# Centre for Distance & Online Education
# (CDOE)

## BACHELOR OF COMMERCE

# BCOM 303

# BUSINESS LAWS


## Guru Jambheshwar University of Science & Technology, Hisar – 125001

# Contents

| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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# INDIAN CONTRACT ACT 1872: ESSENTIALS OF VALID CONTRACT, OFFER AND ACCEPTANCE

## STRUCTURE



## 1.0 LEARNING OBJECTIVES

After going through this lesson, you should be able to:

(i) Explain the origin and importance of Indian Contract Act 1872;

(ii) Define a contract and explain the essentials of a valid contract;

(iii) Discuss the various kinds of contracts;

(iv) Understanding the meaning of offer and explain its essentials;

(v) Describe the relationship between offer and acceptance;

(vi) Explain the essentials of a valid acceptance; and

(vii) Describe when communication of offer and acceptance and their revocation is complete.

## 1.1 INTRODUCTION

Law of contract is the most important branch of Business Law. It would have been very difficult to carry on trade or commerce in the absence of this law. It is not only the business community which is concerned with the law of contracts, but it affects every person. Contract is considered as the foundation of the civilized world. Every one of us enters into a number of contracts from sunrise to sunset. When a person drinks a cup of tea, or rides a bus, or goes to the cinema to see a movie or purchases the goods, or gives a loan to friend, etc. he enters into a contract though he may be unaware of it. Such contracts create legal rights and obligations. The law of contract is mainly concerned with the enforcement of these rights and obligations.

The law of contract determines the circumstances in which a promise or an agreement shall be legally binding on the person making it. It is concerned with rights in *personam* as distinguished from rights in *rem*. For example, if X is entitled to receive a sum of money from Y, this right can only be exercised by X and not by others. This is a right in *personam*. On the other hand, if X owns a plot of land and Y is the immediate neighbour, the right of X to have complete possession and enjoyment of land is available not only against Y but against the whole world. This right of X is known as the right in *rem*.

An agreement is the most significant and essential to make a contract. Agreement* arises from proposal and its acceptance. There must be a definite offer by one party and its acceptance by the other to create an agreement. Proposal and acceptance become effective only when they are communicated. An agreement is created when an offer in accepted.

## 1.2 INDIAN CONTRACT ACT, 1872

The laws of contract in India is contained in the Indian Contract Act, 1872. This Act is based mainly on English Common Law which is to a large extent made up of judicial precedents. It extends to the whole

of India except the State of Jammu and Kashmir and came into force on the first day of September 1872. The Act is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts which deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc.

The provisions of Indian Contract Act are subjection to some assumptions underlying the Act which include: (i) Subject to certain limiting principles, there shall be freedom of contract to the contracting parties and the law shall enforce only what the parties have agreed to be bound. The law shall not lay down absolute rights and liabilities of the contracting parties. Instead it shall lay down only the essentials of a valid contract and the rights and obligations it would create between the parties in the absence of anything to the contrary agreed to by the parties; and (ii) Expectations created by promises of the parties shall be fulfilled and their non-fulfilment shall give rise to legal consequences. If the plaintiff asserts that the defendant undertook to do a certain act and failed to fulfil his promise an action at law shall apply.

### 1.2.1 DEFINITION OF CONTRACT

A legally binding agreement is called a contract. In other words, a contract is an agreement which will be enforced by the courts. Salmond defines contract as, "an agreement creating and defining obligation between the parties". Halsbury defines a contract to be, "an agreement between two or more persons which is intended to be enforceable at law and is constituted by the acceptance by one party of an offer made to him by the other party to do or abstain from doing some act".

Section 2(h) of the Indian Contract Act defines a contract as, "An agreement which is enforceable at law". This definition has two important components which constitute the basis for a contract. They are: (1) An agreement, and (2) Legal obligation. We shall now examine these elements in detail.

1. **Agreement:** Every promise and every set of promises, forming the consideration for each other, is an agreement [Sec. 2 (e)]. Thus it is clear from this definition that a promise is an agreement. What is a promise? The answer to this question is contained in Section 2(b) which defines the term:"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". An agreement, therefore, comes into existence only when one party makes a proposal or offer to the other party and that other party signifies his assent (i.e., gives his acceptance) thereto. In short, an agreement is the sum total of 'offer' and 'acceptance'.

