shares on a specified day, is a gambling and hence void.
- (iv) **Horse Race Transactions:** A horse race competition where prize payable to the bet winner is less than ₹ 500, is a wager.

Example 48: A and B enter into an agreement in which A promises to pay ₹ 2,00,000 provided 'Chetak' wins the horse race competition. This is not a wagering transaction.

However, Section 30 is not applicable in an agreement to contribute toward plate, prize or sum of money of the value of ₹ 500 or above to be awarded to the winner of a horse race.

Transactions resembling with wagering transaction but are not void

- (i) **Chit fund:** Chit fund does not come within the scope of wager (Section 30). In case of a chit fund, a certain number of persons decide to contribute a fixed sum for a specified period and at the end of a month, the amount so contributed is paid to the lucky winner of the lucky draw.
- (ii) **Commercial transactions or share market transactions:** In these transactions in which delivery of goods or shares is intended to be given or taken, do not amount to wagers.
- (iii) **Games of skill and Athletic Competition:** Crossword puzzles, picture competitions and athletic competitions where prizes are awarded on the basis of skill and intelligence are the games of skill and hence such competition are valid. According to the Prize Competition Act, 1955 prize competition in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.
- (iv) **A contract of insurance:** A contract of insurance is a type of contingent contract and is valid under law and these contracts are different from wagering agreements.

Distinction between Contract of Insurance and Wagering Agreement

| | Basis | Contracts of Insurance | Wagering Agreement |
|----|------------------------------|-----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| 1. | Meaning | It is a contract to indemnify the loss. | It is a promise to pay money or money's worth on the happening or non- happening of an uncertain event. |
| 2. | Consideration | The crux of insurance contract is the mutual consideration (premium and compensation amount). | There is no consideration between the two parties. There is just gambling for money. |
| 3. | Insurable Interest | Insured party has insurable interest in the life or property sought to be insured. | There is no property in case of wagering agreement. There is betting on other's life and properties. |
| 4. | Contract of Indemnity | Except life insurance, the contract of insurance indemnifies the insured person against loss. | Loser has to pay the fixed amount on the happening of uncertain event. |
| 5. | Enforceability | It is valid and enforceable | It is void and unenforceable agreement. |

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| 6. | Premium | Calculation of premium is based on scientific and actuarial calculation of risks. | No such logical calculations are required in case of wagering agreement. |
| 7. | Public Welfare | They are beneficial to the society. | They have been regarded as against the public welfare. |

SUMMARY

The following persons are incompetent to contract: (a) minor, (b) persons of unsound mind, (c) other disqualified persons.

- (a) **Minor:** Agreement with a minor is altogether void but his property is liable for necessities supplied to him. He cannot be a partner but can be admitted to benefits of partnership with the consent of all partners. He can always plead minority and cannot be asked to compensate for any benefit received under a void agreement. Under certain circumstances, a guardian can enter into valid contract on behalf of minor. Minor cannot ratify a contract on attaining majority.
- (b) **Persons of unsound mind:** Persons of unsound mind such as idiots, lunatics and drunker cannot enter into a contract, but a lunatic can enter into a valid contract when he is in a sound state of mind. The liability for necessities of life supplied to persons of unsound mind is the same as in case of minors. (Section 68).
- (c) Certain other persons are disqualified due to their status.

Free Consent

Two or more persons are said to consent when they agree upon the same thing in the same sense (Section 13). Consent is free when it is not caused by mistake, misrepresentation, undue influence, fraud or coercion. When consent is caused by any of above said elements, the contract is voidable at the option of the party whose consent was so caused (Sections 19 and 19A)

- (a) **Coercion:** 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 with the intention of causing any person to enter into an agreement (Section 15). A contract induced by coercion is voidable at the option of the aggrieved party.
- (b) **Undue influence:** When one party to a contract is able to dominate the will of the other and uses the position to obtain an unfair advantage, the contract is said to be induced by undue influence. (Section 16). Such contract is voidable, not void.

- (c) **Fraud:** Fraud exists when a false representation has been made knowingly with an intention to deceive the other party, or to induce him to enter a contract (Section 17). Contract in the case is voidable.
- (d) **Misrepresentation:** Means a misstatement of a material fact made believing it to be true, without an intent to deceive the other party (Section 18). Contract will be voidable in this case.
- (e) **Mistake:** When both the parties are at a mistake to a matter of fact to the agreement, the agreement is altogether void.

Lawful Object and Consideration

An agreement where the object or the consideration is unlawful, is void. Object or consideration is unlawful if it is forbidden by law, it defeats the provisions of law; or is fraudulent, or involves injury to the person or property of another; or is immoral; or is opposed to public policy.

Besides the above said agreements, certain agreements have been expressly declared to be void by the Contract Act such as - wagering agreements, agreement with uncertain meaning, agreements where consideration is unlawful in part etc.

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| <p>Minor: Sec.3 Indian Majority Act, 1875: Minor who is under 18 years.</p> <p>Position of a contract with Minor</p> | | <ol style="list-style-type: none"> 1. Contract with person of unsound mind is void. 2. Person usually Unsound. sometimes sound - can contract when sound. 3. Person usually sound. sometimes unsound - cannot contract when unsound. |
| <ol style="list-style-type: none"> 1. Agreement with or by minor is void-ab-initio agreement 2. Cannot be ratified on attaining majority. 3. Minor can be a beneficiary or can take benefit out of a contract. 4. Minor can always plead minority. 5. Minor's estate is liable for necessities. 6. Minor is personally liable for contracts for his benefit or supply of necessities entered by guardian within scope of authority. 7. No specific performance can be claimed. 8. Minor cannot be adjusted insolvent. 9. Minor cannot enter into partnership. | <ol style="list-style-type: none"> 10. Minor can be an agent without incurring any personal liability. 11. Parents/guardians are not liable for the contract entered into by him. 12. In case of joint contract by adult and minor, only adult is liable. 13. If adult is surety for minor, adult is liable as direct contract between adult and third party. 14. Shares cannot be allotted to minor but minor can become a shareholder by transfer or transmission of fully paid shares to him. 15. Minor is Liable for torts. | |
| | | <p>Disqualified by Law</p> <ol style="list-style-type: none"> 1. Foreign sovereigns (Rulers) 2. Alien Enemy 3. Corporations 4. Convicts. |

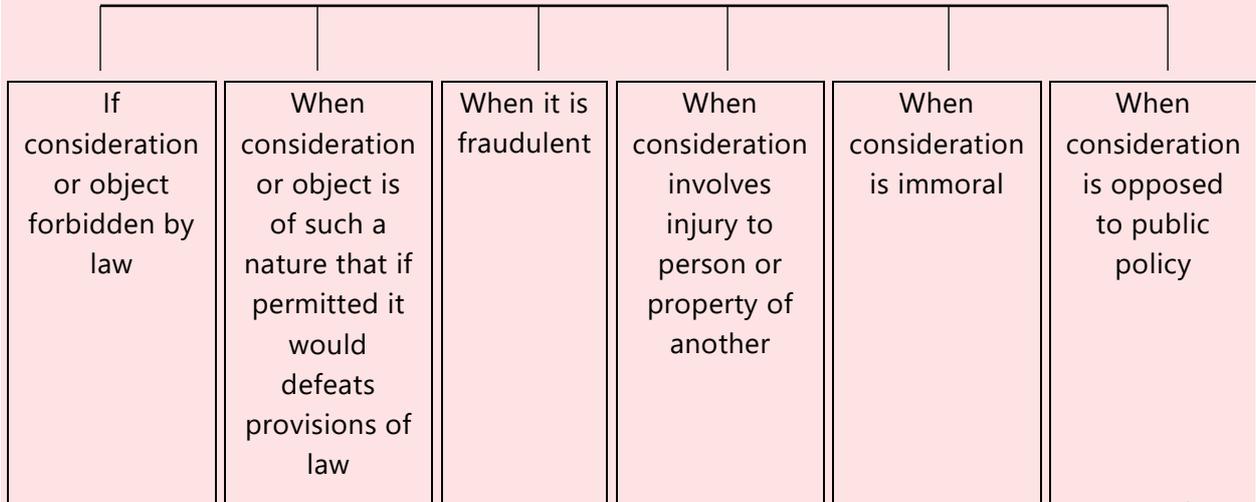
CONSENT & FREE CONSENT

Consent: "Two or more persons are said to consent when they agree upon the same thing in the same sense." (Consensus-ad-idem). When there is no consent, there is no contract.

Free Consent (Sec.14): Consent is said to be free when it is not caused by

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| <p><u>Coercion (Sec. 15)</u></p> <p>(i) Committing or threatening to commit any act forbidden by IPC</p> <p>(ii) Unlawful detaining or threatening to detain any property.</p> <p><u>Consequences</u></p> <p>(i) Voidable at the option of party whose consent was so caused.</p> <p>(ii) Person to whom money is paid or thing delivered under coercion must repay or return it.</p> <p><u>Burden of Proof</u></p> <p>Lies on the aggrieved party</p> <p>Note: Threat to commit suicide is coercion</p> | <p><u>Undue Influence (Sec. 16)</u></p> <p>One party is in the position to dominate the will of other and it takes unfair advantages of relation.</p> <p><u>Consequences</u></p> <p>(i) Voidable at the option of party whose consent was so caused.</p> <p>(ii) Such contract may be set aside either absolutely or if the party who is entitled to avoid it has received any benefit thereunder, upon such terms and conditions as to the court may seem just and equitable.</p> <p><u>Burden of Proof</u></p> <p>Firstly, Lies on the aggrieved party after that other party has to prove that no undue influence.</p> | <p><u>Fraud (Sec. 17)</u></p> <p>(i) Knowingly make a false suggestion.</p> <p>(ii) Active concealment of a fact</p> <p>(iii) Promise without any intention of performance.</p> <p>(iv) Any other act fitted to deceive.</p> <p>(v) Act or omission declared by law as fraud.</p> <p><u>Essentials</u></p> <p>(i) The representation must be false.</p> <p>(ii) Misrepresentation must be made willfully.</p> <p>(iii) Misrepresentation must be made with intention to deceive the other party.</p> <p>(iv) The other party is actually deceived.</p> <p>(v) The other party has suffered a loss.</p> <p><u>Note. Silence amounts to fraud where:</u></p> <p>(i) There is a duty to speak.</p> <p>(ii) His silence is speech.</p> <p><u>Consequences</u></p> <p>Party can</p> <ul style="list-style-type: none"> • rescind the contract. • insist for genuine performance. • sue for damages. <p>Note: -If party takes any benefit, contract is not voidable.</p> | <p><u>Mis-representation (Sec. 18)</u></p> <p>(i) False statement but maker believes it to be true.</p> <p>(ii) Breach of duty without any intention to deceive.</p> <p>(iii) Mis-representation even made innocently, the other party has actually acted.</p> <p><u>Consequences</u></p> <p>Party can</p> <ul style="list-style-type: none"> • rescind the contract. • insist for genuine performance. | <p><u>Mistake (Sec. 20 to Sec.22)</u></p> <p><u>Mistake of Law</u></p> <p>(i) Mistake of law of the country- Contract is not voidable.</p> <p>(ii) Mistake of law of a foreign country- Contract is void.</p> <p><u>Mistake of Fact</u></p> <p>(i) Bilateral Mistake- Contract is void if- mistakes relates to material fact; both parties are under mistake.</p> <p>(ii) Unilateral Mistake- Contract is neither void nor voidable</p> |
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UNLAWFUL OBJECT AND CONSIDERATION (Sec.23)



| | | |
|-----------------------------------|--------------------------------------------------|-----------------------------------------|
| Agreements of trading with enemy | Trafficking relating to Public Offices & titles. | Interference with the course of justice |
| Agreement of stifling prosecution | Agreements tending to create monopolies | Interest against obligation |
| Maintenance & champerty | Marriage brokerage agreements | Consideration unlawful in part |

VOID AGREEMENTS

| | | |
|------------------------------------------------|------------------------------------------|-------------------------------|
| Made by Incompetent Parties(S.11) | Without consideration (S.25) | With uncertain meaning (S.29) |
| Under a mutual mistake of fact (S.20) | In restraint of marriage (S.26) | Wagering Agreements (S.30) |
| Unlawful consideration or object (S.23) | In restraint of trade (S.27) | To do impossible act (S.56) |
| Unlawful consideration or object in part(S.24) | In restraint of legal proceedings (S.28) | |

WAGERING AGREEMENT (SEC. 30)

| | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Meaning: Agreement between two parties by which one promises to pay money or money's worth on the happening of same uncertain event in consideration of the other party's promises to pay if the event does not happen.</p> | <p style="text-align: center;">Essentials</p> <ul style="list-style-type: none"> (i) Promises to pay money (ii) Uncertain event (iii) Mutual Chances of win or lose. (iv) No control over the event (v) No other interest in the event. <p style="text-align: center;">Effects</p> <ul style="list-style-type: none"> (i) Agreement is void (ii) No suit to recover amount won. | <p style="text-align: center;">Transactions are not Wager</p> <ul style="list-style-type: none"> (i) Chit Fund (ii) Share market transactions in which delivery of stocks and shares is intended to be given & taken. (iii) Game of skill, crossword, etc. (iv) a contribution toward any prize value of Rs. 500 or above to be awarded to the winner or winners of a horse race. (v) A contract of insurance. |
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TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Ordinarily, a minor's agreement is
 - (a) Void ab initio
 - (b) Voidable
 - (c) Valid
 - (d) Unlawful

2. Consent is not said to be free when it is caused by
 - (a) Coercion
 - (b) Undue influence
 - (c) Fraud
 - (d) All of these

3. *When the consent of a party is obtained by fraud, the contract is;*
- (a) *Void*
 - (b) *Voidable*
 - (c) *Valid*
 - (d) *Illegal*
4. *The threat to commit suicide amounts to*
- (a) *Coercion*
 - (b) *Undue influence*
 - (c) *Misrepresentation*
 - (d) *Fraud*
5. *Moral pressure is involved in the case of*
- (a) *Coercion*
 - (b) *Undue Influence*
 - (c) *Misrepresentation*
 - (d) *Fraud*
6. *A wrong representation when made without any intention to deceive the other party amounts to*
- (a) *Coercion*
 - (b) *Undue influence*
 - (c) *Misrepresentation*
 - (d) *Fraud*
7. *Which of the following statement is true?*
- (a) *A threat to commit suicide does not amount to coercion*
 - (b) *Undue influence involves use of physical pressure*
 - (c) *Ignorance of law is no excuse*
 - (d) *Silence always amounts to fraud*
8. *In case of illegal agreement, the collateral agreements are:*
- (a) *Valid*
 - (b) *Void*

- (c) Voidable
- (d) Any of these
9. An agreement the object or consideration of which is unlawful, is
- (a) Void
- (b) Valid
- (c) Voidable
- (d) Contingent
10. An agreement is void if it is opposed to public policy. Which of the following is not covered by heads of public policy?
- (a) Trading with an enemy
- (b) Trafficking in public offices
- (c) Marriage brokerage contracts
- (d) Contracts to do impossible acts.
11. A paid ₹ 5000 to a Government servant to get him a contract for the canteen. The Government servant could not get the contract. Can A recover ₹ 5000 paid by him to the Government servant?
- (a) Yes, the agreement is opposed to public policy
- (b) No, the agreement is opposed to public policy
- (c) No, the agreements are a voidable agreement and can be avoided by A
- (d) No, the agreement falls under section 23 and hence illegal
12. With regard to the contractual capacity of a person of unsound mind, which one of the following statements is most appropriate?
- (a) A person of unsound mind can never enter into a contract
- (b) A person of unsound mind can enter into a contract
- (c) A person who is usually of unsound mind can contract when he is, at the time of entering into a contract, of sound mind
- (d) A person who is occasionally of unsound mind can contract although at the time of making the contract, he is of unsound mind

13. *An agreement made under mistake of fact, by both the parties, forming the essential subject matter of the agreement is:*
- (a) *Void*
 - (b) *Voidable*
 - (c) *Valid*
 - (d) *Unenforceable*
14. *A is in dire need of ₹ 1,00,000 but was unable to get any loan from banks as he had no security to offer. A approached his friend B who knowing the helpless position of A lent money at a very high rate of interest, saying that he had himself borrowed money from C. The contract is:*
- (a) *Vitiated by undue influence that B had exercised over A due to his close friendship.*
 - (b) *Void as the rate of interest being very high was unconscionable.*
 - (c) *Not valid as B had wrongly misled A that he had borrowed money from C.*
 - (d) *Valid as a friend could not be supposed to have wielded undue influence only because the money lent carried higher rate of interest.*
15. *Which of the following is not an exception to the rule that the agreement in restraint of trade is void:*
- (a) *A partner can be prevented for carrying on similar business*
 - (b) *An outgoing partner can be restrained on carrying similar business*
 - (c) *On dissolution of firm, partners may agree not to carry on similar business*
 - (d) *The seller of goodwill of business can be prevented for carrying any kind of business at any place.*
16. *An agreement to pay money or money's worth on the happening or non-happening of a specified uncertain event, is a*
- (a) *Wagering agreement*
 - (b) *Contingent contract*
 - (c) *Quasi contract*
 - (d) *Uncertain agreement*

17. *A wagering agreement in India is declared by the Contract Act as*
- (a) *Illegal and void*
 - (b) *Void but not illegal*
 - (c) *Voidable at the option of the aggrieved party*
 - (d) *Immoral*
18. *An agreement, the object of which is to procure a public post, is*
- (a) *Void*
 - (b) *Voidable*
 - (c) *Valid*
 - (d) *Defective*
19. *While obtaining the consent of the promisee, keeping silence by the promisor when he has a duty to speak about the material facts, amounts to consent obtained by:*
- (a) *Coercion*
 - (b) *Misrepresentation*
 - (c) *Mistake*
 - (d) *Fraud*
20. *A enters into an agreement with B who has robbed A of ₹ 10,000 to drop prosecution against him in consideration of B's returning ₹ 8,000. Afterwards B refused to pay. A can get from B*
- (a) *₹ 8,000*
 - (b) *₹ 100*
 - (c) *Nothing*
 - (d) *₹ 10,000 plus damages*
21. *On attaining the age of majority, a minor's agreement:*
- (a) *cannot be ratified by him*
 - (b) *becomes valid*
 - (c) *can be ratified by him*
 - (d) *becomes void*

22. *A threat to kidnap one's son in consideration of ₹ 5,00,000 is void because of:*
- (a) *inadequacy of consideration*
 - (b) *incompetence of parties*
 - (c) *absence of free consent*
 - (d) *all of the above*
23. *In which of the following case, aggrieved part can sue for damages:*
- (a) *Fraud*
 - (b) *mistake*
 - (c) *undue influence*
 - (d) *misrepresentation*
24. *A mere attempt to deceive a party to a contract:*
- (a) *is fraud even though the party is not deceived*
 - (b) *is not fraud unless the party is actually deceived*
 - (c) *amounts to coercion*
 - (d) *amounts to misrepresentation*

Descriptive Questions

1. *"An agreement, the meaning of which is not certain, is void". Discuss.*
2. *"Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor". Discuss.*
3. *A student was induced by his teacher to sell his brand new car to the later at less than the purchase price to secure more marks in the examination. Accordingly, the car was sold. However, the father of the student persuaded him to sue his teacher. State whether the student can sue the teacher?*
4. *Explain the concept of 'misrepresentation' in matters of contract. Sohan induced Suraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Suraj complained that there were many defects in the motorcycle. Sohan proposed to get it repaired and promised to pay 40% cost of repairs. After few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons whether Suraj can rescind the contract?*
5. *Mr. SAMANT owned a motor car. He approached Mr. CHHOTU and offered to sell his motor car for ₹ 3,00,000. Mr. SAMANT told Mr. CHHOTU that the motor car is running*

at the rate of 30 KMs per litre of petrol. Both the fuel meter and the speed meter of the car were working perfectly. Mr. CHHOTU agreed with the proposal of Mr. SAMANT and took delivery of the car by paying ₹ 3,00,000/- to Mr. SAMANT. After 10 days, Mr. CHHOTU came back with the car and stated that the claim made by Mr. SAMANT regarding fuel efficiency was not correct and therefore there was a case of misrepresentation. Referring to the provisions of the Indian Contract Act, 1872, decide and write whether Mr. CHHOTU can rescind the contract in the above ground.

6. Ishaan, aged 16 years, was studying in an engineering college. On 1st March, 2018 he took a loan of ₹ 2 lakhs from Vishal for the payment of his college fee and agreed to pay by 30th May, 2019. Ishaan possesses assets worth ₹ 15 lakhs. On due date Ishaan fails to pay back the loan to Vishal. Vishal now wants to recover the loan from Ishaan out of his assets. Decide whether Vishal would succeed referring to the provisions of the Indian Contract Act, 1872.

ANSWER/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 1. | (a) | 2. | (d) | 3. | (b) | 4. | (a) | 5. | (b) | 6. | (c) |
| 7. | (c) | 8. | (b) | 9. | (a) | 10. | (d) | 11. | (d) | 12. | (c) |
| 13. | (a) | 14. | (d) | 15. | (d) | 16. | (a) | 17. | (b) | 18. | (a) |
| 19. | (d) | 20. | (c) | 21. | (a) | 22. | (c) | 23. | (a) | 24. | (b) |

Answers to the Descriptive Questions

- 1. Agreement - the meaning of which is uncertain (Section 29):** An agreement, the meaning of which is not certain, is void, but where the meaning thereof is capable of being made certain, the agreement is valid. For example, A agrees to sell B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. But the agreement would be valid if A was dealer only in coconut oil; because in such a case its meaning would be capable of being made certain.
- 2. Minor can be a beneficiary or can take benefit out of a contract:** Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor. Thus, a promissory note duly executed in favour

of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.

A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).

Example: A mortgage was executed in favour of a minor. Held, he can get a decree for the enforcement of the mortgage.

3. Yes, A can sue his teacher on the ground of undue influence under the provisions of Indian Contract Act, 1872.

According to section 16 of the Indian Contract Act, 1872, "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 he uses that position to obtain an unfair advantage over the other".

A person is deemed to be in position to dominate the will of another:

- (a) Where he holds a real or apparent authority over the other; or
- (b) Where he stands in a fiduciary relationship to the other; or
- (c) 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 for example, an old illiterate person.

A contract brought as a result of coercion, undue influence, fraud or misrepresentation would be voidable at the option of the person whose consent was caused.

4. **Misrepresentation:** According to Section 18 of the Indian Contract Act, 1872, misrepresentation is:

1. 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.
2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.
3. 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 of the agreement.

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party

loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it.

Accordingly, in the given case, Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amount to final acceptance of the sale.

5. As per the provisions of Section 19 of the Indian Contract Act, 1872, when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

A party to contract, whose consent was caused by fraud or misrepresentation, 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 representations made had been true.

Exception: If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 18, the contract, nevertheless, is not voidable if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

In the situation given in the question, both the fuel meter and the speed meter of the car were working perfectly, Mr. CHHOTU had the means of discovering the truth with ordinary diligence. Therefore, the contract is not voidable. Hence, Mr. CHHOTU cannot rescind the contract in the above ground.

6. According to Section 11 of the Indian Contract Act, 1872, 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.

A person who has completed the age of 18 years is a major and otherwise he will be treated as minor. Thus, Ishaan who is a minor is incompetent to contract and any agreement with him is void [*Mohori Bibi Vs Dharmo Das Ghose 1903*].

Section 68 of the Indian Contract Act, 1872 however, prescribes the liability of a minor for the supply of the things which are the necessaries of life to him. It says that though minor is not personally liable to pay the price of necessaries supplied to him or money lent for the purpose, the supplier or lender will be entitled to claim the money/price of goods or services which are necessaries suited to his condition of life provided that the minor has a property. The liability of minor is only to the extent of the minor's property. Thus, according to the above provision, Vishal will be entitled to recover the amount of loan given to Ishaan for payment of the college fees from the property of the minor.

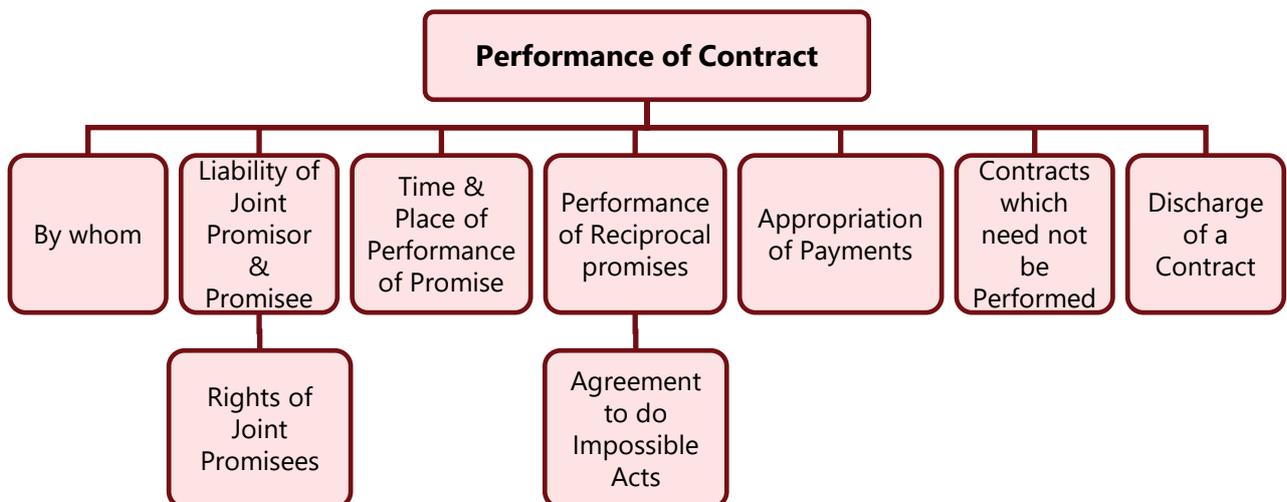
UNIT-4: PERFORMANCE OF CONTRACT

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ How obligations under a contract must be carried out by the parties.
- ◆ Various modes of performance.
- ◆ Consequence of refusal of performance or refusal to accept performance, by either of the parties.
- ◆ Rights of joint promisees, liabilities of joint promisors, and rules regarding appropriation of payments.

UNIT OVERVIEW



This unit explains who must perform his obligation, what should be the mode of performance, and what shall be the consequences of non- performance.

4.1 PERFORMANCE OF CONTRACT

Meaning: "Performance of Contract" means fulfilment of obligations to the contract. According to Section 37, 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 provisions of the Contract Act or of any other law.

Types: On the basis of Section 37, "Performance of Contract" may be actual or attempted.

- (a) **Actual Performance:** Where a party to a contract has done what he had undertaken to do or either of the parties has fulfilled their obligations under the contract within the time and in the manner prescribed.

Example 1: X borrows ₹ 5,00,000 from Y with a promise to be paid after 1 month. X repays the amount on the due date. This is actual performance.

- (b) **Offer to perform or attempted performance or tender of performance:** It may happen sometimes, when the performance becomes due, the promisor offers to perform his obligation but the promisee refuses to accept the performance.

Example 2: 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. This is an attempted performance as A the promisor has done what he was required to do under the contract.

4.2 CONDITIONS TO BE SATISFIED FOR A VALID TENDER OR ATTEMPTED PERFORMANCE

- (i) **It must be unconditional.**

Example 3: A offers to B to repay only the principal amount of the loan. This is not a valid tender since the whole amount of principal and interest is not offered.

- (ii) **It must be made at proper time and place.**

Example 4: If the promisor wants to deliver the goods at 2 a.m., this is not a valid tender unless it was so agreed.

- (iii) **Reasonable opportunity to examine goods.**

Example 5: A contract's to deliver B at his warehouse 1000 Kgs of wheat on certain date. A must bring the wheat to B's warehouse on the appointed day, under such circumstances that B may have reasonable opportunity of satisfying himself that the thing offered is wheat of the quality contracted for, and that there are 1000 Kgs.

(iv) **It must be for whole obligation.**

Example 6: X, a singer enters into a contract with Y, the manager of a theatre to sing at his theatres two nights in every week during the next two months, and Y engaged to pay her ₹ 10,000 for each night's performance. On the sixth night, X willfully absents herself from the theatre. Y is at liberty to put an end to the contract.

Example 7: A promises to deliver 100 bales of cotton on a certain day. On the agreed day and place 'A' offers to deliver 80 bales only. This is not a valid tender.

4.3 BY WHOM A CONTRACT MAY BE PERFORMED (SECTION 40, 41 AND 42)

The promise under a contract may be performed, as the circumstances may permit, by the promisor himself, or by his agent or his legal representative.

1. **Promisor himself:** If there is something in the contract to show 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 means contracts which involve the exercise of personal skill or diligence, or which are founded on personal confidence between the parties must be performed by the promisor himself.

Example 8: A promises to paint a picture for B and this must be performed by the promisor himself.

2. **Agent:** Where personal consideration is not the foundation of a contract, the promisor or his representative may employ a competent person to perform it.
3. **Legal Representatives:** A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract (Section 37, para 2). But their liability under a contract is limited to the value of the property they inherit from the deceased.

Example 9: A promises to B to pay ₹ 100,000 on delivery of certain goods. A may perform this promise either himself or causing someone else to pay the money to B. If A dies before the time appointed for payment, his representative must pay the money or employ some other person to pay the money. If B dies before the time appointed for the delivery of goods, B's representative shall be bound to deliver the goods to A and A is bound to pay ₹100,000 to B's representative.

Example 10: A promises to paint a picture for B for a certain price. A is bound to perform the promise himself. He cannot ask some other painter to paint the picture on his behalf. If A dies before painting the picture, the contract cannot be enforced either by A's representative or by B.

4. **Third persons: Effect of accepting performance from third person- Section 41:** When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is, performance by a stranger, if accepted by the promisee, this results in discharging the promisor, although the latter has neither authorised nor ratified the act of the third party.

Example 11: A received certain goods from B promising to pay ₹ 100,000/-. Later on, A expressed his inability to make payment. C, who is known to A, pays ₹ 60,000/- to B on behalf of A. However, A was not aware of the payment. Now B is intending to sue A for the amount of ₹ 100,000/-. Therefore, in the present instance, B can sue only for the balance amount i.e., ₹ 40,000/- and not for the whole amount.

5. **Joint promisors (Section 42):** When two or more persons have made a joint promise, then unless a contrary intention appears by the contract, all such persons must jointly fulfil the promise. If any of them dies, his legal representatives must, jointly with the surviving promisors, fulfil the promise. If all of them die, the legal representatives of all of them must fulfil the promise jointly.

Example 12: 'A', 'B' and 'C' jointly promised to pay ₹ 6,00,000 to 'D'. Here 'A', 'B' and 'C' must jointly perform the promise. If 'A' dies before performance, then his legal representatives must jointly with 'B' and 'C' perform the promise, and so on. And if all the three (i.e. 'A', 'B' and 'C') die before performance, then the legal representatives of all must jointly perform the promise.



4.4 DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT

Distinction between two legal concepts, viz., succession and assignment may be noted carefully. When the benefits of a contract are succeeded to by process of law, then both burden and benefits attaching to the contract, may sometimes devolve on the legal heir. Suppose, a son succeeds to the estate of his father after his death, he will be liable to pay the debts and liabilities of his father owed during his life-time. But if the debts owed by his father exceed the value of the estate inherited by the son then he would not be called upon to pay the excess. In other words, the liability of the son will be limited to the extent of the property inherited by him.

In the matter of assignment, however the benefit of a contract can only be assigned but not the liabilities thereunder. This is because when liability is assigned, a third party gets involved therein. Thus, a debtor cannot relieve himself of his liability to creditor by assigning to someone else his obligation to repay the debt.

On the other hand, if a creditor assigns the benefit of a promise, he thereby entitles the assignee to realise the debt from the debtor but where the benefit is coupled with a liability or when a personal consideration has entered into the making of the contract then the benefit cannot be assigned.

4.5 LIABILITY OF JOINT PROMISOR & PROMISEE

Devolution of joint liabilities (Section 42)

If two or more persons have made a joint promise, ordinarily all of them during their life-time must jointly fulfil the promise. After death of any one of them, his legal representative jointly with the survivor or survivors should do so. After the death of the last survivor the legal representatives of all the original co-promisors must fulfil the promise.

Example 13: X, Y and Z who had jointly borrowed money must, during their life-time jointly repay the debt. Upon the death of X his representative, say, S along with Y and Z should jointly repay the debt and so on. If in an accident all the borrowers X, Y and Z dies then their legal representatives must fulfil the promise and repay the borrowed amount. This rule is applicable only if the contract reveals no contrary intention.

We have seen that **Section 42 deals with voluntary discharge of obligations by joint promisors**. But if they do not discharge their obligation on their own volition, **what will happen?** This is what Section 43 resolves.

Any one of joint promisors may be compelled to perform – Section 43

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.

Each promisor may compel contribution – Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

In other words, if one of the joint promisors is made to perform the whole contract, he can call for a contribution from others.

Sharing of loss by default in contribution – If any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

Explanation to Section 43

Nothing in this section shall prevent a surety from recovering, from his principal, payments made by the surety on behalf of the principal, or entitle the principal to recover anything from the surety on account of payment made by the principal.

Example 14: A, B and C jointly promise to pay D ₹ 3,00,000. D may compel either A or B or C to pay him ₹ 3,00,000.

Example 15: A, B and C are under a joint promise to pay D ₹ 3,00,000. C is unable to pay anything A is compelled to pay the whole. A is entitled to receive ₹ 1,50,000 from B.

Example 16: X, Y and Z jointly promise to pay ₹ 6,000 to A. A may compel either X or Y or Z to pay the amount. If Z is compelled to pay the whole amount; X is insolvent but his assets are sufficient to pay one-half of his debts. Z is entitled to receive ₹ 1,000 from X's estate and ₹ 2,500 from Y.

We thus observe that the effect of Section 43 is to make the liability in the event of a joint contract, both joint & several, in so far as the promisee may, in the absence of a contract to the contrary, compel anyone or more of the joint promisors to perform the whole of the promise.

Effect of release of one joint promisor- Section 44

The effect of release of one of the joint promisors is dealt with in Section 44 which is stated below:

Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or joint promisors, neither does it free the joint promisors so released from responsibility to the other joint promisor or promisors.

Example 17: 'A', 'B' and 'C' jointly promised to pay ₹ 9,00,000 to 'D'. 'D' released 'A' from liability. In this case, the release of 'A' does not discharge 'B' and 'C' from their liability. They remain liable to pay the entire amount of ₹ 9,00,000 to 'D'. And though 'A' is not liable to pay to 'D', but he remains liable to pay to 'B' and 'C' i.e. he is liable to make the contribution to the other joint promisors.

Rights of Joint Promisees

The law relating to Devolution of joint rights is contained in Section 45 which is reproduced below:

“When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and after the death of the last survivor, with the representatives of all jointly”.

Example 18: A, in consideration of ₹ 5,00,000 rupees lent to him by B and C, promises B and C jointly to repay them that sum with interest on a specified day but B dies. In such a case right to demand payment shall rest with B’s legal representatives, jointly with C during C’s life-time, and after the death of C, with the legal representatives of B and C jointly.

4.6 TIME AND PLACE FOR PERFORMANCE OF THE PROMISE

The law on the subject is contained in Sections 46 to 50 explained below:

(i) Time for performance of promise, where no application is to be made and no time is specified - Section 46

Where, by the contract, a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time.

Explanation to Section 46 - The expression reasonable time is to be interpreted having regard to the facts and circumstances of a particular case.

(ii) Time and place for performance of promise, where time is specified and no application to be made – Section 47

When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business, on such day and the place at which the promise ought to be performed.

Example 19: If the delivery of goods is offered say after 8.30 pm, the promisee may refuse to accept delivery, for the usual business hours are over. Moreover, the delivery must be made at the usual place of business.

(iii) Application for performance on certain day to be at proper time and place – Section 48

When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business.

Explanation to Section 48 states that the question “what is a proper time and place” is, in each particular case, a question of fact.

(iv) Place for the performance of promise, where no application to be made and no place fixed for performance - Section 49

When a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such a place.

Example 20: A undertakes to deliver a thousand maunds of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

(v) Performance in manner or at time prescribed or sanctioned by promisee - Section 50

The performance of any promise may be made in any such manner, or at any time which the promisee prescribes or sanctions.

4.7 PERFORMANCE OF RECIPROCAL PROMISE

The law on the subject is contained in Sections 51 to 58. The provisions thereof are summarized below:

(i) Promisor not bound to perform, unless reciprocal promisee ready and willing to perform- Section 51

When a contract consists of reciprocal promises to be simultaneously performed, no promisor needs to perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

Example 21: A and B contract that A shall deliver the goods to B to be paid for by B on delivery. A need not deliver the goods, unless B is ready and willing to pay for the goods on delivery.

(ii) Order of performance of reciprocal promises- Section 52

When the order of performance of the reciprocal promises is expressly fixed by the contract, they shall 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.

Example 22: 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.

(iii) Liability of party preventing event on which the contract is to take effect – Section 53

When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented; and he is entitled to compensation from the other party for any loss he may sustain in consequence of the non-performance of the contract.

Example 23: A and B contract that B shall execute some work for A for a thousand rupees. B is 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 elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

Example 24: In a contract for the sale of standing timber, the seller is to cut and cord it, whereupon buyer is to take it away and pay for it. The seller cords only a part of the timber and neglects to cord the rest. In that event the buyer may avoid the contract and claim compensation from the seller for any loss which he may have sustained for the non-performance of the contract.

(iv) Effect of default as to that promise which should be first performed, in contract consisting of reciprocal promises (Section 54)

Section 54 applies when the promises are reciprocal and dependent. If the promisor who has to perform his promise before the performance of the other's promise fails to perform it, he cannot claim performance of the other's promise, and is also liable for compensation for his non-performance.

Example 25: A hires B's ship to take in and convey, from Kolkata to the Mauritius, a cargo to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.

Example 26: A hires B to make a shoe rack. A will supply the plywood, fevicol and other items required for making the shoe rack. B arrived on the appointed day and time but A could not arrange for the required materials. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.

(v) Effects of Failure to Perform at a Time Fixed in a Contract in which Time is Essential (Section 55)

The law on the subject is contained in Section 55 which is reproduced below:

"When a party to a contract promises to do certain thing at or before the specified time, and fails to do any such thing at or before the specified time, 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 of essence of the contract".

Effect of such failure when time is not essential

If it was not the intention of the parties that time should be of 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.

Effect of acceptance of performance at time other than agreed upon -

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 agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of acceptance, he gives notice to the promisor of his intention to do so.

(vi) Agreement to do Impossible Act (Section 56)

The impossibility of performance may be of the two types, namely (a) initial impossibility, and (b) subsequent impossibility.

(a) Initial Impossibility (Impossibility existing at the time of contract): When the parties agree upon doing of something which is obviously impossible in itself the agreement would be void. Impossible in itself means impossible in the nature of things. The fact of impossibility may be and may not be known to the parties.

Example 27: 'A', a Hindu, who was already married, contracted to marry 'B', a Hindu girl. According to law, 'A' being married, could not marry 'B'. In this case, 'A' must make compensation to 'B' for the loss caused to her by the non-performance of the contract.

- (1) **If known to the parties:** It would be observed that an agreement constituted, quite unknown to the parties, may be impossible of being performed and hence void.

Example 28: B promises to pay a sum of ₹ 5,00,000 if he is able to swim across the Indian Ocean from Mumbai to Aden within a week. In this case, there is no real agreement, since both the parties are quite certain in their mind that the act is impossible of achievement. Therefore, the agreement, being impossible in itself, is void.

- (2) **If unknown to the parties:** Where both the promisor and the promisee are ignorant of the impossibility of performance, the contract is void.

Example 29: A contracted B to sell his brown horse for ₹ 2,50,000 both unaware that the horse was dead a day before the agreement.

- (3) **If known to the promisor only:** Where at the time of entering into a contract, the promisor alone knows about the impossibility of performance, or even if he does not know though he should have known it with reasonable diligence, the promisee is entitled to claim compensation for any loss he suffered on account of non-performance.

- (b) **Subsequent or Supervening impossibility (Becomes impossible after entering into contract):** When performance of promise become impossible or illegal by occurrence of an unexpected event or a change of circumstances beyond the contemplation of parties, the contract becomes void e.g. change in law etc. In other words, sometimes, the performance of a contract is quite possible when it is made. But subsequently, some event happens which renders the performance impossible or unlawful. **Such impossibility is called the subsequent or supervening. It is also called the post-contractual impossibility.** The effect of such impossibility is that it makes the contract void, and the parties are discharged from further performance of the contract.

Example 30: 'A' and 'B' contracted to marry each other. Before the time fixed for the marriage, 'A' became mad. In this case, the contract becomes void due to subsequent impossibility, and thus discharged.

(vii) Reciprocal promise to do certain things that are legal, and also some other things that are illegal- Section 57

Where persons reciprocally promise, first to do certain things which are legal and secondly, under specified circumstances, to do certain other things which are illegal, the first set of promises is a valid contract, but the second is a void agreement.

Example 31: A and B agree that A will sell a house to B for ₹ 50,00,000 and also that if B uses it as a gambling house, he will pay a further sum of ₹ 75,00,000. The first set of reciprocal promises, i.e. to sell the house and to pay ₹ 50,00,000 for it, constitutes a valid contract. But the object of the second, being unlawful, is void.

(viii) 'Alternative promise' one branch being illegal- Section 58

The law on this point is contained in Section 58 which says that "In the case of the alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced".

Example 32: A and B agree that A shall pay B ₹ 1,00,000, for which B shall afterwards deliver to A either rice or smuggled opium.

This is a valid contract to deliver rice, and a void agreement as to the opium.

4.8 APPROPRIATION OF PAYMENTS

Sometimes, a debtor owes several debts to the same creditor and makes payment, which is not sufficient to discharge all the debts. In such cases, the payment is appropriated (i.e. adjusted against the debts) as per **Section 59 to 61** of the Indian Contract Act.

- (i) Application of payment where debt to be discharged is indicated (Section 59):** Where a debtor, owing several distinct debts to one person, makes a payment to him either with express intimation or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied accordingly.
- (ii) Application of payment where debt to be discharged is not indicated (Section 60):** Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor, where its recovery is or is not barred by the law in force for the time being as to the limitation of suits. However, he cannot apply the payment to the disputed debt.

- (iii) **Application of payment where neither party appropriates (Section 61):** Where neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payments shall be applied in discharge of each proportionately.

4.9 CONTRACTS, WHICH NEED NOT BE PERFORMED – WITH THE CONSENT OF BOTH THE PARTIES

Under this heading, we shall discuss the principles of Novation, Rescission and Alteration. The law is contained in Sections 62 to 67 of the Contract Act.

(i) **Effect of novation, rescission, and alteration of contract (Section 62)**

“If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed”.

Analysis of Section 62

- (a) **Effect of novation:** The parties to a contract may substitute a new contract for the old. If they do so, it will be a case of novation. On novation, the old contract is discharged and consequently it need not be performed. Thus, it is a case where there being a contract in existence some new contract is substituted for it either between the same parties or between different parties the consideration mutually being the discharge of old contract. Novation can take place only by mutual agreement between the parties.

Example 33: A owes B ₹ 100,000. A, B and C agree that C will pay B and he will accept ₹ 100,000 from C in lieu of the sum due from A. A's liability thereby shall come to an end, and the old contract between A and B will be substituted by the new contract between B and C.

- (b) **Effect of rescission:** A contract is also discharged by rescission. When the parties to a contract agree to rescind it, the contract need not be performed. In the case of rescission, only the old contract is cancelled and no new contract comes to exist in its place. It is needless to point out that novation also involves rescission. Both in novation and in rescission, the contract is discharged by mutual agreement.
- (c) **Effect of alteration of contract:** As in the case of novation and rescission, so also in a case where the parties to a contract agree to alter it, the original contract is rescinded, with the result that it need not be performed. In other

words, a contract is also discharged by alteration. The terms of contract may be so altered by mutual agreement that the alteration may have the effect of substituting a new contract for the old one. In other words, the distinction between novation and alteration is very slender.

Novation and alteration: The law pertaining to novation and alteration is contained in Sections 62 to 67 of the Indian Contract Act. In both these cases the original contract need not be performed. Still there is a difference between these two.

1. Novation means substitution of an existing contract with a new one. Novation may be made by changing in the terms of the contract or there may be a change in the contracting parties. But in case of alteration the terms of the contract may be altered by mutual agreement by the contracting parties but the parties to the contract will remain the same.
2. In case of novation there is altogether a substitution of new contract in place of the old contract. But in case of alteration it is not essential to substitute a new contract in place of the old contract. In alteration, there may be a change in some of the terms and conditions of the original agreement.

- (ii) **Promisee may waive or remit performance of promise (Section 63):** "Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance or may accept instead of it any satisfaction which he thinks fit". In other words, a contract may be discharged by remission.

Example 34: A owes B ₹5,00,000. A pays to B, and B accepts, in satisfaction of the whole debt, ₹ 2,00,000 paid at the time and place at which the ₹ 5,00,000 were payable. The whole debt is discharged.

- (iii) **Restoration of Benefit under a Voidable Contract (Section 64)**

The law on the subject is "When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding avoidable contract shall, if he has received any benefit thereunder from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received".

Analysis of Section 64

Such a contract can be terminated at the option of the party who is empowered to do so. If he has received any benefit under the contract, he must restore such benefit to the person from whom he has received it.

Example 35: An insurance company may rescind a policy on the ground that material fact has not been disclosed. When it does so, the premium collected by it in respect of the policy reduced by the amount of expenses incurred by it in this connection must be repaid to the policy holder.

(iv) Obligations of Person who has Received Advantage under Void Agreement or contract that becomes void (Section 65)

“When an agreement is discovered to be void or when a contract 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.”

Analysis of Section 65

From the language of the Section, it is clear that in such a case either the advantage received must be restored back or a compensation, sufficient to put the position prior to contract, should be paid.

Example 36: A pays B ₹ 1,00,000, in consideration of B's promising to marry C, A's daughter. C is dead at the time of the promise. The agreement is void, but B must repay A ₹ 1,00,000.

In a case, the plaintiff hired a godown from the defendant for twelve months and paid the whole of the rent in advance. After about seven months the godown was destroyed by fire, without any fault or negligence on the part of the plaintiff and the plaintiff claimed a refund of a proportionate amount of the rent. Held, the plaintiff was entitled to recover the rent for the unexpired term, of the contract.

The Act requires that a party must give back whatever he has received under the contract. The benefit to be restored under this section must be benefit received under the contract (and not any other amount). A agrees to sell land to B for ₹ 400,000. B pays to A ₹ 40,000 as a deposit at the time of the contract, the amount to be forfeited by A if B does not complete the sale within a specified period. B fails to complete the sale within the specified period, nor is he ready and willing to complete the sale within a reasonable time after the expiry of that period. A is entitled to rescind the contract and to retain the deposit. The deposit is not a benefit

received under the contract, it is a security that the purchaser would fulfil his contract and is ancillary to the contract for the sale of the land.

- (v) **Communication of rescission (Section 66):** You have noticed that a contract voidable at the option of one of the parties can be rescinded; but rescission must be communicated to the other party in the same manner as a proposal is communicated under Section 4 of the Contract Act. Similarly, a rescission may be revoked in the same manner as a proposal is revoked.
- (vi) **Effects of neglect of promisee to afford promisor reasonable facilities for performance (Section 67):** If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby.

Example 37: If an apprentice refuses to learn, the teacher cannot be held liable for not teaching.

Example 38: A contracts with B to repair B's house. B neglects or refuses to appoint out to A the places in which his house requires repair. A is excused for the non-performance of the contract, if it is caused by such neglect or refusal.

4.10 DISCHARGE OF A CONTRACT

A contract is discharged when the obligations created by it come to an end. A contract may be discharged in any one of the following ways:

- (i) **Discharge by performance:** It takes place when the parties to the contract fulfil their obligations arising under the contract within the time and in the manner prescribed. Discharge by performance may be
- (1) Actual performance; or
 - (2) Attempted performance.

Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance or tender.

Example 39: A contracts to sell his car to B on the agreed price. As soon as the car is delivered to B and B pays the agreed price for it, the contract comes to an end by performance.

Example 40: A contracted to supply certain quantity of timber to B. B made the supply of timber at appointed time and place but A refused to accept the delivery. This is called as attempted performance.

- (ii) **Discharge by mutual agreement:** Section 62 of the Indian Contract Act provides if the parties to a contract agree to substitute a new contract for it, or to rescind or remit or alter it, the original contract need not be performed. The principles of Novation, Rescission, Alteration and Remission are already discussed.

Example 41: A owes B ₹ 1,00,000. A enters into an agreement with B and mortgage his (A's), estates for ₹ 50,000 in place of the debt of ₹ 1,00,000. This is a new contract and extinguishes the old.

Example 42: A owes B ₹ 5,00,000. A pays to B ₹ 3,00,000 who accepts it in full satisfaction of the debt. The whole is discharged.

- (iii) **Discharge by impossibility of performance:** The impossibility may exist from the very start. In that case, it would be impossibility ab initio. Alternatively, it may supervene. Supervening impossibility may take place owing to:

- (a) an unforeseen change in law;
- (b) the destruction of the subject-matter essential to that performance;
- (c) the non-existence or non-occurrence of particular state of things, which was naturally contemplated for performing the contract, as a result of some personal incapacity like dangerous malady;
- (d) the declaration of a war (Section 56).

Example 43: A agrees with B to discover a treasure by magic. The agreement is void due to initial impossibility.

Example 44: A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.

Example 45: A contracts to act at a theatre for six months in consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

Example 46: X agrees to sell his horse to Y for ₹ 5,000 but the horse died in an accident. Here, it become impossible to perform the contract due to destruction of the subject. Thus, a valid contract changes into void contract because of impossibility of performance.

- (iv) **Discharge by lapse of time:** A contract should be performed within a specified period as prescribed by the Limitation Act, 1963. If it is not performed and if no

action is taken by the promisee within the specified period of limitation, he is deprived of remedy at law.

Example 47: If a creditor does not file a suit against the buyer for recovery of the price within three years, the debt becomes time-barred and hence irrecoverable.

- (v) **Discharge by operation of law:** A contract may be discharged by operation of law which includes by death of the promisor, by insolvency etc.
- (vi) **Discharge by breach of contract:** Breach of contract may be actual breach of contract or anticipatory breach of contract. If one party defaults in performing his part of the contract on the due date, he is said to have committed breach thereof. When on the other hand, a person repudiates a contract before the stipulated time for its performance has arrived, he is deemed to have committed anticipatory breach. If one of the parties to a contract breaks the promise the party injured thereby, has not only a right of action for damages but he is also discharged from performing his part of the contract.

Example 48: A contracted with B to supply 100 kgs of rice on 1st June. But A failed to deliver the same on said date. This is actual breach of contract. If time is not essential essence of contract B can give him another date for supply of goods and he will not be liable to claim for any damages if prior notice for the same is not given to A while giving another date.

- (vii) **Promisee may waive or remit performance of promise:** Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance or may accept instead of it any satisfaction which he thinks fit. In other words, a contract may be discharged by remission. (Section 63)

Example 49: A owes B ₹ 5,00,000. C pays to B ₹1,00,000 and B accepts them, in satisfaction of his claim on A. This payment is a discharge of the whole claim.

- (viii) **Effects of neglect of promisee to afford promisor reasonable facilities for performance:** If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby. (Section 67)
- (ix) **Merger of rights:** Sometimes, the inferior rights and the superior rights coincide and meet in one and the same person. In such cases, the inferior rights merge into the superior rights. On merger, the inferior rights vanish and are not required to be enforced.

Example 50: A took a land on lease from B. Subsequently, A purchases that very land. Now, A becomes the owner of the land and the ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.

SUMMARY

1. The promisor or his representative must perform unless the nature of contract shows that it may be performed by a third person, but the promisee may accept performance by a third party. (Sections 37, 40 and 41)
2. In case of joint promisors, all must perform, and after the death of any of them, the survivors and the representatives of the deceased must perform. But their liability is joint and several. If the promisee requires any one of them perform the whole promise, he can claim contribution from others. (Sections 42, 43 and 44)
3. Joint promisees have only a joint right to claim performance. (Section 45)
4. The promisor must offer to perform and such offer must be unconditional, and be made at the proper time and place, allowing the promisee a reasonable opportunity of inspection of the things to be delivered. (Sections 38, 46, 47, 48, 49 and 50)
5. If the performance consists of payment of money and there are several debts to be paid, the payment shall be appropriated as per provisions of Sections 59, 60 and 61. The debtor has, at the time of payment, the right of appropriating the payment. In default of debtor, the creditor has option of election and in default of either the law will allow appropriation of debts in order of time.
6. If an offer of performance is not accepted, the promisor is not responsible for non-performance and does not lose his rights under the contract; so also, if the promisee fails to afford reasonable facilities. He may sue for specific performance or he may avoid the contract and claim compensation (Sections 38, 39, 53 and 67).
7. Rescission is communicated and revoked in the same way as a promise. The effect is to dispense with further performance and to render the party rescinding liable to restore any benefit he may have received. (Sections 64 and 66)
8. Parties may agree to cancel the contract or to alter it or to substitute a new contract for it. (Section 62)

| PERFORMANCE OF CONTRACTS (SEC.37) | | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Meaning: Fulfillment of obligations to contract</p> <p>Types</p> <p>(i) Actual: Party actually fulfills the obligation.</p> <p>(ii) Tender Performance (Sec. 38): Promisor offers to perform his obligation under the contract at the proper time and place but the promisee refuses to accept the performance.</p> | <p>Condition for a Valid Tender Performance</p> <p>1. Must be unconditional.</p> <p>2. At proper time & Place.</p> <p>3. Reasonable opportunity to examine goods.</p> <p>4. For whole obligation.</p> | <p>By Whom</p> <p>1. Promisor himself</p> <p>2. Agent: Where contract doesn't involve personal skills.</p> <p>3. Legal Representative: In case of death of promisor. However, if contract involves personal skill, it comes to an end with death of promisor.</p> <p>4. Third persons: When promisee accepts performance from a third person, he cannot afterward enforce it against promisor.</p> | <p>Performance of Joint Promises</p> <p>1. All joint promisors are liable jointly and severally. However Contract may provide otherwise.</p> <p>2. In case of death of any joint promisor, legal representative with surviving joint promisors jointly fulfill the promise.</p> <p>3. One has right of contribution from others.</p> <p>4. If one of the joint promisors is released, he is responsible to the other joint promisor or promisors.</p> |
| <p>Time place and manner: As decided otherwise during business hours at business place or residence of promisee.</p> | | | |

| | | |
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| <p>Performance of Reciprocal Promises</p> <p>1. Mutual and Concurrent- Promises have to be simultaneously performed.</p> <p>2. Mutual and Dependent- If the promisor, who must perform, fails to perform it, he cannot claim the performance of the reciprocal promise.</p> <p>3. Mutual and Independent- Each party must perform his promise without waiting for the performance or readiness to perform on the part of the other.</p> <p>Note1: Where contract is not complete in time &:-</p> <p>(a) Time is essential – Contract is voidable.</p> <p>(b) Time is not essential – Contract not voidable but compensation is there.</p> <p>Note2: Contract to do impossible act is void.</p> <p>Note3: Reciprocal promises to do things legal and also other things illegal-first set of promises is a contract but second is a void agreement.</p> | <p>Appropriation of Payment (Adjustment of Payment Against Debt)</p> <p>Rule 1: Appropriation by Debtor- if accepted, must be applied to that debt.</p> <p>Rule 2: Appropriation by Creditor- Debtor does not intimate, the creditor may apply it at his discretion to any lawful debt including a time-barred debt. (But not to a disputed debt)</p> <p>Rule 3: Where neither party appropriates – neither party makes any appropriation the payment is to be applied in discharge of the debts in order of time, including time-barred debts. If the debts are equal the payment is to be applied proportionately.</p> | <p>Contracts which need not be performed</p> <p>1. If the parties mutually agree to substitute the original contract by a new one or to rescind or alter it.</p> <p>2. If the promise dispenses with or remits, wholly or in part the performance of the promise made to or extends the time for such performance or accepts any satisfaction for it.</p> <p>3. If the person, at whose option the contract is voidable, rescinds it.</p> <p>4. If the promisee neglects or refuses.</p> <p>5. If it is illegal.</p> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *On the valid performance of the contractual obligations by the parties, the contract*
 - (a) *Is discharged*
 - (b) *becomes enforceable*
 - (c) *becomes void*
 - (d) *None of these*
2. *Which of the following person can perform the contract?*
 - (a) *Promisor alone*
 - (b) *Legal representatives of promisor*
 - (c) *Agent of the promisor*
 - (d) *All of these.*
3. *A contract is discharged by novation which means the*
 - (a) *cancellation of the existing contract*
 - (b) *change in one or more terms of the contract*
 - (c) *substitution of existing contract for a new one*
 - (d) *none of these*
4. *A contract is discharged by rescission which means the*
 - (a) *change in one or more terms of the contract*
 - (b) *acceptance of lesser performance*
 - (c) *abandonment of rights by a party*
 - (d) *cancellation of the existing contract*
5. *If a person accepts a lesser sum of money than what was contracted for in discharge of the whole debt, it is known as:*
 - (a) *Waiver*
 - (b) *Rescission*
 - (c) *Alteration*
 - (d) *Remission*

6. *Novation discharges a contract*
- (a) *No, it means, no new contract comes to existence*
 - (b) *No, it means, new contract comes to existence, but old contract is not discharged*
 - (c) *Yes, on novation, old contract is discharged and consequently it need not be performed*
 - (d) *Yes, but only if parties agreed to discharge.*
7. *Novation and alteration are same*
- (a) *True, both result in discharging old contract.*
 - (b) *False, novation discharges old contract, in alteration, the obligation remains.*
 - (c) *False, however, both may have the effect of substituting a new contract for the old one*
 - (d) *None of the above*
8. *A, B and C jointly promised to pay ₹ 60,000 to D. before performance of the contract, C dies. Here, the contract*
- (a) *Becomes void on C's death*
 - (b) *Should be performed by A and B along with C's legal representatives*
 - (c) *Should be performed by A and B alone*
 - (d) *Should be renewed between A, B and D.*
9. *Vivaan lives on rent in a house owned by Swasti. Later he purchases the house from Swasti. The rent agreement is discharged due to:*
- (a) *Waiver of rights*
 - (b) *Novation of contract*
 - (c) *Merger of rights*
 - (d) *Remission of contract*
10. *When prior to the due date of performance, the promisor refuses to perform the contract, it is known as:*
- (a) *Novation of the contract*
 - (b) *Anticipatory breach of contract*

- (c) Actual breach of contract
- (d) waiver of contract
11. A owes ₹ 15000 to B. A die leaving his estate of ₹ 12000. Legal representatives of A are:
- (a) liable to pay ₹ 12000 to B
- (b) liable to pay ₹ 15000 to B
- (c) not liable to pay B
- (d) liable to pay ₹ 3000 to B
12. Rani contracted to teach dance to Shruti. Shruti paid an advance of ₹ 5000 for the same. Rani met with an accident and will not be able to dance. She has a daughter as her legal representative. Shruti can
- (a) force her daughter to teach her dance
- (b) rescind the contract and ask for refund of money
- (c) rescind the contract but cannot ask for refund
- (d) can sue Rani for non-performance of contract

Descriptive Questions

1. X, Y and Z jointly borrowed ₹ 50,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:
- (i) Y can recover the contribution from X and Z,
- (ii) Legal representatives of X are liable in case of death of X,
- (iii) Y can recover the contribution from the assets, in case Z becomes insolvent.
2. Mr. Rich aspired to get a self-portrait made by an artist. He went to the workshop of Mr. C an artist and asked whether he could sketch the former's portrait on oil painting canvass. Mr. C agreed to the offer and asked for ₹ 50,000 as full advance payment for the above creative work. Mr. C clarified that the painting shall be completed in 10 sittings and shall take 3 months.
- On reaching to the workshop for the 6th sitting, Mr. Rich was informed that Mr. C became paralyzed and would not be able to paint for near future. Mr. C had a son Mr. K who was still pursuing his studies and had not taken up his father's profession yet?