On analyzing the above definition, the following characteristics of an agreement become evident:

(a) *Plurality of persons:* There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself.

(b) *Consensus-ad-idem*: Both the parties to an agreement must agree about the subject matter of the agreement in the same sense and at the same time.

**2. Legal Obligation:** As stated, an agreement to become a contract must give rise to a legal obligation. Obligation is an undertaking to do or to abstain from doing some definite act. The obligation must be such as is enforceable by law. In other words, it must be a legal obligation and not merely moral, social or religious. To take an example, "Please, come to my house", says Ram to Mohan, "and we shall go out for a walk together". Mohan came to the house of Ram but Ram could not leave the house because of some important engagement. Mohan cannot sue Ram in damages for his not fulfilling the promise, the reason being that there had been no intention between Mohan and Ram to create any legal obligation by the agreement as made between them. In the circumstances, there was in eye of law, no contract between Ram and Mohan.

Similarly, an another kind of obligation which does not constitute a contract is the arrangement made between husband and wife. Such agreements are purely domestic and are not intended to create legal relationship.

The Leading case on this point is **Balfour v. Balfour (1919)**

**Facts of the case are:** Mr. Balfour was employed in Ceylon. Mrs. Balfour owing to ill health, had to stay in England and could not accompany him to Ceylon. On the accusation of leaving she in England for medical treatment Mr. Balfour promised to send her 30 per month while he was in abroad. But Mr. Baulfour failed to pay that amount. So Mrs. Balfour filed a suit against her husband for recovering the said amount. The court held that it was a mere domestic agreement and that the promise made by the husband in this case was not intended to be a legal obligation. Hence the suit filed by Mrs. Barfour was dismissed since there was no contract enforceable in a court of law.

**Decision of the Case**

(a) Agreements which do not create legal relations are not contracts.

(b) Agreements between husband and wife in domestic affairs is not a contract.

It may be noted that the law of contract deals only with such obligations which spring from agreements. Obligations which are not contractual in nature are outside the scope of the law of contract. For example, obligation to maintain wife and children, obligation to comply with the orders of a court and obligation arising from a trust do not fall within the scope of The Contract Act. Sir John Salmond has rightly observed. "The law of contract is not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations and those obligations which arise from an agreement".

### 1.2.2 ESSENTIAL OF A VALID CONTRACT

It must be remembered that all agreements are not contracts. Only that agreement which is enforceable at law is a contract. In other words, the parties to the agreement must have intended that it shall have legal consequences and be legally enforceable. An agreement which is not enforceable at law cannot be a contract. Thus, the term 'agreement' is more wider in scope than contract. All contracts are agreements but all agreements are not contact.

An agreement, to be enforceable by law, must possess the essential elements of a valid contract as contained in Section 10 of the Indian Contract Act. According to Section 10, "All agreements are contract 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". As the details of these essentials form the subject matter of our subsequent lesson, it is proposed to discuss them in brief here.

The essential elements of a valid contract are as follows:

1. **Offer and acceptance:** There must be a 'lawful offer' and a 'lawful acceptance' of the offer, thus resulting in an agreement. The adjective 'lawful' implies that the offer and acceptance must satisfy the requirements of the Contract Act in relation thereto.

2. **Intention to create legal relations:** There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. Agreements of a social or domestic nature do not contemplate legal relations, and as such they do not give rise to a contract. An agreement to take dinner at a friend's house is not an agreement intended to create legal relations and therefore is not a contract. Agreements between husband and wife also lack the intention to create legal relationship and thus do not result in contracts.

**Example:** H promises his wife W to get her a saree if she will sing a song. W sang the song but H did not bring the saree for her. W cannot bring an action in a court to enforce the agreement as it lacked the intention to create legal relations.

In commercial agreements an intention to create legal relations is presumed. Thus, an agreement to buy and sell goods intends to create legal relationship, hence is a contract, provided other requisites of a valid contract are present. But if the parties have expressly declared their resolve that the agreement is not to create legal obligation, even a business agreement does not amount to a contract. The case of Rose & Frank Co. vs Crompton and Brothers Ltd., provides a good illustration on the point.