Discuss in light of the Indian Contract Act, 1872?

- (i) *Can Mr. Rich ask Mr. K to complete the artistic work in lieu of his father?*
 - (ii) *Could Mr. Rich ask Mr. K for refund of money paid in advance to his father?*
3. *Mr. JHUTH entered into an agreement with Mr. SUCH to purchase his (Mr. SUCH's) motor car for ₹ 5,00,000/- within a period of three months. A security amount of ₹ 20,000/- was also paid by Mr. JHUTH to Mr. SUCH in terms of the agreement. After completion of three months of entering into the agreement, Mr. SUCH tried to contract Mr. JHUTH to purchase the car in terms of the agreement. Even after lapse of another three month period, Mr. JHUTH neither responded to Mr. SUCH, nor to his phone calls. After lapse of another period of six months. Mr. JHUTH contracted Mr. SUCH and denied to purchase the motor car. He also demanded back the security amount of ₹ 20,000/- from Mr. SUCH. Referring to the provisions of the Indian Contract Act, 1872, state whether Mr. SUCH is required to refund the security amount to Mr. JHUTH.*

Also examine the validity of the claim made by Mr. JHUTH, if the motor car would have destroyed by an accident within the three month's agreement period.

4. *Mr. Murari owes payment of 3 bills to Mr. Girdhari as on 31st March, 2022. (i) ₹ 12,120 which was due in May 2018. (ii) ₹ 5,650 which was due in August 2020 (iii) ₹ 9,680 which was due in May 2021. Mr. Murari made payment on 1st April 2022 as below without any notice of how to appropriate them:*

- (i) *A cheque of ₹ 9,680*
- (ii) *A cheque of ₹ 15,000*

Advice under the provisions of the Indian Contract Act, 1872.

5. *What will be rights with the promisor in following cases? Explain with reasons:*
- (a) *Mr. X promised to bring back Mr. Y to life again.*
 - (b) *A agreed to sell 50 kgs of apple to B. The loaded truck left for delivery on 15th March but due to riots in between reached A on 19th March.*
 - (c) *An artist promised to paint on the fixed date for a fixed amount of remuneration but met with an accident and lost his both hands.*
 - (d) *Abhishek entered into contract of import of toys from China. But due to disturbance in the relation of both the countries, the imports from China were banned.*

ANSWER/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|----|-----|----|-----|----|-----|-----|-----|-----|-----|-----|-----|
| 1. | (a) | 2. | (d) | 3. | (c) | 4. | (d) | 5. | (d) | 6. | (c) |
| 7. | (c) | 8. | (b) | 9. | (c) | 10. | (b) | 11. | (a) | 12. | (b) |

Answer to the Descriptive Question

1. Section 42 of the Indian Contract Act, 1872 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfill the promise. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisors, the representatives of all jointly must fulfill the promise.

Section 43 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Section 43 provides that in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

Section 43 deals with the contribution among joint promisors. The promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

As per the provisions of above sections,

- (i) Y can recover the contribution from X and Z because X, Y and Z are joint promisors.
 - (ii) Legal representative of X are liable to pay the contribution to Y. However, a legal representative is liable only to the extent of property of the deceased received by him.
 - (iii) Y also can recover the contribution from Z's assets.
2. A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract (Section 37 of the Indian

Contract Act, 1872). But their liability under a contract is limited to the value of the property they inherit from the deceased.

- (i) In the instant case, since painting involves the use of personal skill and on becoming Mr. C paralyzed, Mr. Rich cannot ask Mr. K to complete the artistic work in lieu of his father Mr. C.
- (ii) According to section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void or when a contract 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.

Hence, in the instant case, the agreement between Mr. Rich and Mr. C has become void because of paralysis to Mr. C. So, Mr. Rich can ask Mr. K for refund of money paid in advance to his father, Mr. C.

3. In terms of the provisions of Section 65 of the Indian Contract Act, 1872, when an agreement is discovered to be void or when a contract 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.

Referring to the above provision, we can analyse the situation as under.

The contract is not a void contract. Mr. SUCH is not responsible for Mr. JHUTH's negligence. Therefore, Mr. SUCH can rescind the contract and retain the security amount since the security is not a benefit received under the contract, it is a security that the purchaser would fulfil his contract and is ancillary to the contract for the sale of the Motor Car.

Regarding the second situation given in the question, the agreement becomes void due to the destruction of the Motor car, which is the subject matter of the agreement here. Therefore, the security amount received by Mr. SUCH is required to be refunded back to Mr. JHUTH.

4. If the performance consists of payment of money and there are several debts to be paid, the payment shall be appropriated as per provisions of Sections 59, 60 and 61. The debtor has, at the time of payment, the right of appropriating the payment. In default of debtor, the creditor has option of election and in default of either the law will allow appropriation of debts in order of time.

In the present case, Mr. Murari had made two payments by way of two cheques. One cheque was exactly the amount of the bill drawn. It would be understood even though not specifically appropriated by Mr. Murari that it will be against the bill of

exact amount. Hence cheque of ₹9,680 will be appropriated against the bill of ₹ 9,680 which was due in May 2019.

Cheque of ₹ 15000 can be appropriated against any lawful debt which is due even though the same is time-barred.

Hence, Mr. Girdhari can appropriate the same against the debt of ₹12,120 which was due in 2016 and balance against ₹ 5650 which was due in August 2018.

5. (a) The contract is void because of its initial impossibility of performance.
- (b) Time is essence of this contract. As by the time apples reached B they were already rotten. The contract is discharged due to destruction of subject matter of contract.
- (c) Such contract is of personal nature and hence cannot be performed due to occurrence of an event resulting in impossibility of performance of contract.
- (d) Such contract is discharged without performance because of subsequent illegality nature of the contract.

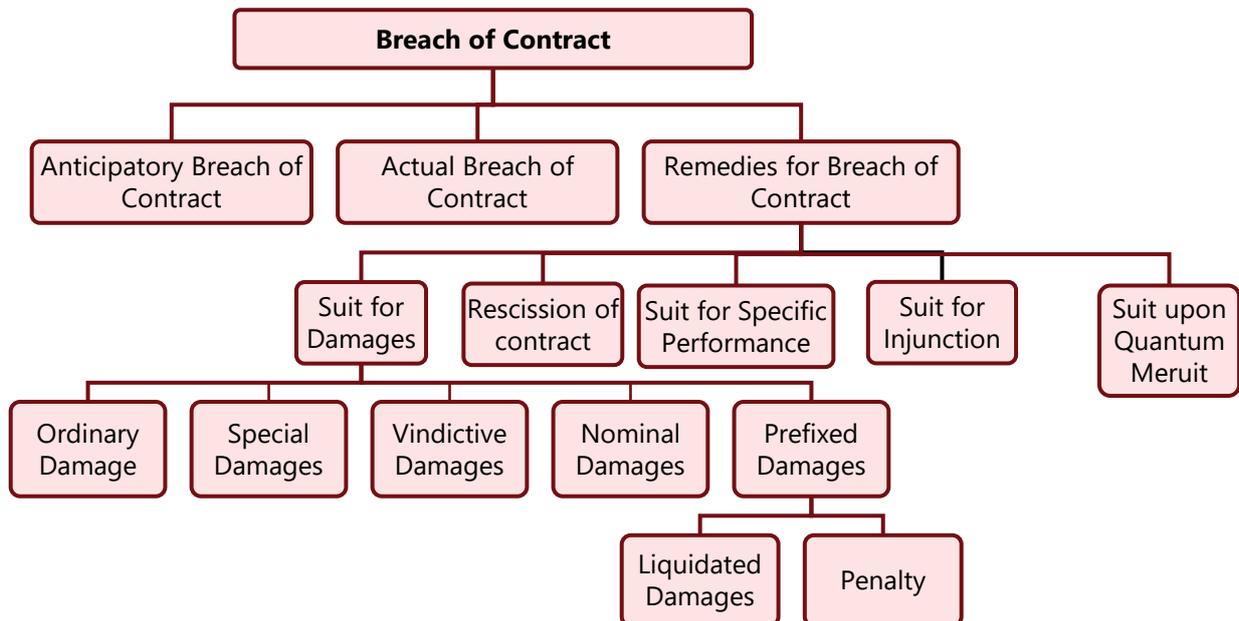
UNIT – 5: BREACH OF CONTRACT AND ITS REMEDIES

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ Concept of breach of contract and various modes thereof.
- ◆ How the damages are to be measured.

UNIT OVERVIEW



We have so far seen how a contract is made, the essential of a valid contract and also how a contract is to be performed as well as how a contract may be put an end. We shall now discuss about the breach of contract and also the mode in which compensation for breach of contract is estimated.



Breach means failure of a party to perform his or her obligation under a contract. Breach of contract may arise in two ways:

- (1) Actual breach of contract
- (2) Anticipatory breach of contract

5.1 ANTICIPATORY BREACH OF CONTRACT

An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach.

Anticipatory breach of a contract may take either of the following two ways:

- (a) Expressly by words spoken or written, and
- (b) Impliedly by the conduct of one of the parties.

Example 1: Where A contracts with B on 15th July, 2022 to supply 10 bales of cotton for a specified sum on 14th August, 2022 and on 30th July informs B, that he will not be able to supply the said cotton on 14th August, 2022, there is an express rejection of the contract.

Example 2: Where A agrees to sell his white horse to B for ₹ 50,000/- on 10th of August, 2022, but he sells this horse to C on 1st of August, 2022, the anticipatory breach has occurred by the conduct of the promisor.

Section 39 of the Indian Contract Act deals with anticipatory breach of contract and provides as follows:

“When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance.”

Effect of anticipatory breach: The promisee is excused from performance or from further performance. Further he gets an option:

- (1) To either treat the contract as “rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance;
or
- (2) He may elect not to rescind but to treat the contract as still operative and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in this case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides

on re-consideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.

5.2 ACTUAL BREACH OF CONTRACT

In contrast to anticipatory breach, it is a case of refusal to perform the promise on the scheduled date. The parties to a lawful contract are bound to perform their respective promises. But when one of the parties breaks the contract by refusing to perform his promise, he is said to have committed a breach. In that case, the other party to the contract obtains a right of action against the one who has refused to perform his promise.

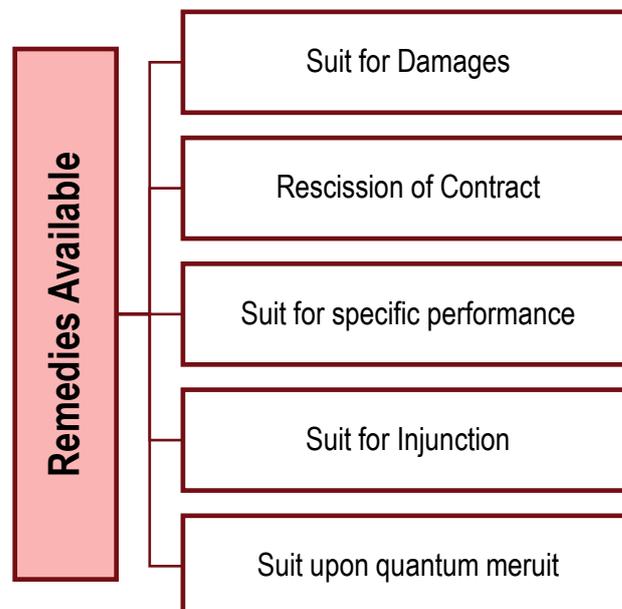
Actual breach of contract may be committed-

(a) At the time when the performance of the contract is due.

Example 3: A agrees to deliver 100 bags of sugar to B on 1st February 2022. On the said day, he failed to supply 100 bags of sugar to B. This is actual breach of contract. The breach has been committed by A at the time when the performance becomes due.

(b) 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 it by express or implied act.

Remedies for Breach of Contract



5.3 SUIT FOR DAMAGES

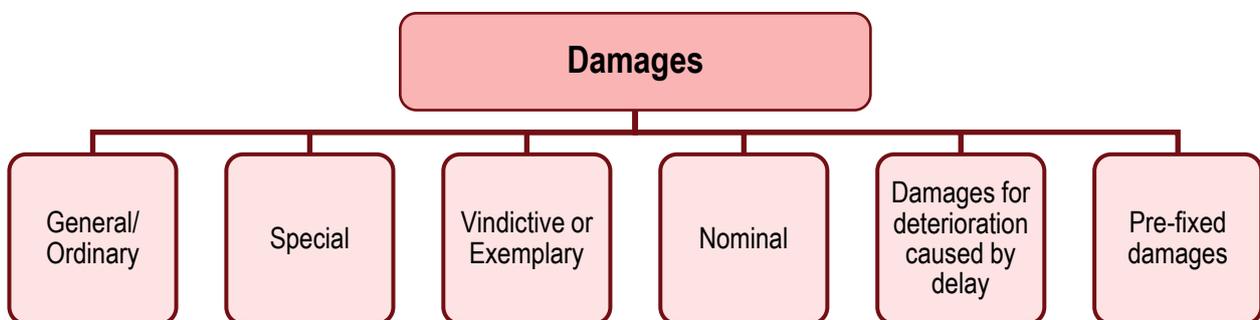
The Act in Section 73, has laid down the rules as to how the amount of compensation is to be determined. On the breach of the contract, the party who suffers from such a breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him by breach.

Compensation can be claimed for any loss or damage which naturally arises in the usual course of events.

A compensation can also be claimed for any loss or damage which the party knew when they entered into the contract, as likely to result from the breach.

That is to say, special damage can be claimed only on a previous notice. But the party suffering from the breach is bound to take reasonable steps to minimise the loss.

No compensation is payable for any remote or indirect loss.



- (i) **Ordinary damages:** When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage cause to him thereby, which naturally arose in the usual course of things from such breach, or which the parties know, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reasons of the breach. **(Section 73 of the Contract Act and the rule in Hadley vs. Baxendale).**

HADLEY vs. BAXENDALE- Facts

The crankshaft of P's flour mill had broken. He gives it to D, a common carrier who promised to deliver it to the foundry in 2 days where the new shaft was to be made. The mill stopped working, D delayed the delivery of the crankshaft so the mill remained idle for another 5 days. P received the repaired crankshaft 7 days later than he would have otherwise received. Consequently, P sued D for damages not only for

the delay in the delivering the broken part but also for loss of profits suffered by the mill for not having been worked. The court held that P was entitled only to ordinary damages and D was not liable for the loss of profits because the only information given by P to D was that the article to be carried was the broken shaft of a mill and it was not made known to them that the delay would result in loss of profits.

Example 4: A agrees to sell to B bags of rice at ₹ 5,000 per bag, delivery to be given after two months. On the date of delivery, the price of rice goes up to ₹ 5,500 per bag. A refuse to deliver the bags to B. B can claim from A ₹ 500 as ordinary damages arising directly from the breach.

- (ii) **Special damages:** Where a party to a contract receives a notice of special circumstances affecting the contract, he will be liable not only for damages arising naturally and directly from the breach but also for special damages.

Example 5: 'A' delivered a machine to 'B', a common carrier, to be conveyed to 'A's mill without delay. 'A' also informed 'B' that his mill was stopped for want of the machine. 'B' unreasonably delayed the delivery of the machine, and in consequence 'A' lost a profitable contract with the Government. In this case, 'A' is entitled to receive from 'B', by way of compensation, the average amount of profit, which would have been made by running the mill during the period of delay. But he cannot recover the loss sustained due to the loss of the Government contract, as 'A's contract with the Government was not brought to the notice of 'B'.

- (iii) **Vindictive or Exemplary damages**

These damages may be awarded only in two cases -

- (a) for breach of promise to marry because it causes injury to his or her feelings; and
 - (b) for wrongful dishonour by a banker of his customer's cheque because in this case the injury due to wrongful dishonour to the drawer of cheque is so heavy that it causes loss of credit and reputation to him. A business man whose credit has suffered will get exemplary damages even if he has sustained no pecuniary loss. But a non-trader cannot get heavy damages in the like circumstances, unless the damages are alleged and proved as special damages. (*Gibbons v West Minister Bank*)
- (iv) **Nominal damages:** Nominal damages are awarded where the plaintiff has proved that there has been a breach of contract but he has not in fact suffered any real damage. It is awarded just to establish the right to decree for the breach of contract. The amount may be a rupee or even 10 paise.

- (v) **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' not only implies physical damages to the goods but it may also mean loss of special opportunity for sale.
- (vi) **Pre-fixed damages:** Sometimes, parties to a contract stipulate at the time of its formation that on a breach of contract by any of them, a certain amount will be payable as damage. It may amount to either liquidated damages (i.e., a reasonable estimate of the likely loss in case of breach) or a penalty (i.e., an amount arbitrarily fixed as the damages payable). Section 74 provides that if a sum is named in a contract as the amount to be paid in case of a breach, the aggrieved party is entitled to receive from the party at fault a reasonable compensation not exceeding the amount so named (Section 74).

Example 6: If the penalty provided by the contract is ₹ 1,00,000 and the actual loss because of breach is ₹ 70,000, only ₹ 70,000 shall be available as damages, i.e., the amount of actual loss and not the amount stipulated. But if the loss is, say, ₹ 1,50,000, then only, ₹ 1,00,000 shall be recoverable.

Example 7: X promised Y, a priest, to pay ₹ 10,000 as charity. The priest on X's promise incurred certain liabilities towards the repairing of the temple to the extent of Rs. 7,500. Y, the priest, can recover from X ₹ 7,500.

5.4 PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

The parties to a contract may provide before hand, the amount of compensation payable in case of failure to perform the contract. In such cases, the question arises whether the courts will accept this figure as the measure of damage.

English Law: According to English law, the sum so fixed in the contract may be interpreted either as liquidated damages or as a penalty.

If the sum fixed in the contract represents a genuine pre-estimate by the parties of the loss, which would be caused by a future breach of the contract it is liquidated damages. It is an assessment of the amount which in the opinion of the parties will compensate for the breach. Such a clause is effective and the amount is recoverable. But where the sum fixed in the contract is unreasonable and is used to force the other party to perform the contract; it is penalty. Such a clause is disregarded and the injured party cannot recover more than the actual loss.

Indian Law: Indian law makes no distinction between 'penalty' and liquidated damages'. The Courts in India award only a reasonable compensation not exceeding the sum so mentioned in the contract. Section 74 of the Contract Act lays down if the parties have fixed what the damages will be, the courts will never allow more. But the court may allow less. A decree is to be passed only for reasonable compensation not exceeding the sum named by the parties. Thus, Section 74 entitles a person complaining of breach of contract to get reasonable compensation and does not entitle him to realise anything by way of penalty.

Exception: Where any person gives any bond to the Central or State government for the performance of any public duty or act in which the public are interested, on breach of the condition of any such instrument, he shall be liable to pay the whole sum mentioned therein.

Example 8: A contracts with B, that if A practices as a surgeon in Kolkata, he will pay B ₹ 50,000. A practice as a surgeon at Kolkata, B is entitled to such compensation not exceeding ₹ 50,000 as the court considers reasonable.

Example 9: A borrows ₹ 10,000 from B and gives him a bond for ₹ 20,000 payable by five yearly instalments of ₹ 4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.

Example 10: A undertakes to repay B, a loan of ₹ 10,000 by five equal monthly instalments with a stipulation that in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms.

Distinction between liquidated damages and penalty

Penalty and liquidated damages have one thing in common that both are payable on the occurrence of a breach of contract. It is very difficult to draw a clear line of distinction between the two but certain principles as laid down below may be helpful.

1. If the sum payable is so large as to be far in excess of the probable damage on breach, it is certainly a penalty.
2. Where a sum is expressed to be payable on a certain date and a further sum in the event of default being made, the latter sum is a penalty because mere delay in payment is unlikely to cause damage.
3. The expression used by the parties is not final. The court must find out whether the sum fixed in the contract is in truth a penalty or liquidated damages. If the sum fixed is extravagant or exorbitant, the court will regard it as a penalty even if, it is termed as liquidated damages in the contract.
4. The essence of a penalty is payment of money stipulated as a *terrorem* of the offending party. The essence of liquidated damages is a genuine pre-estimate of the damage.

5. English law makes a distinction between liquidated damages and penalty, but no such distinction is followed in India. The courts in India must ascertain the actual loss and award the same which amount must not, however exceed the sum so fixed in the contract. The courts have not to bother about the distinction but to award reasonable compensation not exceeding the sum so fixed.

Besides claiming damages as a remedy for the breach of contract, the following remedies are also available:

- (i) **Rescission of contract:** When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case, he is absolved of all his obligations under the contract and is entitled to compensation for any damages that he might have suffered.

Example 11: A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.

- (ii) **Quantum Meruit:** Where one person has rendered service to another in circumstances which indicate an understanding between them that it is to be paid for although no particular remuneration has been fixed, the law will infer a promise to pay. *Quantum Meruit* i.e. as much as the party doing the service has deserved. It covers a case where the party injured by the breach had at time of breach done part but not all of the work which he is bound to do under the contract and seeks to be compensated for the value of the work done. For the application of this doctrine, two conditions must be fulfilled:

- (1) It is only available if the original contract has been discharged.
- (2) The claim must be brought by a party not in default.

The object of allowing a claim on quantum meruit is to recompensate the party or person for value of work which he has done. Damages are compensatory in nature while quantum meruit is restitutory. It is but reasonable compensation awarded on implication of a contract to remunerate. Where a person orders only 12 bottles of a whiskey from a wine merchant but also receives 2 bottles of brandy, and the purchaser accepts them, the purchaser must pay a reasonable price for the brandy.

The claim for quantum meruit arises in the following cases:

- (a) When an agreement is discovered to be void or when a contract becomes void.
- (b) When something is done without any intention to do so gratuitously.
- (c) Where there is an express or implied contract to render services but there is no agreement as to remuneration.
- (d) When one party abandons or refuses to perform the contract.

- (e) Where a contract is divisible and the party not in default has enjoyed the benefit of part performance.
- (f) When an indivisible contract for a lump sum is completely performed but badly the person who has performed the contract can claim the lump sum, but the other party can make a deduction for bad work.

Example 12: X wrongfully revoked Y's (his agent) authority before Y could complete his duties. Held, Y could recover, as a quantum meruit, for the work he had done and the expenses he had incurred in the course of his duties as an agent.

Example 13: A agrees to deliver 100 bales of cottons to B at a price of ₹ 1000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

- (iii) **Suit for specific performance:** Where damages are not an adequate remedy in the case of breach of contract, the court may in its discretion on a suit for specific performance direct party in breach, to carry out his promise according to the terms of the contract.
- (iv) **Suit for injunction:** Where a party to a contract is negating the terms of a contract, the court may by issuing an 'injunction orders', restrain him from doing what he promised not to do.

Example 14: N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

Example 15: A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

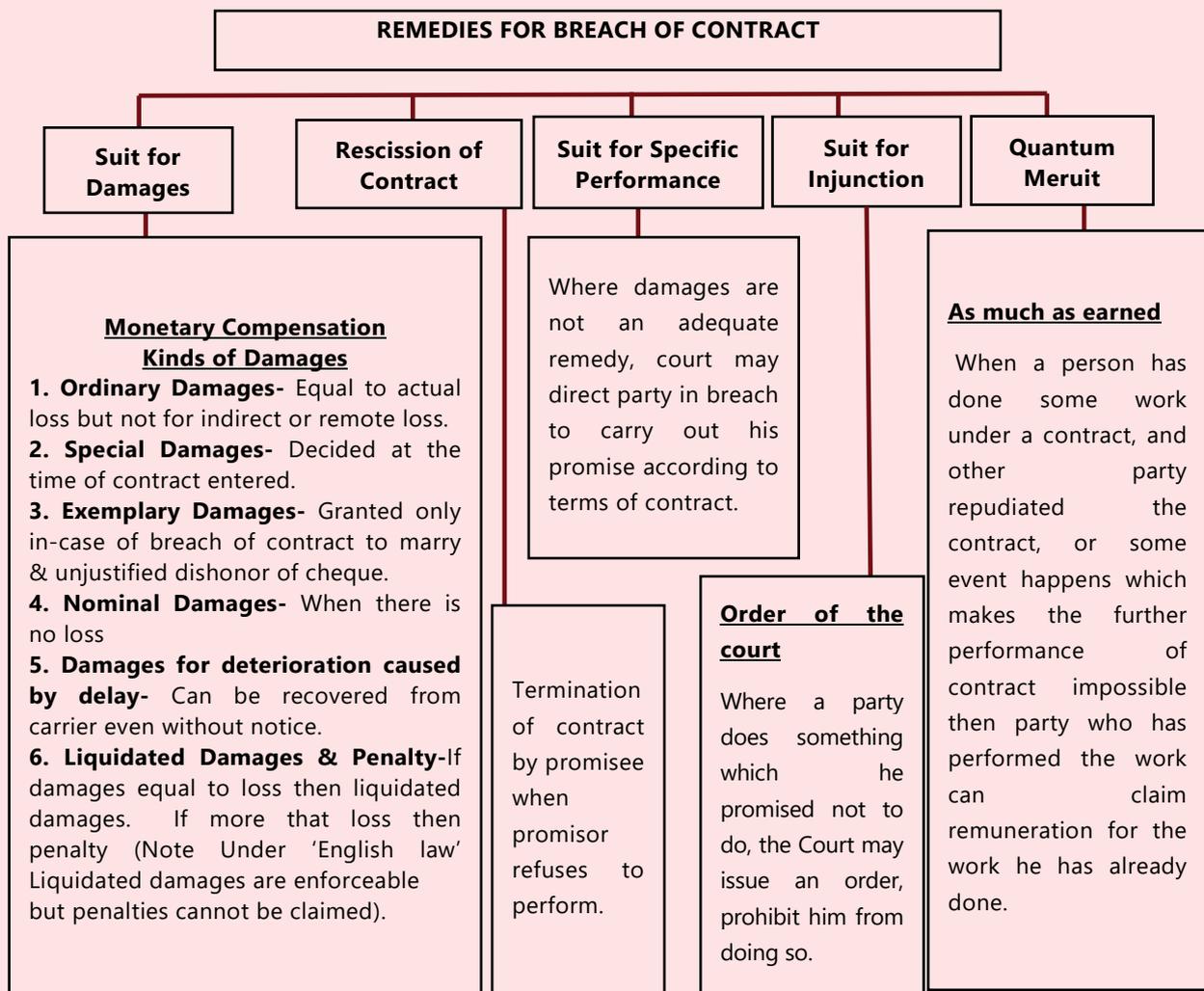
Party rightfully rescinding contract, entitled to compensation (Section 75)

A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through non-fulfilment of the contract.

Example 16: 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 engages to pay her ₹ 10000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

SUMMARY

1. In case of breach of contract by one party, the other party need not perform his part of the contract and is entitled to compensation for the loss occurred to him.
2. Damages for breach of contract must be such loss or damage as naturally arise, in the usual course of things or which had been reasonably supposed to have been in contemplation of the parties when they made the contract, as the probable result of the breach.
3. Any other damages are said to be remote or indirect damages, hence, cannot be claimed.



TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *When prior to the due date of performance, the promisor absolutely refuses to perform the contract, it is known as*
 - (a) *abandonment of contract*
 - (b) *remission of contract*
 - (c) *actual breach of contract*
 - (d) *anticipatory breach of contract*
2. *In case of anticipatory breach, the aggrieved party may treat the contract*
 - (a) *as discharged and bring an immediate action for damages*
 - (b) *as operative and wait till the time for performance arrives*
 - (c) *exercise option either (a) or (b)*
 - (d) *only option (a) is available*
3. *In case of breach of contract, which of the following remedy is available to the aggrieved party?*
 - (a) *Suit for rescission*
 - (b) *Suit for damages*
 - (c) *Suit for specific performance*
 - (d) *All of these*
4. *Sometimes, a party is entitled to claim compensation in proportion to the work done by him. It is possible by a suit for*
 - (a) *damage*
 - (b) *injunction*
 - (c) *quantum meruit*
 - (d) *none of these*
5. *Generally, the following damages are not recoverable?*
 - (a) *Ordinary damages*
 - (b) *Special damages*

- (c) *Remote damages*
 - (d) *Nominal damages*
6. *Damages which arise naturally in usual course of things from breach itself are called:*
- (a) *Special damages*
 - (b) *Liquidated damages*
 - (c) *Nominal damages*
 - (d) *General damages*
7. *A contracted to supply 200 bags of rice to B on 30th December, 2021. After supplying 20 bags of rice. A informed B that he will not supply remaining bags of rice to B. In this case,*
- (a) *There is anticipatory breach of contract*
 - (b) *There is actual breach of contract*
 - (c) *Both of the above*
 - (d) *None of the above*
8. *Where the Court orders the defaulting party to carry out the promise according to the terms of the contract, it is called*
- (a) *Quantum Meruit*
 - (b) *Rescission*
 - (c) *Injunction*
 - (d) *Specific Performance*
9. *Quantum Meruit means*
- (a) *a non-gratuitous promise*
 - (b) *as gratuitous promise*
 - (c) *as much as is earned*
 - (d) *as much as is paid*
10. *Wrongful dishonour of cheque by a banker having sufficient funds in the account of customer, the court may award:*
- (a) *Mitigation of damages*
 - (b) *contemptuous damages*
 - (c) *Quantum Meruit*
 - (d) *exemplary damages*

Descriptive Questions

1. "An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived". Discuss stating also the effect of anticipatory breach on contracts.
2. "Liquidated damage is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract whereas Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties". Explain.
3. 'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ ₹ 5.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ ₹ 4.50 per water bottle, and at the same time told 'Z' that he did so for the purpose of performing his contract entered into with 'Y'. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was ₹ 5.25 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. Calculate the amount of damages which 'X' could claim from 'Z' in the circumstances? What would be your answer if 'Z' had not informed about the 'Y's contract? Explain with reference to the provisions of the Indian Contract Act, 1872.
4. Mr. Chetan was travelling to Manali with his wife by bus of Himalayan Travels Pvt. Ltd. Due to some technical default in the bus, the driver has to stop the bus in a mid-way in cold night. The driver advised the passengers to get to the shelter in the nearest hotel which was at a distance of only one kilometer from that place. The wife of Mr. Chetan caught cold and fell ill due to being asked to get down and she had to walk in cold night to reach hotel. Mr. Chetan filed the suit against Himalayan Travels Pvt. Ltd. for damages for the personal inconvenience, hotel charges and medical treatment for his wife. Explain, whether Mr. Chetan would get compensation for which he filed the suit under the Indian Contract Act, 1872?

ANSWER/HINTS

Answers to MCQs

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

Answer of Descriptive Questions

1. An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach. The law in this regard has very well summed up in ***Frost v. Knight and Hochster v. DelaTour***:

Section 39 of the Indian Contract Act deals with anticipatory breach of contract and provides as follows: "When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, but words or conduct, his acquiescence in its continuance."

Effect of anticipatory breach: The promisee is excused from performance or from further performance. Further he gets an option:

- (1) To either treat the contract as "rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance; or
 - (2) He may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in this case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on re-consideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.
2. **Liquidated damage** is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract. This estimate is agreed to between parties to avoid at a later date detailed calculation and the necessity to convince outside parties.

Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties.

In terms of Section 74 of the Act "where a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damages or loss is proved to have been caused thereby, to receive from the other party who has broken the contract, a

reasonable compensation not exceeding the amount so named, or as the case may be the penalty stipulated for.

Explanation to Section 74

A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

In terms of Section 74, courts are empowered to reduce the sum payable on breach whether it is 'penalty' or "liquidated damages" provided the sum appears to be unreasonably high.

Sri Chunnilal vs. Mehta & Sons Ltd (Supreme Court)

Supreme Court laid down the ratio that the aggrieved party should not be allowed to claim a sum greater than what is specific in the written agreement. But even then, the court has powers to reduce the amount if it considers it reasonable to reduce.

- 3. Breach of Contract-Damages:** Section 73 of the Indian Contract Act, 1872 lays down that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it.

The leading case on this point is "*Hadley vs. Baxendale*" in which it was decided by the Court that the special circumstances under which the contract was actually made were communicated by the plaintiff to the defendant, and thus known to both the parties to the contract, the damages resulting from the breach of such contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from the breach of contract under these special circumstances so known and communicated.

The problem asked in this question is based on the provisions of Section 73 of the Indian Contract Act, 1872. In the instant case 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y'. Thus, 'Z' had the knowledge of the special circumstances. Therefore, 'X' is entitled to claim from 'Z' ₹ 500/- at the rate of 0.50 paise i.e. 1000 water bottles x 0.50 paise (difference between the procuring price of water bottles and contracted selling price to 'Y') being the amount of profit 'X' would have made by the performance of his contract with 'Y'.

If 'X' had not informed 'Z' of 'Y's contract, then the amount of damages would have been the difference between the contract price and the market price on the day of

default. In other words, the amount of damages would be ₹ 750/- (i.e. 1000 water bottles x 0.75 paise).

4. Section 73 of Indian Contract Act, 1872 provides that when a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. But such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

In the instant case, Mr. Chetan filed the suit against Himalayan Travels Pvt. Ltd. for damages for the personal inconvenience, hotel charges and medical treatment for his wife.

On the basis of above provisions and facts of the case, it can be said that Mr. Chetan can claim damages for the personal inconvenience and hotel charges but not for medical treatment for his wife because it is a remote or indirect loss.

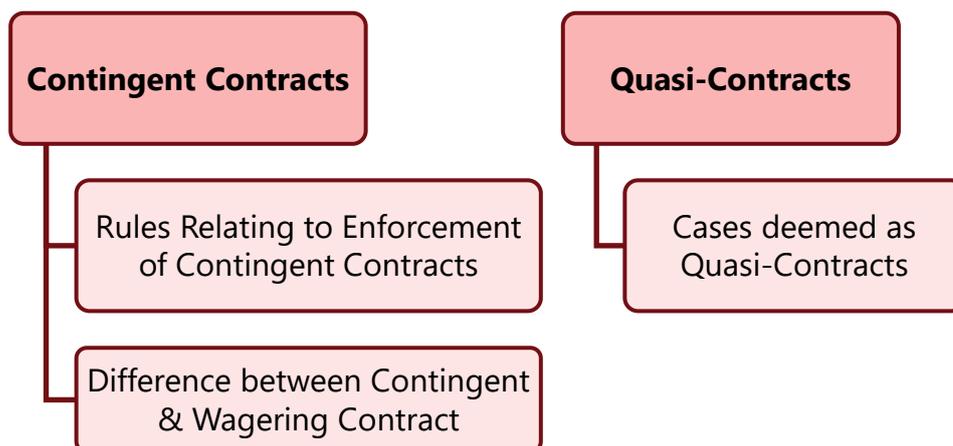
UNIT – 6: CONTINGENT AND QUASI CONTRACTS

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ Basic characteristics of 'Contingent contract' and 'Quasi-contract' so that you are able to distinguish between a contract of any of these types and a simple contract.
- ◆ Rules relating to enforcement of these in order to gain an understanding of rights and obligations of the parties to the contract.

UNIT OVERVIEW



6.1 CONTINGENT CONTRACTS

In this unit, we shall briefly examine what is called a 'contingent contract', its essentials and the rules regarding enforcement of this type of contracts. The Contract Act recognises certain cases in which an obligation is created without a contract. Such obligations arise out of certain relations which cannot be called as contracts in the strict sense. There is no offer, no acceptance, no *consensus ad idem* and in fact neither agreement nor promise and yet the

law imposes an obligation on one party and confers a right in favour of the other. We shall have a look on these cases of 'Quasi-contracts'.

A contract may be absolute or a contingent. An Absolute contract is one where the promisor undertakes to perform the contract in any event without any condition.

Definition of 'Contingent Contract' (Section 31)

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

Contracts of Insurance, indemnity and guarantee fall under this category.

Example 1: A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract.

Example 2: A makes a contract with B to buy his house for ₹ 50,00,000 if he is able to secure to bank loan for that amount. The contract is contingent contract.

Meaning of collateral Event: Pollock and Mulla defined collateral event as "an event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise".

Example 3: A contracts to pay B ₹ 10,00,000 if B's house is burnt. This is a contingent contract. Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. The liability of A arises only on the happening of the collateral event.

Example 4: A agrees to transfer his property to B if her wife C dies. This is a contingent contract because the property can be transferred only when C dies.

Essentials of a contingent contract

(a) **The performance of a contingent contract would depend upon the happening or non-happening of some event or condition.** The condition may be precedent or subsequent.

Example 5: 'A' promises to pay ₹ 50,000 to 'B' if it rains on first of the next month.

(b) **The event referred to as collateral to the contract.** The event is not part of the contract. The event should be neither performance promised nor a consideration for a promise.

Thus (i) 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 part of the promise itself and not a collateral event. (ii) Similarly, where A promises to pay B ₹ 1,00,000 if he marries

C, it is not a contingent contract. (iii) 'A' agreed to construct a swimming pool for 'B' for ₹ 20,00,000. And 'B' agreed to make the payment only on the completion of the swimming pool. It is not a contingent contract as the event (i.e. construction of the swimming pool) is directly connected with the contract.

- (c) **The contingent event should not be a mere 'will' of the promisor.** The event should be contingent in addition to being the will of the promisor.

Example 6: If A promises to pay B ₹ 100,000, if he so chooses, it is not a contingent contract. (In fact, it is not a contract at all). However, where the event is within the promisor's will but not merely his will, it may be contingent contract.

Example 7: If A promises to pay B ₹100,000 if it rains on 1st April and A leave Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but raining is not merely his will.

- (d) **The event must be uncertain.** Where the event is certain or bound to happen, the contract is due to be performed, then it is a not contingent contract.

Example 8: 'A' agreed to sell his agricultural land to 'B' after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.

6.2 RULES RELATING TO ENFORCEMENT

The rules relating to enforcement of a contingent contract are laid down in **sections 32, 33, 34, 35 and 36 of the Act.**

- (a) **Enforcement of contracts contingent on an event happening:**

Section 32 says that "where a contingent contract is made to do or not to do anything if an uncertain future event happens, it cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void".

Example 9: A contracts to pay B a sum of money when B marries C. C dies without being married to B. The Contract becomes void.

- (b) **Enforcement of contracts contingent on an event not happening:** Section 33 says that "Where a contingent contract is made to do or not do anything if an uncertain future event does not happen, it can be enforced only when the happening of that event becomes impossible and not before".

Example 10: Where 'P' agrees to pay 'Q' a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

Where A agrees to pay sum of money to B if certain ship does not return however the ship returns back. Here the contract becomes void.

- (c) **A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does something to make the 'event' or 'conduct' as impossible of happening.**

Section 34 says that "if a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to have 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".

Example 11: Where 'A' agrees to pay 'B' a sum of money if 'B' marries 'C'. 'C' marries 'D'. This act of 'C' has rendered the event of 'B' marrying 'C' as impossible; it is though possible if there is divorce between 'C' and 'D'.

In **Frost V. Knight**, the defendant promised to marry the plaintiff on the death of his father. While the father was still alive, he married another woman. It was held that it had become impossible that he should marry the plaintiff and she was entitled to sue him for the breach of the contract.

- (d) **Contingent on happening of specified event within the fixed time:** Section 35 says that Contingent contracts to do or not to do anything, if a specified uncertain event happens within a fixed time, becomes void if, at the expiration of time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible.

Example 12: A promises to pay B a sum of money if 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.

- (e) **Contingent on specified event not happening within fixed time:** Section 35 also says that - "Contingent contracts to do or not to do anything, if a specified uncertain event does not happen 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 has expired, if it becomes certain that such event will not happen".

Example 13: 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.

- (f) **Contingent on an impossible event (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example 14: 'A' agrees to pay 'B' ₹ one lakh if sun rises in the west next morning. This is an impossible event and hence void.

Example 15: X agrees to pay Y ₹1,00,000 if two straight lines should enclose a space. The agreement is void.

Difference between a contingent contract and a wagering contract

| Basis of difference | Contingent contract | Wagering contract |
|-----------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|
| Meaning | A contingent contract is a contract to do or not to do something with reference to a collateral event happening or not happening. | A wagering agreement is a promise to give money or money's worth with reference to an uncertain event happening or not happening. |
| Reciprocal promises | Contingent contract may not contain reciprocal promises. | A wagering agreement consists of reciprocal promises. |
| Uncertain event | In a contingent contract, the event is collateral. | In a wagering contract, the uncertain event is the core factor. |
| Nature of contract | Contingent contract may not be wagering in nature. | A wagering agreement is essentially contingent in nature. |
| Interest of contracting parties | Contracting parties have interest in the subject matter in contingent contract. | The contracting parties have no interest in the subject matter. |
| Doctrine of mutuality of lose and gain | Contingent contract is not based on doctrine of mutuality of lose and gain. | A wagering contract is a game, losing and gaining alone matters. |
| Effect of contract | Contingent contract is valid. | A wagering agreement is void. |

6.3 QUASI CONTRACTS

A valid contract must contain certain essential elements, such as offer and acceptance, capacity to contract, consideration and free consent. But sometimes the law implies a promise imposing obligations on one party and conferring right in favour of the other even when there is no offer, no acceptance, no genuine consent, lawful consideration, etc. and in fact neither agreement nor promise. Such cases are not contract in the strict sense, but the Court recognises them as **relations resembling those of contracts** and enforces them as if they were contracts. Hence the term **Quasi –contracts (i.e. resembling a contract)**. Even in the absence of a contract, certain social relationships give rise to certain specific obligations to be performed by certain persons. These are known as quasi contracts as they create same obligations as in the case of regular contract.

Quasi contracts are based on principles of equity, justice and good conscience.

A quasi or constructive contract rest upon the maxims, “No man must grow rich out of another person’s loss”.

Example 16: T, a tradesman, leaves goods at C’s house by mistake. C treats the goods as his own. C is bound to pay for the goods.

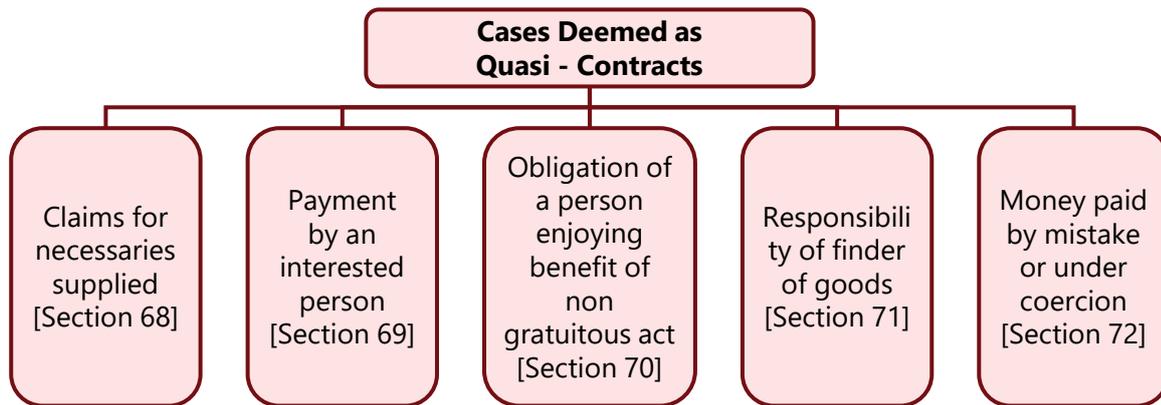
Example 17: A pays some money to B by mistake. It is really due to C. B must refund the money to A.

Example 18: A fruit parcel is delivered under a mistake to R who consumes the fruits thinking them as birthday present. R must return the parcel or pay for the fruits. Although there is no agreement between R and the true owner, yet he is bound to pay as the law regards it a Quasi-contract.

These relations are called as quasi-contractual obligations. In India it is also called as ‘certain relation resembling those created by contracts.

Salient features of quasi contracts:

- (a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.
- (b) Secondly, it does not arise from any agreement of the parties concerned, but is imposed by the law; and
- (c) Thirdly, it is a right which is available not against all the world, but against a particular person or persons only, so that in this respect it resembles a contractual right.



Under the provisions of the Indian Contract Act, the relationship of quasi contract is deemed to have come to exist in five different circumstances which we shall presently dilate upon. But it may be noted that in none of these cases there comes into existence any contract between the parties in the real sense. Due to peculiar circumstances in which they are placed, the law imposes in each of these cases the contractual liability.

(a) Claim for necessities supplied to persons incapable of contracting (Section 68):

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessities 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.

Example 19: A supplies B, a lunatic, or a minor, with necessities suitable to his condition in life. A is entitled to be reimbursed from B's property.

To establish his claim, the supplier must prove not only that the goods were supplied to the person who was minor or a lunatic but also that they were suitable to his actual requirements at the time of the sale and delivery.

(b) Payment by an interested person (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 20: B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of the sale will be the annulment of B's lease. B, to prevent the sale and the consequent annulment of his own lease, pays to the government the sum due from A. A is bound to make good to B the amount so paid.

- (c) **Obligation of person enjoying benefits of non-gratuitous act (Section 70):** In term of section 70 of the Act “where a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuitously and such other person enjoys the benefit thereof, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered”.

It thus follows that for a suit to succeed, the plaintiff must prove:

- (i) that he had done the act or had delivered the thing lawfully;
- (ii) that he did not do so gratuitously; and
- (iii) that the other person enjoyed the benefit.

The above can be illustrated by a case law where ‘K’ a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the meantime government went on appeal. The appeal was decided in favour of the government and ‘K’ was directed to return the salary paid to him during the period of reinstatement. **[Shyam Lal vs. State of U.P. A.I.R (1968) 130]**

Example 21: 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.

- (d) **Responsibility of finder of goods (Section 71):** ‘A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as if he were a bailee’.

Thus, a finder of lost goods has:

- (i) to take proper care of the property as man of ordinary prudence would take
- (ii) no right to appropriate the goods and
- (iii) to restore the goods if the owner is found.

In **Hollins vs. Howler L. R. & H. L.**, ‘H’ picked up a diamond on the floor of ‘F’s shop and handed over the same to ‘F’ to keep till the owner was found. In spite of the best efforts, the true owner could not be traced. After the lapse of some weeks, ‘H’ tendered to ‘F’ the lawful expenses incurred by him and requested to return the diamond to him. ‘F’ refused to do so. **Held**, ‘F’ must return the diamond to ‘H’ as he was entitled to retain the goods found against everybody except the true owner.

Example 22: ‘P’ a customer in ‘D’s shop puts down a brooch worn on her coat and forgets to pick it up and one of ‘D’s assistants finds it and puts it in a drawer over the weekend. On Monday, it was discovered to be missing. ‘D’ was held to be liable in the absence of ordinary care which a prudent man would have taken.

- (e) **Money paid by mistake or under coercion (Section 72):** "A person to whom money has been paid or anything delivered by mistake or under coercion, must repay or return it".

Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable. [*Shivprasad Vs Sirish Chandra A.I.R. 1949 P.C. 297*]

Example 23: A payment of municipal tax made under mistaken belief or because of mis-understanding of the terms of lease can be recovered from municipal authorities. The above law was affirmed by Supreme Court in cases of *Sales tax officer vs. Kanhaiyalal A. I. R. 1959 S. C. 835*

Similarly, any money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act. The word is interpreted to mean and include oppression, extortion, or such other means [*Seth Khanjelek vs National Bank of India*].

In a case where 'T' was traveling without ticket in a tram car and on checking he was asked to pay ₹5/- as penalty to compound transaction. T filed a suit against the corporation for recovery on the ground that it was extorted from him. The suit was decreed in his favour. [*Trikamdas vs. Bombay Municipal Corporation A. I. R. 1954*]

In all the above cases the contractual liability arose without any agreement between the parties.

Difference between quasi contracts and contracts

| Basis of distinction | Quasi- Contract | Contract |
|----------------------------------|-----------------------------------------------------------------|------------------------------------------------------------------|
| Essential for the valid contract | The essentials for the formation of a valid contract are absent | The essentials for the formation of a valid contract are present |
| Obligation | Imposed by law | Created by the consent of the parties |

SUMMARY

- ◆ **Contingent Contracts** are the contracts, which are conditional on some future event happening or not happening and are enforceable when the future event or loss occurs. (Section 31)

RULES FOR ENFORCEMENT

- (a) If it is contingent on the happening of a future event, it is enforceable when the event happens. The contract becomes void if the event becomes impossible, or the event does not happen till the expiry of time fixed for happening of the event.
 - (b) If it is contingent on a future event not happening. It can be enforced when happening of that event becomes impossible or it does not happen at the expiry of time fixed for non-happening of the event.
 - (c) If the future event is the act of a living person, any conduct of that person which prevents the event happening within a definite time renders the event impossible.
 - (d) If the future event is impossible at the time of the contract is made, the contract is void ab initio.
- ◆ Wagering Contracts are void.
 - ◆ Quasi Contracts arise where obligations are created without a contract. The obligations which they give rise to are expressly enacted:
 - (a) If necessaries are supplied to a person who is incapable of contracting, the supplier is entitled to claim their price from the property of such a person.
 - (b) A person who is interested in the payment of money which another is bound to pay, and who therefore pays it, is entitled to be reimbursed by the other.
 - (c) A person who enjoys the benefit of a non-gratuitous act is bound to make compensation.
 - (d) A person who finds lost property may retain it subject to the responsibility of a bailee.
 - (e) If money is paid or goods delivered by mistake or under coercion, the recipient must repay or make restoration.

CONTINGENT CONTRACT (SEC.31)

A contract to do or not to do something if some event, collateral to such contract, does or does not happen. E.G. Contracts of insurance, indemnity or guarantee.

Legal Rules

| <u>Contingent upon</u> | <u>When can it be enforced</u> | <u>When it become void?</u> |
|-----------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------|
| Happening of an event | When event has happened | When event becomes impossible |
| Non-happening of an event | When the happening of the event becomes impossible | When event has happened. |
| Behavior of a person within the specified time | Such person acts in specified manner. | When such person does anything which renders it impossible |
| Happening of an event within the specified time | When event has happened within the specified time. | When event has not happened within the specified time OR Event becomes impossible before expiry of specified time. |
| Non-happening of an event within the specified time | When event has not happened within the specified time OR Event becomes impossible before expiry of specified time. | When event has happened within the specified time. |
| Happening of an impossible event | Void, whether the impossibility of the event is known or not known to the parties to the agreement at the time when it is made. | |

QUASI CONTRACTS

Under certain special circumstances, the law creates and enforces legal rights and obligations, although the parties have never entered into a contract.

Types of Quasi Contracts

1. Claims for necessities supplied to a person incompetent to contract (but upto property of incompetent.)
2. Reimbursement to a person paying money due by another in the payment of which he is interested.
3. Obligation of a person enjoying benefits of non-gratuitous (without any cost) acts.
4. Responsibility of a finder of lost goods. His responsibility is same as that of a bailee.
5. Liability of a person to whom money is paid or goods delivered under mistake or coercion.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *A contract dependent on the happening or non-happening of future uncertain event, is*
 - (a) *Uncertain contract*
 - (b) *Contingent contract*
 - (c) *Void contract*
 - (d) *Voidable contract*
2. *A contingent contract is*
 - (a) *Void*
 - (b) *Voidable*
 - (c) *Valid*
 - (d) *Illegal*
3. *A contingent contract dependent on the happening of future uncertain even can be enforced when the event*
 - (a) *happens*
 - (b) *becomes impossible*
 - (c) *does not happen*
 - (d) *either of these*
4. *A agrees to pay ₹ One lakh to B if he brings on earth a star from sky. This is a contingent contract and*
 - (a) *Illegal*
 - (b) *Valid*
 - (c) *Voidable*
 - (d) *Void*
5. *Which of the following is not a contingent contract:*
 - (a) *A promise to pay B if he repairs his scooter.*
 - (b) *A promise to pay B ₹ 10,000 if B's scooter is stolen.*

- (c) *A promise to pay B ₹ 10,000 if B's burnt his hands.*
- (d) *A promise to pay B ₹ 10,000 if it rains on first of the next month.*
6. *Which of the following statements regarding Quasi-contracts is incorrect:*
- (a) *It resembles a contract*
- (b) *It is imposed by law*
- (c) *It is based on the doctrine of unjust enrichment*
- (d) *It is voluntarily created*
7. *For a contingent contract the event must be:*
- (a) *Certain*
- (b) *Uncertain*
- (c) *Independent*
- (d) *Uncertain and collateral*
8. *Which one of the following is not a characteristic of a contingent contract?*
- (a) *Performance depends upon a future event*
- (b) *The event must be uncertain*
- (c) *The event must be collateral to the contract*
- (d) *There must be reciprocal promises*
9. *Wagering contracts are:*
- (a) *Void*
- (b) *Voidable*
- (c) *Valid*
- (d) *Illegal*
10. *A contract of insurance is:*
- (a) *Wagering contract*
- (b) *unilateral contract*
- (c) *Quasi contract*
- (d) *contingent contract*

11. *Finder of goods should take care of goods as*
- (a) *bailee*
 - (b) *owner*
 - (c) *insurer*
 - (d) *custodian*
12. *A swiggy man wrongly delivered the food to Mr. Ishaan. Ishaan who took the delivery, ate the food immediately. The swiggy boy returned soon once he got information about wrong delivery. Ishaan should make the payment as his case is deemed to be a quasi-contract under:*
- (a) *Claim for necessaries supplied to persons incapable of contracting*
 - (b) *responsibility of finder of goods*
 - (c) *Payment by an interest person*
 - (d) *obligation of person enjoying benefits under non-gratuitous act*

Descriptive Questions

1. *Explain the-term 'Quasi Contracts' and state their characteristics.*
2. *X, a minor was studying in M.Com. in a college. On 1st July, 2021 he took a loan of ₹ 1,00,000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December, 2021. X possesses assets worth ₹ 9 lakhs. On due date, X fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of Indian Contract Act, 1872 decide whether B would succeed.*
3. *P left his carriage on D's premises. Landlord of D seized the carriage against the rent due from D. P paid the rent and got his carriage released. Can P recover the amount from D?*
4. *Rahul found a smart watch in a restaurant. He enquired about all the customers present there but the true owner could not be found. He handed over the same to the manager of the restaurant to keep till the true owner is found. After a week he went back to the restaurant to enquire about the smart watch. The manager refused to return it to Rahul, saying that it did not belong to Rahul. In the light of the Indian Contract Act, 1872, can Rahul recover it from the Manager?*

ANSWERS/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|----|-----|----|-----|----|-----|-----|-----|-----|-----|-----|-----|
| 1. | (b) | 2. | (c) | 3. | (a) | 4. | (d) | 5. | (a) | 6. | (d) |
| 7. | (d) | 8. | (d) | 9. | (a) | 10. | (d) | 11. | (a) | 12. | (d) |

Answers to Descriptive Questions

- Quasi Contracts:** Under certain special circumstances, obligation resembling those created by a contract are imposed by law although the parties have never entered into a contract. Such obligations imposed by law are referred to as 'Quasi-contracts'. Such a contract resembles with a contract so far as result or effect is concerned but it has little or no affinity with a contract in respect of mode of creation. These contracts are based on the doctrine that a person shall not be allowed to enrich himself unjustly at the expense of another. The salient features of a quasi-contract are:

 - It does not arise from any agreement of the parties concerned but is imposed by law.
 - Duty and not promise is the basis of such contract.
 - The right under it is always a right to money and generally though not always to a liquidated sum of money.
 - Such a right is available against specific person(s) and not against the whole world.
 - A suit for its breach may be filed in the same way as in case of a complete contract.
- Yes, B can proceed against the assets of X. According to section 68 of Indian Contract Act, 1872, if a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

Since the loan given to X is for the necessaries suited to the conditions in life of the minor, his assets can be sued to reimburse B.
- Yes, P can recover the amount from D. Section 69 states a person who is interested in the payment of money which another person is bound by law to pay, and who therefore pays it, is entitled to get it reimbursed by the other.

In the present case, D was lawfully bound to pay rent. P was interested in making the payment to D's landlord as his carriage was seized by him. Hence being an interested party P made the payment and can recover the same from D.

4. Responsibility of finder of goods (Section 71 of the Indian Contract Act, 1872):

A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as if he were a bailee.

Thus, a finder of lost goods has:

- (i) to take proper care of the property as man of ordinary prudence would take
- (ii) no right to appropriate the goods and
- (iii) to restore the goods if the owner is found.

In the light of the above provisions, the manager must return the smart watch to Rahul, since Rahul is entitled to retain the smart watch found against everybody except the true owner.

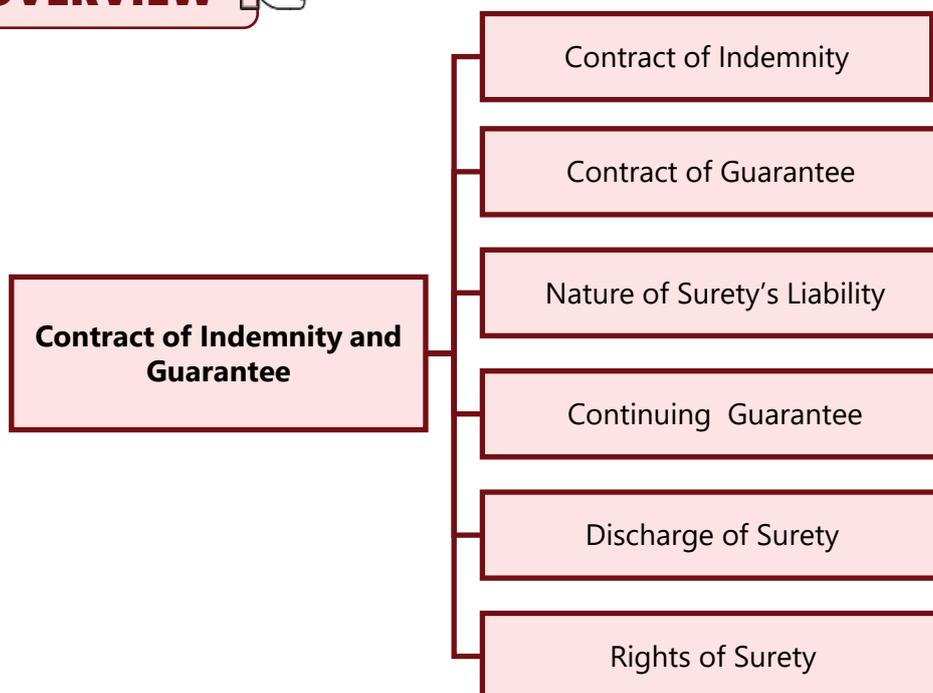
UNIT – 7: CONTRACT OF INDEMNITY AND GUARANTEE

LEARNING OUTCOMES

After studying this Chapter, you will be able to understand:

- ◆ Special type of contracts i.e. Indemnity contracts and Guarantee contracts and also the nature of obligations and rights of each of the parties to the contracts.
- ◆ Distinction between contract of indemnity and contract of guarantee.
- ◆ Mode of discharge of contract of guarantee in various circumstances.

UNIT OVERVIEW



Contract of Indemnity and Guarantee are the specific types of contracts provided under sections 124 to 147 of the Indian Contract Act, 1872. In addition to the specific provisions (i.e. Section 124 to Section 147 of the Indian Contract Act, 1872), the general principles of contracts are also applicable to such contracts. Even though both the contracts are modes of compensation based on similar principles, they differ considerably in several aspects.

In this unit, the law relating to indemnity and guarantee are discussed in detail.

7.1 CONTRACT OF INDEMNITY

The term "Indemnity" literally means "Security against loss" or "to make good the loss" or "to compensate the party who has suffered some loss".

The term "Contract of Indemnity" is defined under Section 124 of the Indian Contract Act, 1872. It is "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."

Example 1: Mr. X contracts with the Government to return to India after completing his studies (which were funded by the Government) at University of Cambridge and to serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

Parties:

- The party who promises to indemnify/ save the other party from loss- "indemnifier",
- The party who is promised to be saved against the loss- "indemnified" or "indemnity holder".

Example 2: A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹ 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Example 3: X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighboring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.

However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused by:

- the conduct of the promisor himself, or
- the conduct of any other person.

Thus, loss occasioned by an accident not caused by any person, or an act of God/ natural event, is not covered.

In case of ***Gajanan Moreshwar v/s Moreshwar Madan (1942)***, decision is taken on the basis of English Law. As per English Law, Indemnity means promise to save another harmless from the loss. Here it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

Mode of contract of indemnity: A contract of indemnity like any other contract may be **express or implied.**

- a. A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss.
- b. A 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.

A contract of indemnity is like any other contract and must fulfil all the essentials of a valid contract.

Example 4: A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined ₹1000, B cannot claim this amount from A because the object of the agreement is unlawful.

A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.

Rights of Indemnity-holder when sued (Section 125): The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—

- (a) all damages which he may be compelled to pay in any suit
- (b) all costs which he may have been compelled to pay in bringing/ defending the suit and
- (c) all sums which he may have paid under the terms of any compromise of suit.

When does the liability of an indemnifier commence?

Although the Indian Contract Act, 1872, is silent on the time of commencement of liability of indemnifier, however, on the basis of judicial pronouncements it can be stated that the liability of an indemnifier commences as soon as the liability of the indemnity-holder becomes absolute and certain. This principle has been followed by the courts in several cases.

Example 5: A promises to compensate X for any loss that he may suffer by filing a suit against Y. The court orders X to pay Y damages of ₹ 10000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

7.2 CONTRACT OF GUARANTEE

“Contract of guarantee”, “surety”, “principal debtor” and “creditor” [Section 126]



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

| | |
|--------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Three parties are involved in a contract of guarantee | Surety - person who gives the guarantee |
| | Principal debtor - person in respect of whose default the guarantee is given |
| | Creditor - person to whom the guarantee is given |

Example 6: When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he (A) will himself pay to B, there is a contract of guarantee.

Here, B is the creditor, C the principal debtor and A the surety.

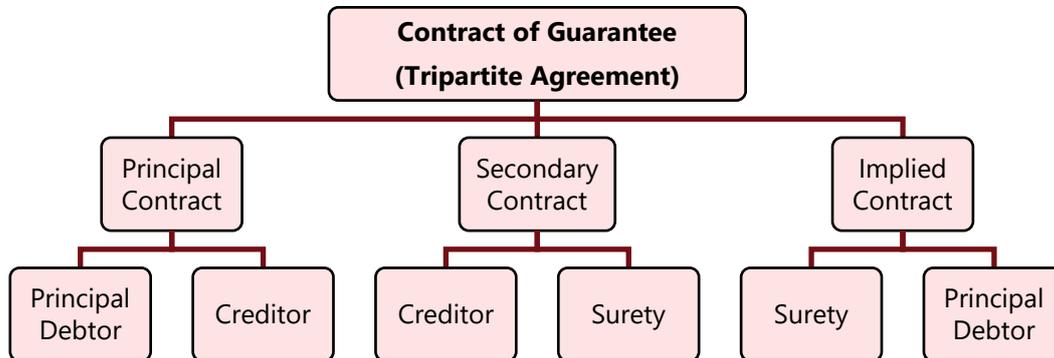
Example 7: X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y, and agrees that if Y fails to pay he will. In case of Y's failure to pay, the car showroom will recover its money from X.

This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

A contract of guarantee is a tripartite agreement between principal debtor, creditor and surety. There are, in effect three contracts

- (i) A principal contract between the principal debtor and the creditor.
- (ii) A secondary contract between the creditor and the surety.
- (iii) An implied contract between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.



ESSENTIAL FEATURES OF A GUARANTEE

The following are the requisites of a valid guarantee:-

1. **Purpose:** The purpose of a guarantee being to secure the payment of a debt, the existence of recoverable debt is necessary. If there is no principal debt, there can be no valid guarantee.
2. **Consideration:** Like every other contract, a contract of guarantee should also be supported by some consideration. A guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.

As per Section 127 consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee, but past consideration is no consideration for the contract of guarantee. Even if the principal debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.

Example 8: B requests A to sell and deliver to him goods on credit. A agrees to do so provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. As per Section 127, there is a sufficient consideration for C's promise. Therefore, the guarantee is valid.

Example 9: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

3. **Existence of a liability:** There must be an existing liability or a promise whose performance is guaranteed. Such liability or promise must be enforceable by law. The liability must be legally enforceable and not time barred.

4. **No misrepresentation or concealment (section 142 and 143):** Any guarantee which has been obtained by the means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (section 142)

Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid (section 143).

Example 10: A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C, with his previous conduct. B afterwards make default. The guarantee is invalid.

Example 11: A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay rupee five per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

5. **Writing not necessary:** Section 126 expressly declares that a guarantee may be either oral or written.
6. **Joining of the other co-sureties (Section 144):** 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. That implies, the guarantee by a surety is not valid if a condition is imposed by a surety that some other person must also join as a co-surety, but such other person does not join as a co-surety.

7.3 TYPES OF GUARANTEES

Guarantee may be classified under two categories:

- A. **Specific Guarantee-** A guarantee which extends to a single debt/ specific transaction is called a specific guarantee. The surety's liability comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

Example 12: A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C. C pays for them. This is a contract for specific guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [Kay v Groves]

- B. Continuing Guarantee [Section 129]** - A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

Example 13: On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

Example 14: A guarantees payment to B, a tea-dealer, to the amount of ₹ 10,000, for any tea he may from time-to-time supply to C. B supplies C with tea to above the value of ₹ 10,000, and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 20,000. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of ₹ 10,000.

7.4 DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

| Point of distinction | Contract of Indemnity | Contract of Guarantee |
|------------------------------------------------|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| Number of party/parties to the contract | There are only two parties namely the indemnifier [promisor] and the indemnified [promisee] | There are three parties - creditor, principal debtor and surety. |
| Nature of liability | The liability of the indemnifier is primary and unconditional. | The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor. |
| Time of liability | The liability of the indemnifier arises only on the happening of a contingency. | The liability arises only on the non-performance of an existing promise or non-payment of an existing debt. |
| Time to Act | The indemnifier need not act at the request of indemnity holder. | The surety acts at the request of principal debtor. |

| | | |
|---------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| Right to sue third party | Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour. | Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts. |
| Purpose | Reimbursement of loss | For the security of the creditor |
| Competency to contract | All parties must be competent to contract. | In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid. |

7.5 NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION 128]

- (i) The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. [Section 128]
- (ii) Liability of surety is of secondary nature as he is liable only on default of principal debtor.
- (iii) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases.
- (iv) A creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

Example 15: A guarantees to B the payment of a bill of exchange by C, the acceptor. 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.

7.6 LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other,

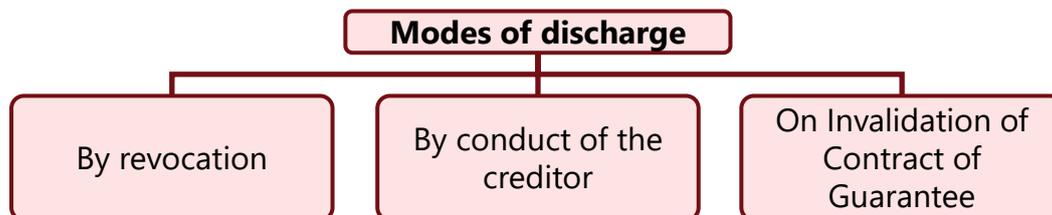
the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence. (Section 132)

Example 16: A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

7.7 DISCHARGE OF A SURETY

A surety is said to be discharged when his liability as surety comes to an end. The various modes of discharge of surety are discussed below:

- (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.



By revocation of the Contract of Guarantee

- (a) **Revocation of continuing guarantee by Notice (Section 130):** The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. Once the guarantee is revoked, the surety is not liable for any future transaction however he is liable for all the transactions that happened before the notice was given.

A specific guarantee can be revoked only if liability to principal debtor has not accrued.

Example 17: Arun promises to pay Rama for all groceries bought by Carol for a period of 12 months if Carol fails to pay. In the next three months, Carol buys ₹ 2000/- worth of groceries. After 3 months, Arun revokes the guarantee by giving a notice to Rama. Carol further purchases ₹ 1000 of groceries. Carol fails to pay. Arun is not liable for ₹ 1000/- of purchase that was made after the notice but he is liable for ₹ 2000/- of purchase made before the notice.

- (b) **Revocation of continuing guarantee by surety's death (Section 131):** In the absence of any contract to the contrary, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.

Example 18: 'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' died. Now guarantee is revoked for future transactions but 'S's estate is still liable for transactions done during previous five days.

- (c) **By novation [Section 62]:** The surety under original contract is discharged if a fresh contract is entered into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.

Example 19: 'S' guarantees 'C' for the payment of the supply of wheat to be done by 'C' & 'P' for next month. After 5 days, the contract is changed. Now 'S' guarantees 'C' for the payment of the supply of rice to be done by 'C' & 'P' for rest of next month. Here, guarantee is revoked for supply of wheat. But 'S' is still liable for supply of wheat done during previous five days.

By conduct of the creditor

- (a) **By variance in terms of contract (Section 133):** Where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Example 20: 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 by the variance made without his consent and is not liable to make good this loss.

- (b) **By release or discharge of principal debtor (Section 134):** The surety is discharged if the creditor:
- i. enters into a fresh/ new contract with principal debtor; by which the principal debtor is released, or
 - ii. does any act or omission, the legal consequence of which is the discharge of the principal debtor.

Example 21: A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

Example 22: A gives a guarantee to C for goods to be delivered to B. Later on, B contracts with C to assign his property to C in lieu of the debt. B is discharged of his liability and A is discharged of his liability.

(c) **Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]:** A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or promises not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

- i. *Composition:* If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged. Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.
- ii. *Promise to give time:* When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt. Accordingly, it is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment.
- iii. *Promise not to sue:* If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged. The main reason is that the surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt when it is due and this right is positively violated when the creditor promises not to sue the principal debtor.

Cases where surety not discharged

- i. **Surety not discharged when agreement made with third person to give time to principal debtor [Section 136]:** Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Example 23: 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.

- ii. **Creditor's forbearance to sue does not discharge surety [Section 137]:** Mere forbearance on the part of the creditor to sue the principal debtor or to

enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

Example 24: B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

- (d) **Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139]:** If the creditor does any act which is inconsistent with the rights 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.

In a case before the Supreme Court of India, "A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost." [*State bank of Saurashtra V Chitranjan Rangnath Raja (1980) 4 SCC 516*]

Example 25: 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 that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

By the invalidation of the contract of guarantee

- (a) **Guarantee obtained by misrepresentation [Section 142]:** 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.

Example 26: 'C' sells AC to 'P' on misrepresenting that it is made of copper while it is made of aluminum. 'S' guarantees for the same as surety without the knowledge of fact that it is made of aluminum. Here, 'S' will not be liable.

- (b) **Guarantee obtained by concealment [Section 143]:** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example 27: A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

Example 28: A guarantees to C payment for iron to be supplied by him to B for the amount of ₹ 2,00,000 tons. B and C have privately agreed that B should pay five

rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

- (c) **Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144):** 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.

Example 29: 'S1' guarantees 'C' for payment to be done by 'P' to 'C' on the condition that 'S1' will be liable only if 'S2' joins him for such guarantee. 'S2' does not give his consent. Here, 'S1' will not be liable.

7.8 RIGHTS OF A SURETY

The surety enjoys the following rights against the creditor:

- (a) Rights against the creditor,
- (b) Rights against the principal debtor,
- (c) Rights against co-sureties.

Right against the principal debtor

- (a) **Rights of subrogation [Section 140]:** 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 is known as right of subrogation. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.

Example 30: 'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within time, the bank can auction his property by giving 15 days notice to 'Raju'. On due date 'Raju' does not repay, hence Pappu being a surety has to repay the loan. Now 'Pappu' can take the house from bank and has a right to auction the house by giving 15 days notice to 'Raju'.

- (b) **Implied promise to indemnify surety [Section 145]:** In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but not sums which he paid wrongfully.

Example 31: B is indebted to C and A is surety for the debt. Upon default, C sues A. A defends the suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt.

In the same case above, if A did not have reasonable grounds for defence, A would still be entitled to recover principal debt from B but not any other costs.

Right against the Creditor

- (a) **Surety's right to benefit of creditor's securities [Section 141]:** A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Example 32: C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

- (b) **Right to set off:** If the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor

Example 33: 'X' took a loan of ₹ 50,000 from 'Y' which was guaranteed by 'Z'. There was one another contract between 'X' and 'Y' in which 'Y' had to pay ₹ 10,000 to 'X'. On default by 'X', 'Y' filed suit against 'Z'. Now 'Z' is liable to pay ₹ 40,000 (₹ 50,000 – ₹ 10,000).

- (c) **Right to share reduction:** The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

Example 34: 'X' took a loan of ₹ 50,000 from 'Y' which was Guaranteed by 'Z'. 'X' became insolvent and only 25% is realised from his property against liabilities. Now 'Y' will receive ₹ 12,500 from 'X' and Now 'Z' is liable to pay ₹ 37,500 (₹ 50,000 – ₹ 12,500).

Rights against co-sureties

“Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties”

- (a) **Co-sureties liable to contribute equally (Section 146):** Unless otherwise agreed, each surety is liable to contribute equally for discharge of whole debt or part of the debt remains unpaid by debtor.

Example 35: A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

Example 36: A, B and C are sureties to D for the sum of 1,00,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.

- (b) **Liability of co-sureties bound in different sums (Section 147):** The principal of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Example 37: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

Example 38: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

Example 39: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

SUMMARY

- ◆ **A contract of indemnity-** A contract where one party promises to indemnify the other from loss caused to him by the conduct of the promisor or by the conduct of any other person.
- ◆ **A contract of guarantee-** 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.
- ◆ Contract of guarantee must be supported by consideration. The consideration received by the principal debtor may be sufficient consideration to the surety for giving guarantee.
- ◆ The liability of surety is co-extensive with that of principle debtor. In certain cases surety will be liable even though the principal debtor is not liable-(i) Principal debtor is incompetent to contract. (ii) Principal debtor is adjudged insolvent. (iii) The debts become time-barred.
- ◆ The rights of a surety can be divided into 3 heads: (i) Right against the principal debtor; (ii) Right against the creditor; (iii) Right against the co- sureties.
- ◆ The surety is discharged from its 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.
- ◆ **Specific/simple guarantee:** Guarantee for single debt/particular transaction.
- ◆ **Continuing guarantee:** Guarantee that extends to a series of transactions.

CONTRACT OF INDEMNITY

| | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>'Indemnify' meaning: To make good the loss incurred by another person.</p> <p>Sec.124 covers the losses caused: i) By the conduct of promisor himself or ii) By the conduct of any other person. But as per decision taken in case of <i>Gajanan Moreshwar v/s Moreshwar Madan (1942)</i>, losses by conduct of promisee, or accident, or act of God.</p> | <p><u>Parties to Contract of Indemnity</u></p> <p>'Indemnifier' - who promises to compensate for the loss,</p> <p>'Indemnity Holder' or the 'Indemnified' - whose loss is to be made good</p> | <p><u>Rights of Indemnity Holder</u></p> <p>Right to recover</p> <ul style="list-style-type: none"> ▪ all damages, ▪ costs of suit, ▪ other sums. |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

CONTRACT OF GUARANTEE

'Guarantee' meaning:

Contract to perform the promise; or discharge the liability, of a third person in case of his default.

Parties to Contract of Guarantee

Surety: Who gives the guarantee,

Principal Debtor: In respect of whose default the guarantee is given,

Creditor: To whom the guarantee is given

Essential Features

1. **Purpose:** To secure the payment of a debt.
2. **Consideration:** Must be there, may be direct or indirect.
3. **Existence of liability:** Liability must be legally enforceable, not time barred.
4. No misrepresentation or concealment
5. May be oral or written.
6. Joining of co-sureties must be if provided in contract.

Types of Guarantee

Specific Guarantee

1. Guarantee which extends to a single debt/ specific transaction,
2. Surety's liability comes to an end when guaranteed debt is duly discharged.

Continue Guarantee

1. Guarantee which extends to a series of transaction,
2. Surety's liability continues until the revocation of the guarantee,

Modes of Discharge of Surety

By Revocation

1. By Notice,
2. By surety's death,
3. By Novation,

By Conduct of Creditors

1. By variance in terms,
2. By release or discharge of PD,
3. Composition with PD,
4. Impairing surety's remedy,

On Invalidation of Contract of Guarantee

1. Guarantee obtained by misrepresentation,
2. Guarantee obtained by concealment,
3. Guarantee on contract that creditor shall not act on it until co-surety joins

Rights of Surety

Against Principal Debtor

1. Right of Subrogation,
2. Right of Indemnity,

Against Creditor

1. Right to Security
2. Right to Set Off
3. Right to share reduction

Against Co-Surities

1. Right to claim contribution equally,
2. Right to claim contribution only agreed sum

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *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) *Surety contract*
 - (b) *Simple contract*
 - (c) *Contract of indemnity*
 - (d) *None of above*

2. *X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. This is called:*
 - (a) *Contract of indemnity*
 - (b) *Contract of Guarantee*
 - (c) *Quasi Contract*
 - (d) *None of the above*

3. *Section 124 to 125, of the Contract Act, deals with:*
 - (a) *Contracts of indemnity*
 - (b) *Contracts of guarantee*
 - (c) *Both (a) and (b)*
 - (d) *None of above*

4. *Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of-*
 - (a) *Indemnity*
 - (b) *Guarantee*
 - (c) *Wagering*
 - (d) *None of the above*

5. 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, which C does not pay for. Whether-
- (a) A is liable for the price of the four sacks.
 - (b) A is not liable for the price of the four sacks.
 - (c) A is liable for the price of the two sacks only.
 - (d) A is liable for the price of the one sack only.
6. X gives guarantee to the extent of ₹ 50,000 for the loans given from time to time by A to B. A gave a loan of ₹ 10,000 to B. Afterwards, X gives notice of revocation. Which is the correct option?
- (a) X is discharged from all liability to A for any loan granted.
 - (b) X is liable to A for ₹ 10,000 on default of B.
 - (c) X is liable to A for ₹ 50,000 on default of B.
 - (d) X is liable to A for ₹ 40,000 on default of B.
7. The guarantee is valid even if ____ is incompetent to contract:
- (a) Principal Debtor
 - (b) Surety
 - (c) Both a & b
 - (d) None of these
8. Section 143 of the Contract Act 1872 deals with
- (a) Guarantee obtained by free consent
 - (b) Guarantee obtained by fraud
 - (c) Guarantee obtained by concealment
 - (d) None of above
9. A surety has a right of indemnity and right of subrogation against_____
- (a) Principal Debtor
 - (b) Creditor
 - (c) Co-Sureties
 - (d) All of these

10. *In contract of guarantee for whom guarantee given is called*
- (a) *Surety holder*
 - (b) *Principal debtor*
 - (c) *Both (a) and (b)*
 - (d) *None of above*

Descriptive Questions

1. *What are the rights of the indemnity-holder when sued?*
2. *Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?*
3. *Mr. X, is employed as a cashier on a monthly salary of ₹ 12,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of ₹ 10,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?*
4. *A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.*
5. *Mr. D was in urgent need of money amounting to ₹ 5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused to contribute, examine whether B can escape liability?*
6. *Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years' contract at a monthly salary of ₹ 50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay ₹ 50,000 to Mr. Chetan because of financial constraints. Chetan agreed for a lower salary of ₹ 30,000 from the company. This was not communicated to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's appointment.*

7. A agrees to sell goods to B on the guarantee of C for the payment of the price of goods in default of B. Is the agreement of guarantee valid in each of the following alternate cases:

Case 1. If A is a Minor

Case 2: If B is a Minor

Case 3: If C is a minor.

8. S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined ₹ 50,000. Can R claim ₹ 50,000 from S.
9. Manoj guarantees for Ranjan, a retail textile merchant, for an amount of ₹ 1,00,000, for which Sharma, the supplier may from time to time supply goods on credit basis to Ranjan during the next 3 months.

After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for ₹ 40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e. ₹ 40,000?

10. 'C' advances to 'B', ₹ 2,00,000 on the guarantee of 'A'. 'C' has also taken a further security for the same borrowing by mortgage of B's furniture worth ₹ 2,00,000 without knowledge of 'A'. C' cancels the mortgage. After 6 months 'B' becomes insolvent and 'C' 'sues 'A' his guarantee. Decide the liability of 'A' if the market value of furniture is worth ₹ 80,000, under the Indian Contract Act, 1872.

ANSWERS/HINTS

Answers to MCQs

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

Answers to the Descriptive Questions

1. **Rights of Indemnity- holder when sued (Section 125):** The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—
- (a) all damages which he may be compelled to pay in any suit

- (b) all costs which he may have been compelled to pay in bringing/ defending the suit and
- (c) all sums which he may have paid under the terms of any compromise of suit.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

2. Section 124 of the Indian Contract Act, 1872 states that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian Contract Act, 1872 states that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default" is called a "contract of guarantee".

The conditions under which the guarantee is invalid or void is provided in section 142, 143 and 144 of the Indian Contract Act. These include:

- (i) Guarantee obtained by means of misrepresentation.
 - (ii) Guarantee obtained by means of keeping silence as to material circumstances.
 - (iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.
3. According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

In the instant case, the creditor has made variance (i.e. change in terms) without the consent of surety. Thus, surety is discharged as to the transactions subsequent to the change.

Hence, Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary.

4. According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor by which the principal debtor is discharged or by any act or omission for the creditor the legal consequence of which is the discharge of the principal debtor.

In the given case, B omits to supply the necessary construction material. Hence, C is discharged from his liability.

5. **Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872):** Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that “when two or more persons are co-sureties for the same debt, or duty, either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor”.

Accordingly, on the default of D in payment, B cannot escape from his liability. All the three sureties A, B and N are liable to pay equally, in absence of any contract between them.

6. As per the provisions of Section 133 of the Indian Contract Act, 1872, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

In the instant case, Mr. Pawan is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chetan during the first six months but not for misappropriations committed after the reduction in salary.

Hence, Mr. Pawan, will be liable as a surety for the act of Mr. Chetan before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Pawan, will discharge Mr. Pawan from all the liabilities towards the act of the Mr. Chetan after such variation.

7. **Case 1:** The agreement of guarantee is void because the creditor is incompetent to contract.

Case 2: The agreement of guarantee is valid because the capability of the principal debtor does not affect the validity of the agreement of the guarantee.

Case 3: The agreement of guarantee is void because the surety is incompetent to contract.

8. R cannot claim ₹ 50,000 from S because the object of the agreement was unlawful. A contract of indemnity to be valid must fulfil all the essentials of a valid contract.

9. **Discharge of Surety by Revocation:** As per section 130 of the Indian Contract Act, 1872, a continuing guarantee may, at any time, be revoked by the surety, as to future

transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions, liability of Manoj is discharged with relation to all subsequent credit supplies made by Sharma after revocation of guarantee, because it is a case of continuing guarantee.

However, liability of Manoj for previous transactions (before revocation) i.e. for ₹ 40,000 remains. He is liable for payment of ₹ 40,000 to Sharma because the transaction was already entered into before revocation of guarantee.

- 10. Surety's right to benefit of creditor's securities:** According to section 141 of the Indian Contract Act, 1872, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

In the instant case, C advances to B, ₹ 2,00,000 rupees on the guarantee of A. C has also taken a further security for ₹ 2,00,000 by mortgage of B's furniture without knowledge of A. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture i.e. ₹ 80,000 and will remain liable for balance ₹ 1,20,000.

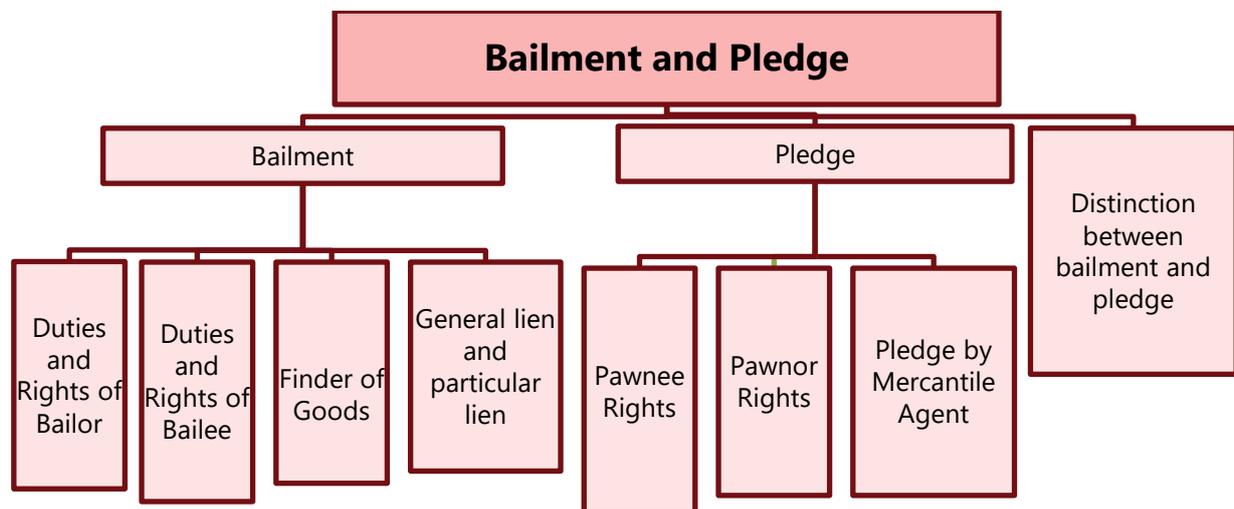
UNIT-8: BAILMENT AND PLEDGE

LEARNING OUTCOMES

After studying this unit, you would be able to understand:

- ◆ The general principles underlying contracts of bailment and pledge.
- ◆ Duties and rights of the parties to the contracts.

UNIT OVERVIEW



8.1 WHAT IS BAILMENT?

The word "Bailment" has been derived from the **French word "ballier"** which means "to deliver". Bailment etymologically means 'handing over' or 'change of possession'.

As per Section 148 of the Act, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

Parties to bailment:

- (a) **Bailor:** The person delivering the goods.
- (b) **Bailee:** The person to whom the goods are delivered.

Example 1: Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

Example 2: X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is contract for bailment.

Example 3: Goods given to a friend for his own use, without any charge.

Example 4: X delivers goods to blue dart for carriage.

Essential Elements:

The **essential elements** of a contract of bailment are—

- (a) **Contract:** Bailment is based upon a contract. The contract may be express or implied. No consideration is necessary to create a valid contract of bailment.
- (b) **Delivery of goods:** It involves the delivery of goods from one person to another for some purposes. Bailment is only for moveable goods and never for immovable goods or money. The delivery of the possession of goods is of the following kinds:
 - i. **Actual Delivery:** When goods are physically handed over to the bailee by the bailor. Eg: delivery of a car for repair to workshop
 - ii. **Constructive Delivery:** Where delivery is made by doing anything that has the effect of putting goods in the possession of the bailee or of any person authorized to hold them on his behalf. Eg: Delivery of the key of car to a workshop dealer for repair of the car.
- (c) **Purpose:** The goods are delivered for some purpose. The purpose may be express or implied.
- (d) **Possession:** In bailment, possession of goods changes. Change of possession can happen by physical delivery or by any action which has the effect of placing the goods in the possession of bailee. The change of possession does not lead to change of ownership. In bailment, bailor continues to be the owner of goods. Where a person is in custody without possession he does not become a bailee.

For **example**, servant of a master who is in custody of goods of the master does not become a bailee.

Similarly, depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in possession of the owner though kept in a locker at the bank.

- (e) **Return of goods:** Bailee is obliged to return the goods physically to the bailor. The goods should be returned in the same form as given or may be altered as per bailor's direction. It should be noted that exchange of goods should not be allowed. The bailee cannot deliver some other goods, even not those of higher value.

Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Types of bailment

1. **On the basis of benefit, bailment can be classified into three types:**

a. ***For the exclusive benefit of bailor:***

Example 5: The delivery of some valuables to a neighbour for safe custody, without charge.

b. ***For the exclusive benefit of bailee:***

Example 6: The lending of a bicycle to a friend for his use, without charge.

c. ***For mutual benefit of bailor and bailee:***

Example 7: Giving of a watch for repair.

2. **On the basis of reward, bailment can be classified into two types:**

- a. ***Gratuitous Bailment:*** The word gratuitous means free of charge. So, a gratuitous bailment is one when the provider of service does it gratuitously i.e. free of charge. Such bailment would be either for the exclusive benefits of bailor or bailee.

- b. ***Non-Gratuitous Bailment:*** Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee



8.2 DUTIES OF A BAILOR

Duties of Bailor: The duties of bailor are spelt out in a number of Sections [Section 150, 158, 159, 164]. These are categorized under the following headings:

Duties of Bailor

- Disclose known facts
- Bear necessary expenses
- Indemnify bailee
- Bound to accept the goods

These are enumerated hereunder:

(i) Bailor's duty to disclose faults in goods bailed [Section 150]:

- a. **In case of gratuitous bailment:** The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

Example 8: A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

- b. **In case of non-gratuitous bailment:** If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Example 9: 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.

In *Hyman & Wife v. Nye & Sons (1881)*, A hired from B a carriage along with a pair of horses and a driver for a specific journey. During the journey a bolt in the under-part of the carriage broke away. As a result of this, the carriage became upset and A was injured. *It was held that B was liable to pay damages to A for the injury sustained by him. The court observed that it was the bailor's duty to supply a carriage fit for the purpose for which it was hired.*

Sometimes, the goods bailed are of dangerous nature (e.g., explosives). In such cases it is the duty of the bailor to disclose the nature of goods. [*Great Northern Ry' case (1932)*]

(ii) Duty to pay necessary expenses [Section 158]:

- a. **In case of Gratuitous bailment:** Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration (gratuitous bailment), the bailor shall repay to the bailee the necessary expenses incurred by him and any extraordinary expenses incurred by him for the purpose of the bailment.
- b. **In case of non-gratuitous bailment** the bailor is liable to pay the extraordinary expenses incurred by the bailee.

Example 10: A hired a taxi from B for the purpose of going to Gurgaon from Noida. During the journey, a major defect occurred in the engine. A had to pay ₹ 5000 as

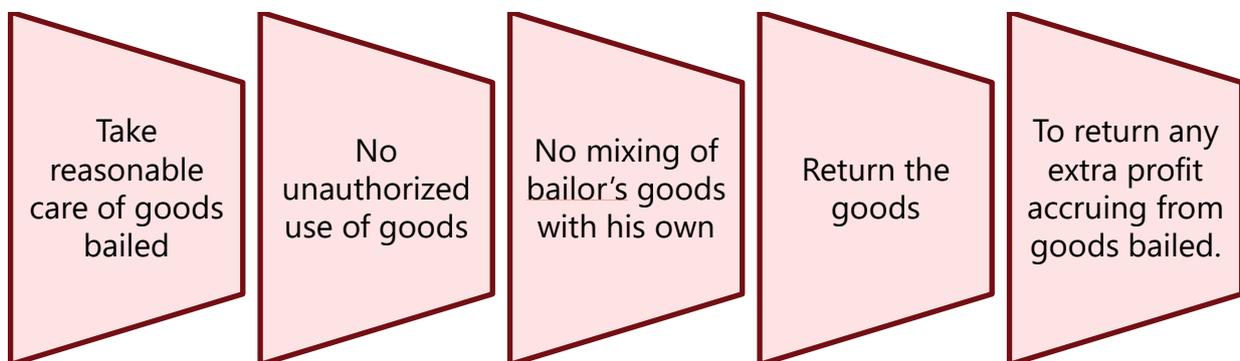
repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc. are to be borne by the bailee itself.

- (iii) **Duty to indemnify the Bailee for premature termination [Section 159]:** The bailor must compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received, where he had lent the goods gratuitously and decides to terminate the bailment before the expiry of the period of bailment.
- (iv) **Bailor's responsibility to bailee [Section 164]:** The bailor is responsible to the bailee for the following:
- Indemnify for any loss** which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give directions, respecting them (defective title in goods).
 - It is the duty of the bailor **to receive back the goods** when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished. If the bailor refuses to take delivery of goods when it is offered at the proper time the bailee can claim compensation for all necessary expenses incurred for the safe custody.

Example 11: X delivered his car to S for five days for safe keeping. However, X did not take back the car for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.



8.3 DUTIES OF A BAILEE



- 1. Take reasonable care of the goods (Section 151 & 152):** In all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take care of his own goods of the same bulk, quality and value, as the goods bailed.

Example 12: If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss caused on account of riot.

Example 13: A deposited his goods in B's warehouse. On account of unprecedented floods, a part of the goods were damaged. It was held that, B is not liable for the loss (*Shanti Lal V. Takechand*).

Exception: Bailee when not liable for loss, etc., of thing bailed [Section 152]: The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken reasonable care as required under section 151.

2. **Not to make inconsistent use of goods (section 153 & 154):** As per Section 154, if the bailee makes any use of the goods bailed, which is not according to the terms and conditions of the bailment, he is liable to compensate the bailor for any loss or destruction of goods.

Example 14: A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

Example 15: 'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse.

As per Section 153, a contract of bailment is voidable at the option of the bailor, if the bailee does not use the goods according to the terms and conditions of bailment.

Example 16: A lends to B, a horse for his own riding. B gives the horse to C for riding. This contract is voidable at the option of A, bailor.

3. **Not to mix the goods (Section 155, 156 and 157):**

- i. If the Bailee, mixes the goods bailed with his own goods, with the consent of the bailor, both the parties 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 bailed with his own goods and the goods can be 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 damage arising from the mixture (Section 156).

Example 17: A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark; A is entitled to have his 100 bales returned, and B is bound to bear all the 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 to deliver them back, the bailor is entitled to be compensated by the bailee for loss of the goods (Section 157).

Example 18: A bails a barrel of Cape flour worth ₹ 4500 to B. B, without A's consent, mixes the flour with country flour of his own, worth only ₹ 2500 a barrel. B must compensate A for the loss of his flour.

4. **Return the goods (Section 160 & 161):** It is the duty of bailee to return, or deliver according to the bailor's directions, the goods bailed without demand, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished. [Section 160]

If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time. [Section 161]

Example 19: X delivered books to Y to be bound. Y promised to return the books within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

5. **Return an accretion from the Goods [Section 163]:** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

Example 20: A leaves a cow in the custody of B. The cow gives birth to a calf. B is bound to deliver the calf along with the cow, to A.

6. **Not to setup Adverse Title:** Bailee must not set up a title adverse to that of the bailor. He must hold the goods on behalf of and for the bailor. He cannot deny the title of the bailor.

8.4 RIGHTS OF A BAILOR

Rights of Bailor: The following are the rights of bailor:-

-  Right to terminate the bailment
-  Right to demand back the goods at any time
-  Right to file a suit against any wrong doer
-  Right to file a suit for enforcement of duties imposed upon a bailee.
-  Right to claim compensation

- (i) **Right to terminate the bailment [Section 153]:** A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Termination of bailment has been discussed in next pages.

- (ii) **Right to demand back the goods (Section 159):** When the goods are lent gratuitously, the bailor can demand back the goods at any time even before the expiry of the time fixed or the achievement of the object.

Example 21: A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired.

However, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.

- (iii) **Right to file a suit against a wrong doer** [Section 180 and section 181] (discussed in next pages)
- (iv) **Right to sue the bailee:** The bailor has a right to sue the bailee for enforcing all the liabilities and duties of him.
- (v) **Right to compensation:** If any damage is caused to the goods bailed because of the unauthorized use of the goods or unauthorized mixing of the goods, the bailor has a right to claim compensation for the same.



8.5 RIGHTS OF A BAILEE

Rights of bailee: The following are the rights of the bailee:-

1. Right to Deliver the Goods to any one of the joint bailors [Section 165]

If several joint owners bailed the goods, the bailee has a right to deliver them to any one of the joint owners unless there was a contract to the contrary.

Example 22: A, B and C are the joint owners of a harvesting combine. They delivered it on hire to D for one month. After the expiry of one month, D may return the "combine" to any one of the joint owners namely, A, B or C.

2. Right to indemnity (Section 166): Bailee is entitled to be indemnified by the bailor for any loss arising to him by reasons that the bailor was not entitled to make the bailment or to receive back the goods or to give directions in respect to them. If the bailor has no title to the goods, and the bailee in good faith, delivers them back to, or according to the directions of the bailor, the bailee shall not be responsible to the owner in respect of such delivery. Bailee can also claim all the necessary expenses incurred by him for the purpose of gratuitous bailment.

3. Right to claim compensation in case of faulty goods (Section 150): A bailee is entitled to receive compensation from the bailor or any loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him. If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults.

4. Right to claim necessary expenses (Section 158): In case of gratuitous bailment, the bailor shall repay to the bailee the necessary expenses incurred by him and any extraordinary expenses incurred by him for the purpose of the bailment.

5. Right to Apply to Court to Decide the Title to the Goods [Section 167]: If the goods bailed are claimed by the person other than the bailor, he may apply to the court to stop its delivery and to decide the title to the goods.

Example 23: A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.

6. Right of particular lien for payment of services [Section 170]: (Discussed in next pages)

7. Right of general lien (Sec. 171): (Discussed in next pages)



8.6 RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY)

Suit by bailor & bailee against wrong doers [Section 180]: 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.

Apportionment of relief or compensation obtained by such suits [Section 181]: 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.



8.7 TERMINATION OF BAILMENT

A contract of bailment shall terminate in the following circumstances:

1. **On expiry of stipulated period:** If the goods were given for a stipulated period, the contract of bailment shall terminate after the expiry of such period.

Example 24: X gives his motorcycle to Y for a month. The bailment terminates after 1 month.

2. **On fulfillment of the purpose:** If the goods were delivered for a specific purpose, a bailment shall terminate on the fulfillment of that purpose.

Example 25: X hires certain tents and crockery on marriage of his daughter. The bailment terminates after marriage.

3. **By Notice:**

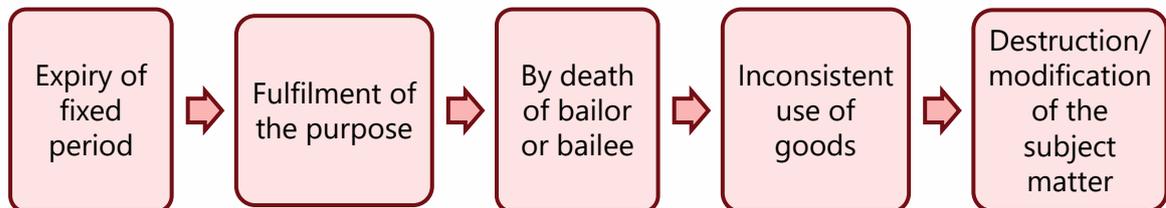
(a) Where the bailee acts in a manner which is inconsistent with the terms of the bailment, the bailor can always terminate the contract of bailment by giving a notice to the bailee.

(b) A gratuitous bailment can be terminated by the bailor at any time by giving a notice to the bailee. However, the termination should not cause loss to the bailee in excess of the benefit derived by him. In case the loss exceeds the benefit derived by the bailee, the bailor must compensate the bailee for such a loss (Sec. 159).

4. **By death:** A gratuitous bailment terminates upon the death of either the bailor or the bailee.

5. **Destruction of the subject matter:** A bailment is terminated if the subject matter of the bailment is destroyed or there is a change in the nature of goods which makes it impossible to be used for the purpose of bailment.

Example 26: X gives his cycle to Y on hire. Cycle damaged beyond repairs. Bailment ends.



8.8 FINDER OF LOST GOODS

Right of finder of lost goods- may sue for specific reward offered [Section 168]: A person who finds some goods which do not belong to him, is called the finder of the goods. It is the duty of the finder of goods to find the true owner and surrender the goods to him. However, the finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him in finding the owner and preserving the goods found. But he has a right to retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward on the lost goods, the finder may sue the owner for such reward, and may retain the goods until then.

When finder of thing commonly on sale may sell it [Section 169]: When a thing which is commonly the subject of sale if lost, if the owner cannot with reasonable diligence be found, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it—

- (1) when the thing is in danger of perishing or of losing the greater part of its value, or
- (2) when the lawful charges of the finder in respect of the thing found amount to two-thirds of its value.



8.9 RIGHT OF LIEN

RIGHT OF LIEN

Lien is the right of a person

- to retain the goods belonging to another

- until his claim is satisfied or
- some debt due to him is repaid.

Types of Lien: Lien may be of two types:

- a. Particular Lien
- b. General Lien

Particular Lien: It is a right to retain only the particular goods in respect of which the claim is due.

Section 170 provides, 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.

Example 27: 'A' gives cloth to 'B', a tailor, to make into a coat. 'B' is entitled to retain the coat until he is paid.

Example 28: If in the above example, 'B' takes 15 days time to make the coat, right of lien will be applicable after 15 days.

Example 29: A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

General Lien: It is a right to retain the goods not only for demands arising out of the goods retained but for a general balance of account in favour of certain persons (in the absence of a contract to the contrary). Section 171 provides this right is available to Bankers, factors, wharfingers, policy brokers and attorneys of law.

Example 30: 'A' borrows ₹ 500/- from the bank without security and subsequently again borrows another ₹ 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹ 1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

Under the right of general lien the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.

Difference between Bailee's General and Particular Lien

| General lien | Particular lien |
|------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|
| Section 171 of the Indian Contract Act, 1872 confer on Bailee the right of General Lien. | Section 170 of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien. |

| | |
|----------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|
| General lien alludes to the right to keep possession of goods belonging to other against general balance of account. | Particular lien implies a right of the bailee to retain specific goods bailed for non-payment of amount. |
| A general lien is not automatic but is recognized through an agreement. It is exercised by the bailee only by name. | It is automatic. |
| It can be exercised against goods even without involvement of labor or skill. | It comes into play only when some labor or skill is involved has been expended on the goods, resulting in an increase in value of goods. |
| Only such persons as are specified under section 171, e.g., Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien. | Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc. are entitled to particular lien. |

8.10 PLEDGE

“Pledge”, “pawnor” and “pawnee” defined [Section 172]: The bailment of goods as security for payment of a debt or performance of a promise is called **“pledge”**. The bailor is in this case called the **“pawnor”**. The bailee is called the **“pawnee”**.

Section 172 to 182 of the Indian Contract Act, 1872 deal with the contract of pledge.

Example 31: A lends money to B against the security of jewellery deposited by B with him. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor/pledger and A is a pawnee/pledgee.

ESSENTIALS OF CONTRACT OF PLEDGE: Since pledge is a special kind of bailment, therefore all the essentials of bailment are also the essentials of the pledge. Apart from that, the other essentials of the pledge are:

There shall be a bailment for security against payment or performance of the promise,

The subject matter of pledge is goods,

Goods pledged for shall be in existence,

There shall be the delivery of goods from pledger to pledgee

RIGHTS OF A PAWNEE/ PLEDGEE: Rights of Pawnee can be classified as under the following headings:

- (a) **Right to retain the pledged goods [Section 173]:** The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Example 32: Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.

- (b) **Right to retention of subsequent debts [Section 174]:** The Pawnee can retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged. But he can exercise this right only when there is a contract to this effect. i.e. a right to retain goods for subsequent debts can be exercised only when it has been provided for in a contract to this effect.
- (c) **Pawnee's right to extraordinary expenses incurred [Section 175]:** The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. For such expenses, however, he does not have the right to retain the goods, but he can sue the pawnor for such expenses.
- (d) **Pawnee's right where pawnor makes default [Section 176]:** If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee has the following rights:
- i. the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or
 - ii. he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

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.

Rights of a pawnor

As the bailor of goods, pawnor has all the rights of the bailor. Along with that he also has the right of redemption to the pledged goods which is enumerated under section 177 of the Act.

Right to redeem [Section 177]: 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 the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

Note: Redemption means to recover back the goods by making of the payment of debt or performance of promise.

Duties of the Pawnee

Pawnee has the following duties:

- a. Duty to take reasonable care of the pledged goods.
- b. Duty not to make unauthorized use of pledged goods.
- c. Duty to return the goods when the debt has been repaid or the promise has been performed.
- d. Duty not to mix his own goods with goods pledged.
- e. Duty not to do any act which is inconsistent with the terms of the pledge.
- f. Duty to return accretion to the goods, if any.

Duties of a Pawnor

Pawnor has the following duties:

- a. The pawnor is liable to pay the debt or perform the promise as the case may be.
- b. It is the duty of the pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.
- c. It is the duty of the pawnor to disclose all the faults which may put the pawnee under extraordinary risks.
- d. If loss occurs to the pawnee due to defect in pawnor's title to the goods, the pawnor must indemnify the pawnee.
- e. If the pawnee sells the good due to default by the pawnor, the pawnor must pay the deficit.



8.11 PLEDGE BY NON-OWNERS

Ordinarily, it is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. 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.

a. Pledge by mercantile agent [Section 178]:

A mercantile agent, who is in the possession of goods or document of title, with the consent of owner, can pledge them while acting in the ordinary course of business as a Mercantile Agent.

Such Pledge shall be valid as if were made with the authority of the owner of goods. Provided, Pawnee acted in good faith and had no notice that Pawnor has no authority to pledge.

b. Pledge by person in possession under voidable contract [Section 178A]: When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A (contracts where consent has been obtained by fraud, coercion, misrepresentation, undue influence), but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

c. Pledge where pawnor has only a limited interest [Section 179]: Where a person pledges goods in which he has only a limited interest i.e. pawnor is not the absolute owner of goods, the pledge is valid to the extent of that interest.

Example 33: Mr. X finds a defective mobile phone lying on the road. He picks it up, gets it repaired for ₹ 5000. He later pledges the mobile phone for ₹ 2,000. The true owner can recover the mobile phone only on paying ₹ 5,000.

Example 34: 'A' pledges his jewellery worth ₹ 1,00,000 with 'B' for an advance of ₹ 70,000. 'B' pledges the same for ₹ 90,000 with 'C'. Now this pledge is valid upto ₹ 70,000 plus interest due thereon.

d. Pledge by a co-owner in possession: Where the goods are owned by many person 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.

- e. **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.

Example 35: 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.



8.12 DISTINCTION BETWEEN BAILMENT AND PLEDGE

| Basis of Distinction | Bailment | Pledge |
|--------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|
| Meaning | Transfer of goods by one person to another for some specific purpose is known as bailment. | Transfer of goods from one person to another as security for repayment of debt is known as the pledge. |
| Parties | The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee". | The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee". |
| Purpose | Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods). | Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise. |
| Consideration | The bailment may be made for consideration or without consideration. | Pledge is always made for a consideration. |
| Right to sell the goods | The bailee has no right to sell the goods even if the charges of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed. | The pawnee has right to sell the goods if the pawnor fails to redeem the goods. |
| Right to use of goods | Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise. | Pledgee or Pawnee cannot use the goods pledged. |

SUMMARY

- ◆ **Bailment**-Delivery of goods by one person to another for some purpose upon a contract that they shall be returned after the purpose is over or disposed off according to the directions of the person delivering them.
- ◆ **Bailor**- Person who delivers the goods for bailment.
- ◆ **Bailee**- Person to whom goods are delivered under the contract of bailment.
- ◆ **Depositing currency notes in a bank**- It is not a bailment as currency notes or moneys are not goods as per the definition of goods given under the Sale of Goods Act, 1930 and also same currency notes are not returned to the depositor by the bank.
- ◆ **Keeping of ornaments/valuables in a bank locker**- It's not a bailment as there is no transfer of possession of ornaments or valuables.
- ◆ **Gratuitous bailment**- No consideration passes between the bailor and the bailee and the bailor is not responsible for the damages in respect of the faults which were not known to him.
- ◆ **Pledge**- Bailment of goods as security for payment of a debt/performance of a promise.
- ◆ **Pawnor**- Person who pledges goods as security.
- ◆ **Pawnee**- Person who receives the goods as security.
- ◆ Some non-owners may also create a valid pledge of goods, such as- Mercantile agents, co-owner, by person having a limited interest, by person having a possession of goods under voidable contract.
- ◆ **Basic distinction between bailment and pledge**- All the pledges are bailments but all the bailments are not pledges.

BAILMENT (SECTION 148-171)

Meaning: 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, according to the directions of the person delivering them.

Parties

Bailor: Who delivers;
Bailee: Who receives;

Essentials

1. Agreement,
2. Delivery of goods,
3. For some purpose,
4. Return of goods

Kinds of Bailment

On the basis of benefit

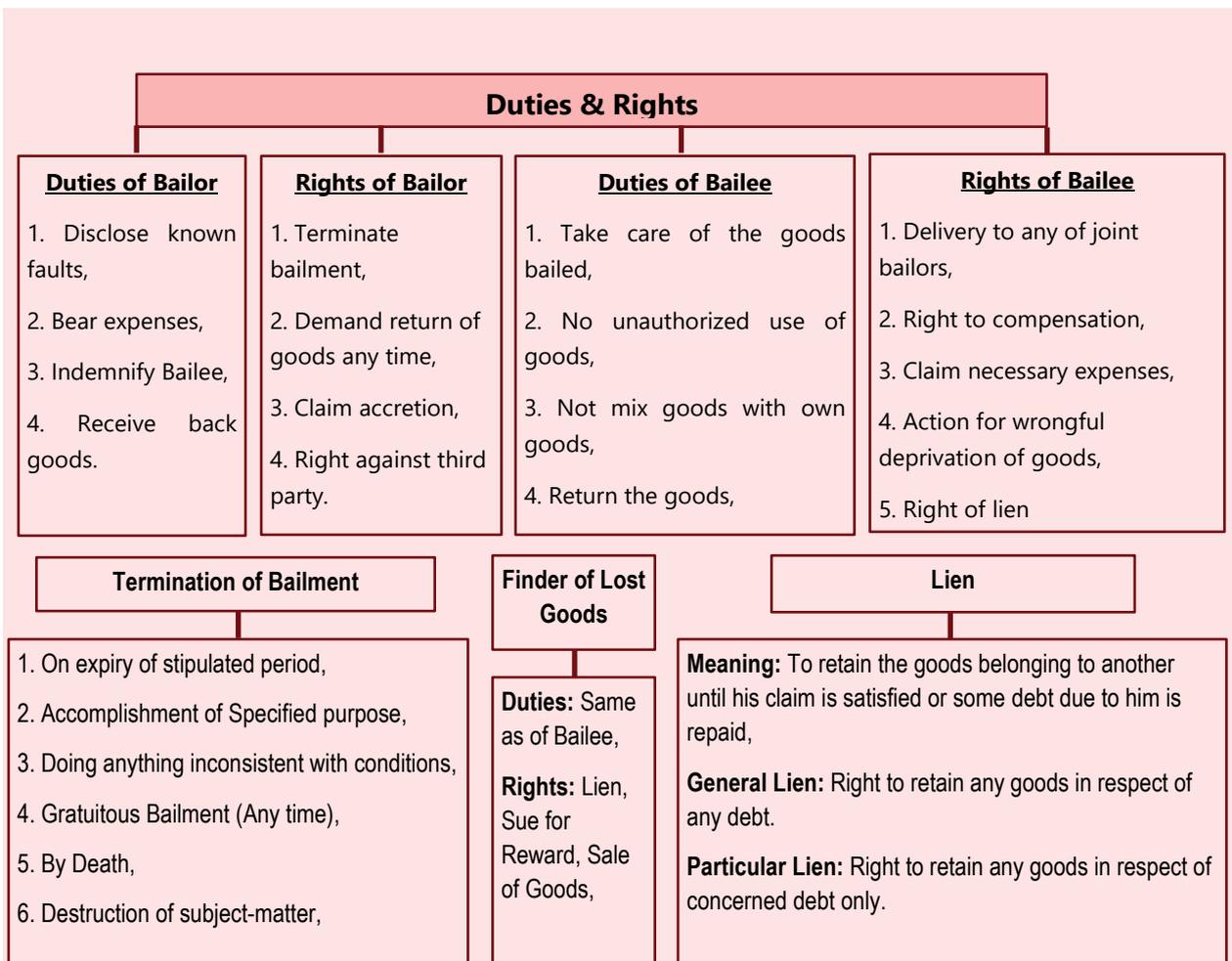
1. For the benefit of Bailor
2. For the benefit of Bailee
3. For the benefit of both

On the basis of consideration

1. Gratuitous – No consideration
2. Non-Gratuitous – For consideration

Gratuitous Bailment : without Consideration, Bailor is liable for known faults Only. All expenses born by Bailor.

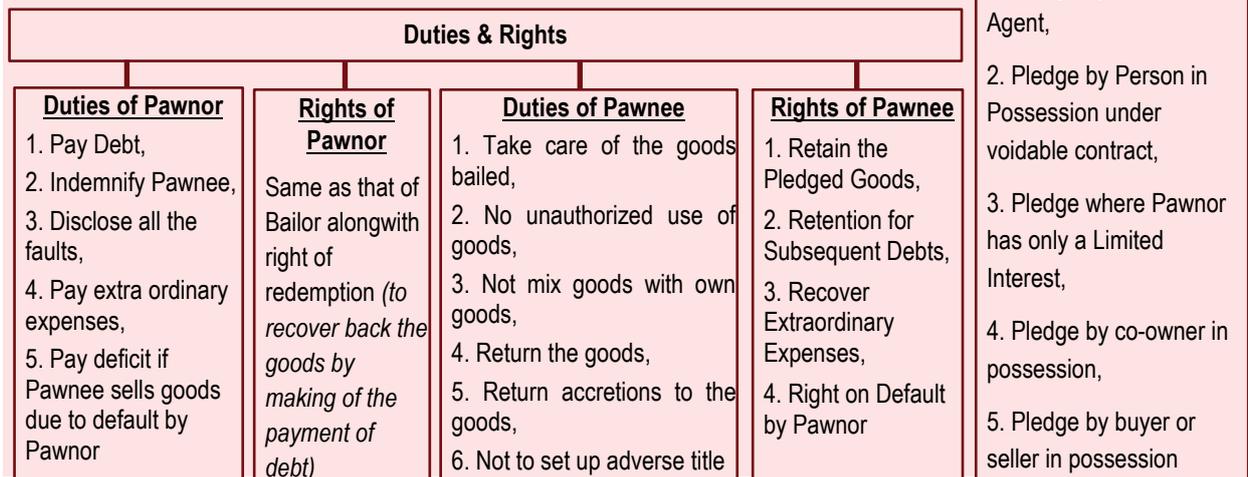
Non-Gratuitous Bailment: With Consideration, Bailor is liable for all faults, Extra Ordinary expenses born by Bailor



PLEDGE (SECTION 171 – 181)

Meaning: Bailment of goods as security for payment of a debt or performance of a promise.

Parties: Bailor – Pawnor; Bailee – Pawnee



TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Bailment means*
 - (a) *temporary delivery of goods.*
 - (b) *permanent delivery of goods.*
 - (c) *partly delivery of goods.*
 - (d) *None*
2. *Which is not essential element of contract of bailment*
 - (a) *doing contract.*
 - (b) *Purchase of goods.*
 - (c) *delivery of goods.*
 - (d) *return of goods in specific time.*
3. *In the contract of bailment the person to whom goods is delivered, called*
 - (a) *seller*
 - (b) *bailee*
 - (c) *bailor*
 - (d) *agent*
4. *Bailee should care the goods as per*
 - (a) *as a man of ordinary prudence*
 - (b) *as owner*
 - (c) *as principal*
 - (d) *as a servant*
5. *Lien means*
 - (a) *to retain goods in his possession*
 - (b) *rights to sell the goods.*
 - (c) *right to purchase the goods.*
 - (d) *right to destroy the goods.*

6. *In case there are two or more joint owners of the goods, the Bailee has to deliver them back to _____, in the absence of any agreement to the contrary :*
- (a) *Any of the Joint owners.*
 - (b) *Such joint owner for which all the joint owners have consented.*
 - (c) *All the Joint owners collectively.*
 - (d) *None of these.*
7. *A finder of goods is subject to the same responsibility as that of a*
- (a) *bailee*
 - (b) *bailor*
 - (c) *surety*
 - (d) *purchaser*
8. *The bailment of goods as security for payment of a debt is called*
- (a) *pledge*
 - (b) *bailment*
 - (c) *mortgage*
 - (d) *none of these*
9. *What is an essential element of a valid pledge?*
- (a) *Delivery of goods*
 - (b) *Delivery of bills*
 - (c) *Price*
 - (d) *None of these*
10. *The pledge is a contract of*
- (a) *bailment*
 - (b) *agency*
 - (c) *guarantee*
 - (d) *mortgage*

Descriptive Questions

1. *State the essential elements of a contract of bailment.*
2. *Give differences between Bailment and Pledge.*

3. *Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:*
 - (i) *V parks his car at a parking lot, locks it, and keeps the keys with himself.*
 - (ii) *Seizure of goods by customs authorities.*
4. *A hires a carriage from B and agrees to pay ₹ 500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B.*
5. *A bails his jewellery with B on the condition to safeguard it in a bank's safe locker. However, B kept it in safe locker at his residence, where he usually keeps his own jewellery. After a month all jewellery was lost in a religious riot. A filed a suit against B for recovery. Referring to provisions of the Indian Contract Act, 1872, state whether A will succeed.*
6. *R gives his umbrella to M during raining season to be used for two days during Examinations. M keeps the umbrella for a week. While going to R's house to return the umbrella, M accidentally slips and the umbrella is badly damaged. Who bear the loss and why?*
7. *Amar bailed 50 kg of high quality sugar to Srijith, who owned a kirana shop, promising to give ₹ 200 at the time of taking back the bailed goods. Srijith's employee, unaware of this, mixed the 50 kg of sugar belonging to Amar with the sugar in the shop and packaged it for sale when Srijith was away. This came to light only when Amar came asking for the sugar he had bailed with Srijith, as the price of the specific quality of sugar had trebled. What is the remedy available to Amar?*
8. *Mrs. A delivered her old silver jewellery to Mr. Y a Goldsmith, for the purpose of making new a silver bowl out of it. Every evening she used to receive the unfinished good (silver bowl) to put it into box kept at Mr. Y's Shop. She kept the key of that box with herself. One night, the silver bowl was stolen from that box. Was there a contract of bailment? Whether the possession of the goods (actual or constructive) delivered, constitute contract of bailment or not?*
9. *Srushti acquired valuable diamond at a very low price by a voidable contract under the provisions of the Indian Contract Act, 1872. The voidable contract was not rescinded. Srushti pledged the diamond with Mr. VK. Is this a valid pledge under the Indian Contract Act, 1872?*

ANSWERS/HINTS

Answers to MCQs

| | | | | | | | | | | | |
|----|-----|----|-----|----|-----|-----|-----|----|-----|----|-----|
| 1. | (a) | 2. | (b) | 3. | (b) | 4. | (a) | 5. | (a) | 6. | (a) |
| 7. | (a) | 8. | (a) | 9. | (a) | 10. | (a) | | | | |

Answers to the Descriptive Questions

1. **Essential elements of a contract of bailment:** Section 148 of the Indian Contract Act, 1872 defines the term 'Bailment'. 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 essential elements of the contract of the bailment are:
 - (i) *Delivery of goods*—The essence of bailment is delivery of goods by one person to another.
 - (ii) *Bailment is a contract*—In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, the goods shall be returned to the bailor.
 - (iii) *Return of goods in specific*—The goods are delivered for some purpose and it is agreed that the specific goods shall be returned.
 - (iv) *Ownership of goods*—In a bailment, it is only the possession of goods which is transferred, and the bailor continues to be the owner of the goods.
 - (v) *Property must be movable*—Bailment is only for movable goods and never for immovable goods or money.

2. **Distinction between bailment and pledge: The following are the distinction between bailment and pledge:**
 - (a) **As to purpose:** Pledge is a variety of bailment. Under pledge goods are bailed as a security for a loan or a performance of a promise. In regular bailment the goods are bailed for other purpose than the two referred above. The bailee takes them for repairs, safe custody etc.
 - (b) **As to right of sale:** The pledgee enjoys the right to sell only on default by the pledgor to repay the debt or perform his promise, that too only after giving due notice. In bailment the bailee, generally, cannot sell the goods. He can either retain or sue for non-payment of dues.

- (c) **As to right of using goods:** Pledgee has no right to use goods. A bailee can, if the terms so provide, use the goods.
- (d) **Consideration:** In pledge there is always a consideration whereas in a bailment there may or may not be consideration.
- (e) **Discharge of contract:** Pledge is discharged on the payment of debt or performance of promise whereas bailment is discharged as the purpose is accomplished or after specified time.
3. As per Section 148 of the Act, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.
- For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it. There must be no transfer in ownership of the goods.
- (i) No. Mere custody of goods does not mean possession. In the given case, since the keys of the car are with V, Section 148, of the Indian Contract Act, 1872 shall not be applicable.
- (ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists and section 148 is applicable.
4. Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case, B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.
5. According to section 152 of the Indian Contract Act, 1872, the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken reasonable care as required under section 151.
- Here, A and B agreed to keep the jewellery at the Bank's safe locker and not at the latter's residence (i.e. B's residence). Thus, B is liable to compensate A for his negligence to keep jewellery at his (B's) residence.
6. M shall have to bear the loss since he failed to return the umbrella within the stipulated time and Section 161 clearly says that where a bailee fails to return the goods within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.

7. According to section 157 of the Contract Act, 1872, 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.

In the given question, Srijith's employee mixed high quality sugar bailed by Amar and then packaged it for sale. The sugars when mixed cannot be separated. As Srijith's employee has mixed the two kinds of sugar, he (Srijith) must compensate Amar for the loss of his sugar.

8. Section 148 of Indian Contract Act 1872 defines 'Bailment' as 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 direction of the person delivering them.

According to Section 149 of the Indian Contract Act, 1872, the delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf. Thus, delivery is necessary to constitute bailment.

Thus, the mere keeping of the box at Y's shop, when A herself took away the key cannot amount to delivery as per the meaning of delivery given in the provision in section 149. Therefore, in this case there is no contract of bailment as Mrs. A did not deliver the complete possession of the good by keeping the keys with herself.

9. Pledge by person in possession under voidable contract [Section 178A of the Indian Contract Act, 1872]: When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

Therefore, the pledge of diamond by Srushti with Mr. VK is valid.

UNIT-9: AGENCY

LEARNING OUTCOMES

After studying this unit, you would be able to understand:

- ◆ The relationship between agent and principal and the intention behind adoption of such course of agency.
- ◆ Rights and obligations of an agent as well as the circumstances under which the agent is personally liable for the acts done by him on behalf of the principal and the legal position of the agent, the principal and the third parties involved.
- ◆ Terms 'sub-agent' and 'substituted agent' and to distinguish between the two.

UNIT OVERVIEW



A relationship of agency is established when one party (agent) is authorized by another party (principal) to act on his/ her behalf. Such relationships are initiated when one party desires to extend his/her activities beyond his/her present limits or capacity. In modern life, it would be impossible for a man to do everything by himself. Thus, he needs agents, to perform activities. A relationship of agency is commonly visible in all business transactions. These include hiring employees or retaining the services of other professionals such as an attorney, design professional, software developer etc. An agent has the potential to form contracts on behalf of the principal and in doing so, will bind the principal. As a result, the relationship of agency is one of trust and confidence and an agent must perform his/her activities in a capable and conscientious manner. The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872.



9.1 WHAT IS AGENCY?

The Indian Contract Act, 1872 does not define the word 'Agency'. However, section 182 of the Indian Contract Act, 1872 defines Agent and Principal as:

Agent means a person employed to do any act for another or to represent another in dealing with the third persons and

The principal means a person for whom such act is done or who is so represented.

Test of Agency

- (a) Whether the person has the capacity to bind the principal and make him answerable to the third party.
- (b) Whether he can establish privity of contract between the principal and third parties.

If the answer to these questions is in affirmative (Yes), then there is a relationship of agency.

Thus, 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim "*Qui facit per alium, facit per se*" i.e., he who acts through an agent is himself acting.

***Qui facit per alium,
facit per se***



9.2 APPOINTMENT AND AUTHORITY OF AGENTS

Who may employ an agent: According to Section 183, “any person who has attained 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 appoint an agent.

Person qualified to appoint agent must be

- major
- sound mind

Who may be an agent:

According to Section 184 of the Act any person may become an agent i.e. even a minor or a person of unsound mind may become an agent and the principal shall be bound by his acts. But as a rule of caution, a minor or a person of unsound mind should not be appointed as an agent because he is incompetent to contract and in case of his misconduct or negligence, the principal shall not be able to proceed against him.

Example 1: P appoints Q, a minor, to sell his car for not less than ₹ 2,50,000. Q sells it for ₹ 2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is ‘void-ab-initio’.

Consideration not necessary: According to Section 185, no consideration is necessary to create an agency. The acceptance of the office of an agent is regarded as a sufficient consideration for the appointment.

9.3 CREATION OF AGENCY

In the words of Desai J, of the Supreme Court of India “The relation of agency arises whenever one person called the agent has the authority to act on behalf of another called the principal and consents to act. The relationship has genesis in a contract”.

The relationship of the principal and the agent may be created in any of the following ways —

The authority may be express or implied: According to Section 186, the authority of an agent may be express or implied.

1. **Definitions of express and implied authority [Section 187]**

Express Authority: An authority is said to be express when it is given by words, spoken or written.

Example 2: A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

Example 3: If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent.

2. **Implied Authority:** An authority is said to be implied when it is to be inferred from the circumstances of the case, conduct of the parties and things spoken or written, or in the ordinary course of dealing, may be accounted from the circumstances of the case.

If a person realises rent and gives it to the landlord, he impliedly acts for the landlord as an agent.

Example 5: A owns a shop in Selampur, living himself in Kolkata and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

Implied Agency includes:-

- a. **Agency by Estoppel [Section 237]:** Where the principal by his conduct or statement willfully induces another person to believe that a certain person is his agent, he is subsequently prevented or estopped from denying the fact of agency.

According to section 237 of the Contract Act, an agency by estoppel may be created when following essentials are fulfilled:

1. the principal must have made a representation;
2. the representation may be express or implied;
3. The representation must state that the agent has an authority to do certain act although really he has no authority;
4. The principal must have induced the third person by such representation; and
5. The third person must have believed the representation and made the contract on the belief of such representation.

Example 6: A consigns goods to B for sale and gives him instructions not to sell below a fixed price. C being ignorant of B's instruction enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. A cannot plead that he had given instructions to B to not sell the goods below certain price. An agency by estoppel is, consequently, deemed between A and B.

Example 7: If Piyal (the principal) has for several months permitted Sunil to buy goods on credit from Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is estopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief.

- b. **Agency by Necessity:** An agency of necessity arises due to some emergent circumstances. In emergency a person is authorised to do what he cannot do in ordinary circumstances. Thus, where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he acquires an extra-ordinary or special authority to prevent his principal from loss.

Example 8: Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire and save the farm from destruction during Raja's absence from the country.

3. **Agency by Operation of Law:** When law treats one person as an agent of other. For example, a partner is the agent of the firm for the purposes of the business of the firm.
4. **Rights of person as to acts done for him without his authority, Effect of ratification [Section 196]:** 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 if they had been performed by his authority. In simple words, "Ratification" means approving a previous act or transaction. Ratification may be express or implied by the conduct of the person on whose behalf the act was done.

Example 9: X who is Y's agent has on 10th January 2022 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2022, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit. Y's subsequent statement on 20th January 2022 amounts to a ratification of the agent's (X's) purchase of goods on 10th January 2022.

Essentials of a valid Ratification

- a. **Ratification may be expressed or Implied [Section 197]:** Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.

Example 10: A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A.

Example 11: A, without B's authority, lends B's money to C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

- b. **Knowledge requisite for valid ratification [Section 198]:** No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

Example 12: A has an authority from P to buy certain goods at the market rate. He buys at a higher rate but P accepts the purchase. Afterwards P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P.

- c. **The whole transaction must be ratified [Section 199]:** There can be ratification of an act in entirety or its rejection in entirety. The principal cannot ratify a part of the transaction which is beneficial to him and reject the rest.

- d. **Ratification cannot injure third person [Section 200]:** When the interest of third parties is affected, the principle of ratification does not apply. Ratification cannot relate back to the date of contract if third party has in the intervening time acquired rights.

Example 13: A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

Example 14: A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

- e. **Ratification within reasonable time:** Ratification must be made within a reasonable period of time.
- f. **Communication of Ratification:** Ratification must be communicated to the other party.

- g. **Act to be ratified must be valid:** Act to be ratified should not be void or illegal, for e.g. payment of dividend out of capital, forgery of signatures, any other criminal offence, or anything which is not permitted under law.



9.4 EXTENT OF AGENT'S AUTHORITY

The agent's authority is governed by two principles, namely (a) in normal circumstances and (b) in emergency.

- (a) **Agent's authority in normal circumstances [Section 188]:** 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.

Example 15: A is employed by B, residing in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt and may give a valid discharge for the same.

Example 16: A constitutes B as his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business.

- (b) **Agent's authority in an emergency [Section 189]:** 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.

To constitute a valid agency in an emergency, following conditions must be satisfied.

- (i) Agent should not be in a position or have any opportunity to communicate with his principal within the time available.
- (ii) There should have been actual and definite commercial necessity for the agent to act promptly.
- (iii) the agent should have acted bonafide and for the benefit of the principal.
- (iv) the agent should have adopted the most reasonable and practicable course under the circumstances, and
- (v) the agent must have been in possession of the goods belonging to his principal and which are the subject of contract.

Example 17: An agent who has authority for sale of goods may repair it if necessary.

Example 18: A consigns perishable goods to B at Srinagar, with directions to send them immediately to C at Tamandu. B may sell the good if they begin to perish before reaching its destination.

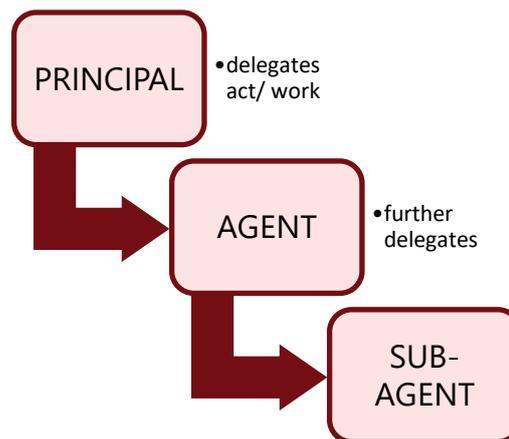
9.5 SUB-AGENTS

When agent cannot delegate [Section 190]: An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or from the nature of the agency, a sub-agent must, be employed.

“Sub-agent” defined [Section 191]: A “Sub-agent” is a person employed by, and acting under the control of, the original agent in the business of the agency.

Analysis: Sub agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegatee and a delegatee cannot further delegate. This is based on the Latin principle “**delegatus non potest delegare**”.

*Delegatus Non Potest
Delegare*



A contract of agency is of a fiduciary character. It is based on the confidence reposed by the principal in the agent and that is why a delegatee cannot further delegate.

Exception where an agent can appoint Sub-agent:

- (1) The appointment of a sub agent would be valid if the terms of appointment originally contemplated it.
- (2) Sometimes **customs of the trade** may provide for appointment of sub agents.

In both these cases the sub agent would be treated as the agent of the principal.

- (3) Where in the course of the agent's employment, **unforeseen emergency** arise making it necessary for him to delegate the authority that was given to him by the principal.

Representation of principal by sub-agent properly appointed [Section 192]: Where a sub-agent is properly appointed,

- (1) Principal is liable to third parties for the acts of the sub-agent.
- (2) **Agents responsibility for sub agents:** The agent is responsible to the principal for the acts of the sub-agent.
- (3) **Sub-agents liability to principal:** The sub-agent is responsible for his acts to the agent, but not to the principal, except in case of fraud or willful wrong.

Agent's responsibility for sub-agent appointed without authority [Section 193]: Where an agent, without having authority to do so, has appointed a person to act as a sub-agent,

- (1) the agent is responsible for his acts both to the principal and to third persons;
- (2) the principal is not responsible for the acts of the sub agent,
- (3) the sub agent is not responsible to the principal at all. He is answerable only to the agent.

Example 19: A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. A asked B, another carrier, to carry the goods. The goods were damaged in transit. Held, A was liable even though it was proved that B was the carrier.



9.6 SUBSTITUTED AGENT

Substituted Agent is a person appointed by the agent to act for the principal, in the business of agency, with the knowledge and consent of the principal. Substituted agents are not sub agents. They are agents of the principal.

Relation between principal and person duly appointed by agent to act in business of agency [Section 194]: Where an agent, holding an express or implied authority to name another person to act for the principal in the business of the 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 to him.

Example 20: A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent, but is A's agent for the conduct of the sale.

Example 21: A authorizes B, a merchant in Kolkata, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co. for the recovery of the money. D is not a sub-agent, but is a solicitor for A.

Agent's duty in naming such person [Section 195]: In selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

Example 22: A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

Example 23: A consigns goods to B, a merchant, for sale. B in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.



9.7 DIFFERENCE BETWEEN A SUB-AGENT AND A SUBSTITUTED AGENT

Both a sub-agent and a substituted agent are appointed by the agent. But, however, the following are the points of distinction between the two.

| S.no | Sub Agent | Substituted Agent |
|------|----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| 1. | A sub-agent does his work under the control and directions of agent. | A substituted agent works under the instructions of the principal. |
| 2. | The agent not only appoints a sub-agent but also delegates to him a part of his own duties. | The agent does not delegate any part of his task to a substituted agent. |
| 3. | There is no privity of contract between the principal and the sub-agent. | Privity of contract is established between a principal and a substituted agent. |
| 4. | The sub-agent is responsible to the agent alone and is not generally responsible to the principal. | A substituted agent is responsible to the principal and not to the original agent who appointed him |
| 5. | The agent is responsible to the principal for the acts of the sub-agent. | The agent is not responsible to the principal for the acts of the substituted agent. |

| | | |
|----|---------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|
| 6. | The sub-agent has no right of action against the principal for remuneration due to him. | The substituted agent can sue the principal for remuneration due to him. |
| 7. | Sub-agents may be improperly appointed. | Substituted agents can never be improperly appointed. |
| 8. | The agent remains liable for the acts of the sub-agent as long as the sub-agency continues. | The agent's duty ends once he has named the substituted agent. |



9.8 DUTIES AND OBLIGATIONS OF AN AGENT

- (i) **Duty to follow instructions or customs:** According to Section 211 an agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the customs which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise and any loss is sustained by the Principal, he must indemnify him, and, if any profit accrues, he must account for it.

Example 24: A, an agent is engaged for managing the business of B, in which it is a custom to invest money at hand for interest. If A omits to make such investment he must indemnify B for the losses i.e. for the interest B would have obtained for such investment.

Example 25: B, a broker, in whose business it is not the custom to sell on credit, sells goods of A on credit to C. C, before payment, becomes insolvent. B will have to indemnify A for the losses.

- (ii) **Duty of reasonable care and skill:** According to section 212, an agent is bound to conduct the business of the principal with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill.

The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss of damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

Example 26: A, a merchant in Kolkata, has an agent, B, in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent.

B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss- e.g. by variation of rate of exchange-but not further.

Example 27: A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must compensate his principal for the loss sustained by him.

Example 28: A, an insurance-broker, employed by B to effect an insurance on a ship, omits to see that the "usual clauses" are inserted in the policy. The ship is afterwards lost. In consequence of the omission nothing can be recovered from the underwriters. A is bound to make good the loss to B.

Example 29: A, a merchant in England, directs B, his agent at Mumbai, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

- (iii) **Duty to render proper accounts [Section 213]:** An agent is bound to render proper accounts to his principal on demand. Rendering accounts does not mean showing the accounts but the accounts supported by vouchers. (*Anandprasad vs. Dwarkanath*)
- (iv) **Agent's duty to communicate with principal [Section 214]:** It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.
- (v) **Duty not to deal on his own account:** Agent should not deal on his own account without first obtaining the consent of the principal, otherwise the principal may—
 - (a) repudiate the transaction, (Section 215)
 - (b) claim from the agent any benefit which may have resulted to him from the transaction. (Section 216)

Example 30: A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

Example 31: A directs B to sell A's 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 allow B to buy,

in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or accept the sale at his option.

Example 32: A directs B, his agent, to buy a certain house for him. B tells A it 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 gave for it.

- (vi) **Duty not to make secret profits:** It is the duty of an agent not to make any secret profit in the business of agency. His relationship with the principal is of fiduciary nature and this requires absolute good faith in the conduct of agency.

Secret Profit means any advantage obtained by the agent over and above his agreed remuneration and which he would not have been able to make but for his position as agent.

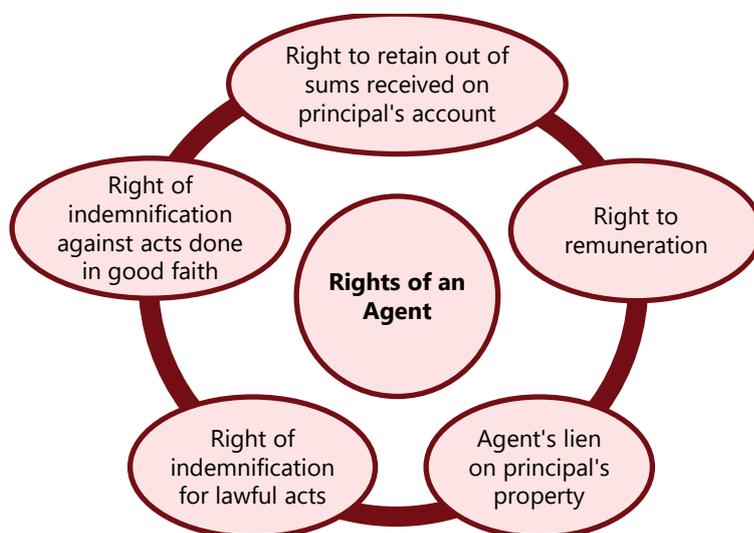
- (vii) **Duty not to delegate:** According to section 190, an agent cannot lawfully employ to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or, from the nature of agency, a sub-agent, must be employed.

- (viii) **Agent's duty to pay sums received for principal [Section 218]:** Subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

- (ix) **Duty not to use any confidential information received in the course of agency against the principal.**



9.9 RIGHTS OF AN AGENT



- (i) **Right of retain out of sums received on principal's account [Section 217]:** This section 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 advances made
 - (b) in respect of expenses properly incurred by him in conducting such business
 - (c) such remuneration as may be payable to him for acting as agent.

The right can be exercised on any sums received on account of the principal in the business of agency.

- (ii) **Right to remuneration [Section 219]:** The agent in the normal course is entitled for remuneration as per the contract. In the absence of any agreed amount of remuneration, he is entitled for usual remuneration which is customary in the business. However, an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business which he has misconducted [Section 220].

Example 33: A employs B to recover ₹1,00,000 from C, and invest it in securities that give good returns. B recovers the amount and lays out ₹ 90,000 on good securities but lays out ₹ 10,000 on securities which he ought to provide poor returns, whereby A loses ₹ 2,000. B is entitled to remuneration for recovering the ₹ 1,00,000 and for investing the ₹ 90,000. He is not entitled to any remuneration for investing the ₹ 10,000, and he must indemnify A for ₹ 2000.

Example 34: A employs B to recover ₹ 1,00,000 from C. Because of B's misconduct the money is not recovered. B is entitled to no remuneration for his services and must make good the loss.

- (iii) **Agent's lien on principal's property [Section 221]:** In the absence of any contract to the contrary, an agent is entitled to retain the goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursement and services in respect of the same has been paid or accounted for him.

The conditions of this right are:

- a. The agent should be lawfully entitled to receive from the principal a sum of money by way of commission earned or disbursement made or services rendered in the proper execution of the business of agency.
- b. The property over which the lien is to be exercised should belong to the principal and it should have been received by the agent in his capacity and

during the course of his ordinary duties as an agent. If the agent obtains possession of the property by unlawful means, he cannot exercise particular lien.

The agent's right to lien is lost in the following cases:

- (a) When the possession of the property is lost.
- (b) When the agent waives his right. Waiver may arise out of agreement express or implied.
- (c) The agent's lien is subject to a contract to the contrary.

(iv) Right to indemnity:

- a. **Right of indemnification for lawful acts [Section 222]:** The principal is bound to indemnify the agent against all consequences of lawful acts done in exercise of his authority.

Example 35: 'A' residing in Delhi appoints 'B' from Mumbai as an agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But A fails to send the merchandise to B and B faces litigations for non- performance. Here, A is bound to protect B against the litigations and all costs, expenses arising of that.

- b. **Right of indemnification against acts done in good faith [Section 223]:** Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal.

Example 36: Where P appoints A as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to P and if third parties sue A for this act, A is entitled for reimbursement and indemnification for such act done in good faith.

However, the agent cannot claim any reimbursement or indemnification for any loss etc. arising out of acts done by him in violation of any penal laws of the country.

- c. **Non-liability of employer of agent to do a criminal act:** According to section 224, where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act.

Example 37: A employs B to beat C and agrees to indemnify him against all consequences of the act. B thereupon beats C and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

Example 38: B, the proprietor of a newspaper, publishes, at A's request, a libel upon C in the paper, and A agrees to indemnify B against the consequences of the publication, and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages, and also incurs expenses. A is not liable to indemnify B.

- (v) **Right to compensation for injury caused by principal's neglect [Section 225]:** Section 225 provides that the principal must compensate his agent in respect of injury caused to such agent due to principal's neglect or want of skill. Thus, every principal owes to his agent the duty of care, and not to expose him to unreasonable risks.

Example 39: A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskillfully put up, and B is in consequence hurt. A must compensate B.



9.10 PRINCIPAL'S LIABILITY TO THIRD PARTIES

An agent does all acts on behalf of the principal but incurs no personal liability. The liability remains that of the principal unless there is a contract to the contrary. This is because there is no privity of contract and passing of consideration between the agent and third party. An agent also cannot personally enforce contracts entered into by him on behalf of the principal.

- (i) **Principal's liability for the Acts of the Agent [Section 226]:** Principal liable for the acts of agents which are within the scope of his authority.

Example 40: A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from B.

Example 41: A, being B's agent with authority to receive money on his behalf, receives from C, a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

- (ii) **Principal's liability when agent exceeds authority [Section 227]:** When an agent does more than he is authorised to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and his principal.

Example 42: A, being owner of a ship and cargo, authorizes B to procure an insurance for ₹ 4,00,000 on the ship. B procures a policy for ₹ 4,00,000 on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

Principal not bound when excess of agent's authority is not separable [Section 228]: Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.

Example 43: A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹ 6,00,000. A may repudiate the whole transaction.

Example 44: A authorizes B to draw bills to the extent ₹ 200 each. B draws bills in the name of A for ₹ 1,000 each. A may repudiate the whole transaction.

Exception: Liability of principal inducing belief that agent's unauthorized acts were authorized [Section 237]: 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.

Example 45: A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

Example 46: A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

- (iii) **Consequences of notice given to agent [Section 229]:** Any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequence as if it had been given to or obtained by the principal.

Example 47: A is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods. Thus, the knowledge of the agent is treated as the knowledge of the principal.

- (iv) **Principal's liability for the agent's fraud, misrepresentation or torts [Section 238]:** Misrepresentations made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by

such agents as if such misrepresentations or frauds had been made, or committed, by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

Example 48: A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

Example 49: A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.



9.11 PERSONAL LIABILITY OF AGENT TO THIRD PARTIES

Agent cannot personally enforce, nor be bound by, contracts on behalf of principal

[Section 230]: 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. He can neither sue nor be sued on contracts made by him on his principal's behalf.

EXCEPTIONS: In the following exceptional cases, the agent is presumed to have agreed to be personally bound:

- (1) Where the contract is made by an agent for the sale or purchase of goods for a **merchant resident abroad/foreign principal**: – When an agent has entered into a contract for the sale or purchase of goods on behalf of a principal resident abroad, the presumption is that the agent undertakes to be personally liable for the performances of such contract.
- (2) Where the agent **does not disclose the name of his principal or undisclosed principal**; (Principal unnamed): when the agent does not disclose the name of the principal then there arises a presumption that he himself undertakes to be personally liable.
- (3) **Non-existent or incompetent principal**: Where the principal, though disclosed, cannot be sued, the agent is presumed to be personally liable.

Example 50: An agent who contracts for a minor, the minor being not liable, the agent becomes personally liable. This result, may not, however, follow where the other party already knows that the principal is a minor.

- (4) **Pretended agent** – if the agent pretends but is not an actual agent, and the principal does not rectify the act but disowns it, the pretended agent will be himself liable (Section 235).
- (5) **When agent exceeds authority**- When the agent exceeds his authority, misleads the third person in believing that the agent he has the requisite authority in doing the act, then the agent can be made liable personally for the breach of warranty of authority.

RIGHTS OF THIRD PARTIES

- i. **Rights of parties to a contract made by undisclosed agent [Section 231]:** If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal, the same right as he would have had as against the agent if the agent had been the principal.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfill the contract, if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.

Example 51: SS bought for himself a ticket of IPL match at Wankahde Stadium through AB because on personal grounds Stadium management would not have issued the ticket to SS. Stadium management may repudiate the contract and refuse SS to enter the stadium.

- ii. **Performance of contract with agent supposed to be principal [Section 232]:** When agent does not disclosed that he is acting as an agent and the principal requires the performance of the contract then the principal can obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example 52: A, who owes 50,000 rupees to B, sells 1,00,000 rupees 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.

- iii. **Option to Third Person- sue the Agent or the Principal:**

- a. **Right of person dealing with agent personally liable [Section 233]:** In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them, liable.

Example 53: A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

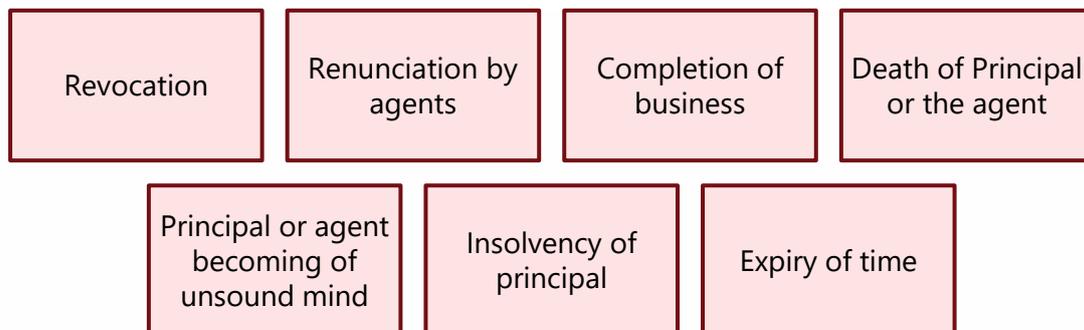
- b. **Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]:** When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.



9.12 REVOCATION OF AUTHORITY

Termination of agency [Section 201]

Termination of agency means putting an end to the legal relationship between principal and agent. Section 201 provides for the following modes of termination:



- a. **Revocation:** An agency may be terminated by the principal revoking the authority of the agent. Principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal [Section 203]. However, 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 for acts already done in the agency. [Section 204]

Example 54: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

Example 55: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in A's

name, and so as not to render himself personally liable for the price. A can revoke B's authority to pay for the cotton.

Compensation for revocation by principal [Section 205]: If there is premature revocation of agency without sufficient cause, the principal must compensate the agent, for such revocation.

Notice of revocation [Section 206]: When the principal, having justification to do so, revokes the authority, he must give reasonable notice of such revocation to the agent, otherwise, he can be liable to pay compensation for any damage caused to the agent (Section 206).

Revocation and renunciation may be expressed or implied [Section 207]: Revocation of agency may be expressed or implied in the conduct of the principal.

Example 56: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

- b. Renunciation by agent [Section 206]:** An agent may renounce the business of agency in the same manner in which the principal has the right of revocation. In the first place, if the agency is for a fixed period, the agent would have to compensate the principal for any premature renunciation without sufficient cause. [Section 205] Secondly, a reasonable notice of renunciation is necessary. Length of notice (time period of notice) is to be determined by the same principles which apply to revocation by the principal. If the agent renounces without proper notice, he shall have to make good any damage thereby resulting to the principal. [Section 206]
- c. Completion of business:** An agency is automatically and by operation of law terminated when its business is completed. Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed.
- d. Death or insanity:** An agency is determined automatically on the death or insanity of the principal or the agent. Winding up of a company or dissolution of partnership has the same effect. Act done by agent before death would remain binding.
- e. Principal's insolvency:** An agency ends on the principal being adjudicated insolvent.
- f. On expiry of time:** Where an agent has been appointed for a fixed term, the expiration of the term puts an end to the agency, whether the purpose of agency has been accomplished or not. An agency comes to an automatic end on expiry of its term.

When the agency is irrevocable?

When the agent is personally interested in the subject matter of agency the agency becomes irrevocable. **Section 202** states that "where the agent has himself an interest in the property

which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.”

Example 57: A gives authority to B to sell A’s land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

Example 58: A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor it is terminated by his insanity or death.

Effects of Termination [Section 208]

When termination of agent’s authority takes effect as to agent, and as to third persons

[Section 208]: The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

Example 59: A directs B to sell goods for him and agrees to give B five per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B’s authority. B, after the letter is sent, but before he receives it sells the goods for ₹ 1,00,000. The sale is binding on A, and B is entitled to ₹ 5,000 as his commission.

Example 60: A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C’s payment is good as against A.

Example 61: A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A’s death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

Agent’s duty on termination of agency by principal’s death or insanity [Section 209]:

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.

Termination of sub-agent’s authority [Section 210]

The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent’s authority) of the authority of all sub-agents appointed by him.

SUMMARY

Agency: Relation between an agent and his principal created by an express/ implied agreement authorising an agent by his principal to create contractual relations with third parties. Person so appointed to represent the principal is called as agent whereas a person who appoints an agent to represent him as per his directions and authority is called as principal.

- Agency can be either expressed or implied.
- **Sub-agent:** Person appointed by the original agent in the business of agency under his direction and control and being responsible to the principal for acts of a sub-agent.
- **Substituted agent:** Person is named by the agent expressly or impliedly to act for the principal in the business of agency.
- **Ratification:** 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 if they had been performed by his authority. Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.
- **Revocation of authority:** An Agency is terminated (a) by the principal revoking his authority; or (b) by the agent renouncing the business of the agency; or (c) by the business of the agency being completed; or (d) by either the principal or agent dying or becoming of unsound mind; or (e) by either the principal or agent dying or becoming of unsound mind.
- **Duties and obligations of an Agent:** (a) Conduct the business according to principal's directions (b) Conduct the business with the skill and diligence (c) Render proper accounts (d) Communicate with principal in cases of difficulty (e) Repudiation of the transaction by principal (f) Not to deal on his own account (g) Agent's duty to pay sums received for principal.
- **Rights of an Agent:** (a) Right of retain out of sums received on principal's account (b) Right to remuneration (c) Agent's particular lien on principal's property (d) Right of indemnification for lawful acts (e) Right of indemnification against acts done in good faith.

AGENCY (SECTION 172-238)

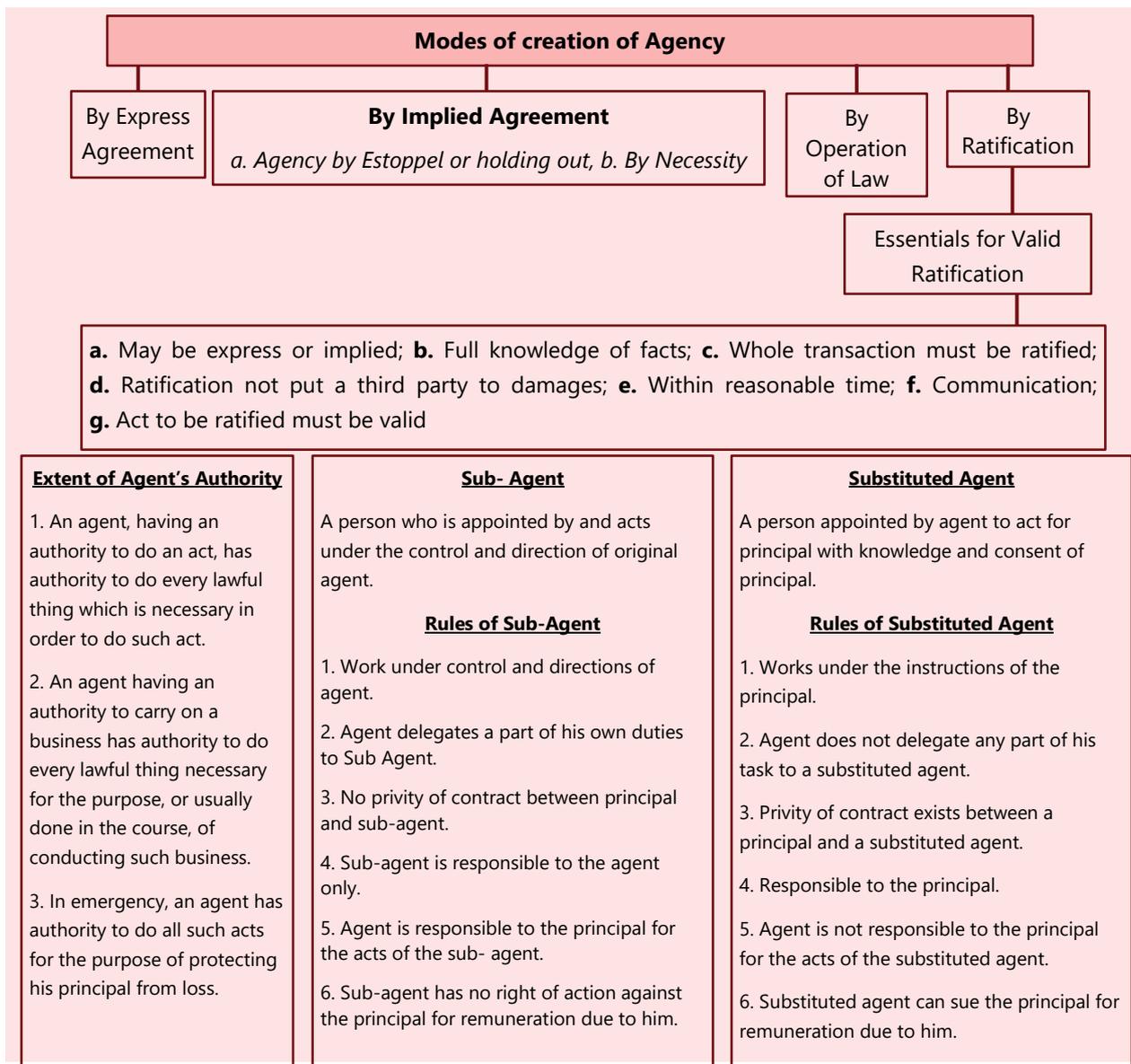
Agency: Relation between an agent and his principal created by an express/ implied agreement authorising an agent by his principal to create contractual relations with third parties.

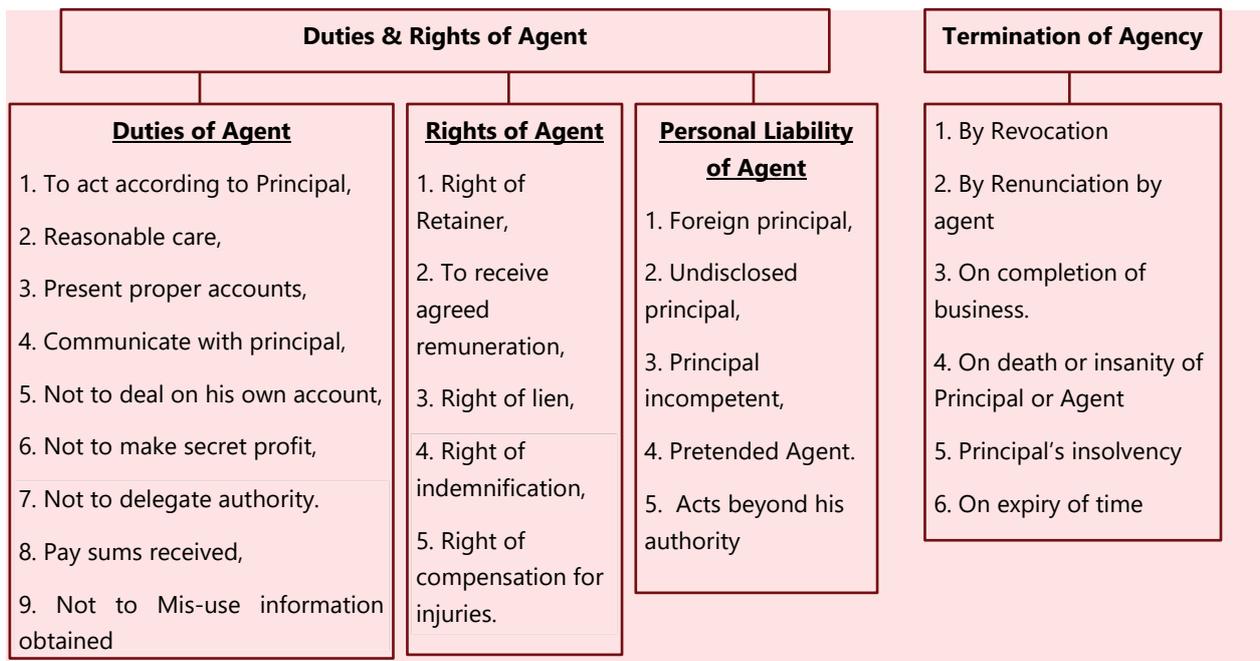
Agent: Person employed to do any act for another, or to represent another.

Principal: person for whom such act is done or who is so represented.

Who can be Agent: any person including minor, Person of unsound mind

Who can appoint an Agent: Major, Person of sound mind





TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. A person employed to do any act and represent is called
 - (a) agent
 - (b) principal
 - (c) owner
 - (d) servant
2. Who can become an agent?
 - (a) Both Minor & Adult
 - (b) Minor
 - (c) Adult person
 - (d) Dead person
3. To create an agency, which is not required?
 - (a) Principal
 - (b) consideration

- (c) *agent*
(d) *third party*
4. _____ is a person employed by, and acting under the control of original agent in the business of agency
- (a) *A substituted agent*
(b) *A sub agent*
(c) *A mercantile agent*
(d) *An universal agent*
5. A substituted agent acts on behalf of _____
- (a) *Principal*
(b) *Sub-agent*
(c) *Agent*
(d) *None of these*
6. The power given to agent is
- (a) *reasonable & unreasonable*
(b) *expressed & implied*
(c) *legal & illegal*
(d) *all above*
7. On whose insolvency the agency is terminated?
- (a) *Sub agent*
(b) *Agent*
(c) *Principal*
(d) *Del credere*
8. Under which circumstances agent become personally responsible?
- (a) *beyond authority*
(b) *fraudulent transactions*
(c) *fraud*
(d) *All of above*

9. *It is the duty of the agent to protect and preserve the interest on behalf of the principal's representative in case of _____*
- (a) *Death of the principal*
 - (b) *Insolvency of the principal*
 - (c) *Both (a) & (b)*
 - (d) *None of these*
10. *Agent should not to deal on his own account without first obtaining the consent of the principal, otherwise the principal may—*
- (a) *repudiate the transaction,*
 - (b) *claim from the agent any benefit which may have resulted to him from the transaction,*
 - (c) *Either (a) or (b)*
 - (d) *Both (a) & (b)*

Descriptive Questions

1. *A appoints M, a minor, as his agent to sell his watch for cash at a price not less than ₹ 700. M sells it to D for ₹ 350. Is the sale valid? Explain the legal position of M and D, referring to the provisions of the Indian Contract Act, 1872.*
2. *State with reason whether the following statement is correct or incorrect: Ratification of agency is valid even if knowledge of the principal is materially defective.*
3. *Rahul, a transporter was entrusted with the duty of transporting tomatoes from a rural farm to a city by Aswin. Due to heavy rains, Rahul was stranded for more than two days. Rahul sold the tomatoes below the market rate in the nearby market where he was stranded fearing that the tomatoes may perish. Can Aswin recover the loss from Rahul on the ground that Rahul had acted beyond his authority?*
4. *Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for ₹ 20 lakhs in the name of a nominee and then purchased it himself for ₹ 24 lakhs. He then sold the same house to Mr. Ahuja for ₹ 26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.*
5. *Comment on the statement 'Principal is not always bound by the acts of a sub-agent'.*

6. ABC Ltd. sells its products through some agents and it is not the custom in their business to sell the products on credit. Mr. Pintu, one of the agents sold goods of ABC Ltd. to M/s. Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. ABC Ltd. sued Mr. Pintu for compensation towards the loss caused due to sale of products to M/s. Parul Pvt. Ltd. Will ABC Ltd. succeed in its claim?
7. R is the wife of P. She purchased sarees on credit from Nalli. Nalli demanded the amount from P. P refused. Nalli filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Nalli would succeed.
8. Bhupendra borrowed a sum of ₹ 3 lacs from Atul. Bhupendra appointed Atul as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds. Afterward, Bhupendra revoked the agency.

Decide under the provisions of the Indian Contract Act, 1872 whether the revocation of the said agency by Bhupendra is lawful.

ANSWERS/HINTS

Answers to MCQs

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

Answers to the Descriptive Questions

- According to the provisions of Section 184 of the Indian Contract Act, 1872, as between the principal and a third person, any person, even a minor 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. Thus, if a person who is not competent to contract is appointed as an agent, the principal is liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch. M is not liable to A for his negligence in the performance of his duties.
- Incorrect:** Section 198 of the Indian Contract Act, 1872 provides that for a valid ratification, the person who ratifies the already performed act must be without defect and have clear knowledge of the facts of the case. If the principal's knowledge is materially defective, the ratification is not valid and hence no agency.
- Agent's authority in an emergency (Section 189 of the Indian Contract Act, 1872):** 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 the instant case, Rahul, the agent, was handling perishable goods like 'tomatoes' and can decide the time, date and place of sale, not necessarily as per instructions of the Aswin, the principal, with the intention of protecting Aswin from losses.

Here, Rahul acts in an emergency as a man of ordinary prudence, so Aswin will not succeed against him for recovering the loss.

4. The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:
- (1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.
 - (2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover ₹ 6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

5. **The statement is correct.** Normally, a sub-agent is not appointed, since it is a delegation of power by an agent given to him by his principal. The governing principle is, a delegate cannot delegate'. (Latin version of this principle is, "*delegates non potest delegare*"). However, there are certain circumstances where an agent can appoint sub-agent.

In case of proper appointment of a sub-agent, by virtue of Section 192 of the Indian Contract Act, 1872 the principal is bound by and is held responsible for the acts of the sub-agent. Their relationship is treated to be as if the sub-agent is appointed by the principal himself.

However, if a sub-agent is not properly appointed, the principal shall not be bound by the acts of the sub-agent. Under the circumstances the agent appointing the sub-agent shall be bound by these acts and he (the agent) shall be bound to the principal for the acts of the sub-agent.

6. **To conduct the business of agency according to the principal's directions (Section 211 of the Indian Contract Act, 1872):** An agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

In the present case, Mr. Pintu, one of the agents, sold goods of ABC Ltd. to M/s Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. Also, it is not the custom in ABC Ltd. to sell the products on credit.

Hence, Mr. Pintu must make good the loss to ABC Ltd.

7. The position of husband and wife is special and significant case of implied authority. According to the Indian Contract Act 1872, where the husband and wife are living together in a domestic establishment of their own, the wife shall have an implied authority to pledge the credit of her husband for necessaries. However, the implied authority can be challenged by the husband only in the following circumstances.
- (1) The husband has expressly forbidden the wife from borrowing money or buying goods on credit.
 - (2) The articles purchased did not constitute necessities.
 - (3) Husband had given sufficient funds to the wife for purchasing the articles she needed to the knowledge of the seller.
 - (4) The creditor had been expressly told not to give credit to the wife.

Further, where the wife lives apart from husband without any of her fault, she shall have an implied authority to bind the husband for necessaries, if he does not provide for her maintenance.

Since, none of the above criteria is being fulfilled; Nalli would be successful in recovering its money.

8. According to Section 202 of the Indian Contract Act, 1872 an agency becomes irrevocable where the agent has himself an interest in the property which forms the subject-matter of the agency, and such an agency cannot, in the absence of an express provision in the contract, be terminated to the prejudice of such interest.

In the instant case, the rule of agency coupled with interest applies and does not come to an end even on death, insanity or the insolvency of the principal.

Thus, when Bhupendra appointed Atul as his agent to sell his land and authorized him to appropriate the amount of loan out of the sale proceeds, interest was created in favor of Atul and the said agency is not revocable. The revocation of agency by Bhupendra is not lawful.