In the above case, R company entered into an agreement with company, by means of which the former was appointed as the agent of the latter. One clause of the agreement was a follows: "This arrangement is not entered into as a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts". It was held that there was no intention to create legal relations on the part of parties to the agreement and hence there was no contract.

3. **Consensus ad idem:** The minds of both the parties must be *ad idem*. In other words, the two parties must have agreed about the subject matter of the contract at the same time and in the same sense. For instance, if A who owns two cars, one Ford and the other Honda city, offers to sell B one car, A intending it to be the Ford, B accepts the offer thinking that it is the Honda city, there is no consensus and hence no contract.

4. **Competency of Parties:** The parties to the agreement must be competent to contract. If either of the parties to the contract is not competent to contract, the contract is not valid. According to Section 11, following are the persons who are competent to contract:

(a) who have attained the age of majority according to the law to which they are subject;

(b) who are of sound mind;

(c) who are not disqualified from contracting by any law to which they are subject.

5. **Lawful consideration:** The next essential element of a valid contract is the presence of 'consideration'. Consideration has been defined as the price paid by one party for the promise of the other. An agreement is legally enforceable only when each of the parties to it gives something and gets something. The something given or obtained is the price for the promise and is called 'consideration'. Subject to certain exception, gratuitous promises are not enforceable at law.

The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. It may be past, present or future. But only those considerations are valid which are lawful. The consideration is lawful, unless it is forbidden by law; or is of such a nature that, if permitted it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or is immoral; or is opposed to public policy (Sec. 23).

6. **Free Consent:** An agreement must have been made by free consent of the parties. A consent may not be free either on account of mistake in the minds of the parties or on account of the consent being obtained by some unfair means like coercion, fraud, misrepresentation or undue influence. In case of mutual mistakes, the contract would be void, while in case the consent is obtained by unfair means, the contract would be voidable.

7. **Lawful object:** For the formation of a valid contract, it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other reasons mentioned above, the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on prosecution, he cannot recover the rent through a court of law.

8. **Written and Registered:** According to the Indian Contract Act, a contract may be oral or in writing. But in certain special cases, it lays down that the agreement to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be in writing and registered (Sec. 25). Similarly, certain other Acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration and Conciliation Act, 1996; (ii) an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882 before they can be legally enforced.

9. **Not declared to be void:** The agreement must not have been declared to be expressly void. Agreements mentioned in Sections 24 to 30 have been expressly declared to be void.

10. **Certainty:** Section 29 of the Contract Act provides that "agreements, the meaning of which is not certain for capable of being made certain, are void". In order to give rise to a valid contract, the

terms of the agreement must not be vague or uncertain. It must be possible to ascertain the meaning of the agreement, for otherwise, it cannot be enforced.

**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.

11. **Possibility of Performance:** Yet another essential feature of a valid contract is that it must be capable of performance. Section 56 lays down that "an agreement to do an act impossible in itself is void". If the act is impossible in itself, physically or legally, the agreement cannot be enforced at law.

**Example:** A agrees with B to discover treasure by magic. The agreement is not enforceable.

All the elements mentioned above must be present in order to make a valid contract. If any one of them is absent, the agreement does not become a contract.

### 1.2.3 KINDS OF CONTRACTS

**From the point of view of Enforceability**

From the point of view of enforceability, a contract may be valid or voidable or void or unenforceable or illegal.

1. **Valid contract:** An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract as laid down in Section 10 are fulfilled. A offers to sell his house for ₹10,000 to B. B agrees to buy it for this price. It is a valid contract.

2. **Void contract:** A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. It is a contract without any legal effects. A contract may be valid at the time when it is made but it may become void subsequent to its formation Thus, a contract with one who had been an alien friend but later on becomes an alien enemy would be a case of a void contract.

However, a void contract is not necessarily unlawful, it is destitute of legal effects. The law will not enforce such a contract, nor can it be made valid by the parties.

A void contract should be distinguished from void agreement. An agreement not enforceable at law is a void agreement. In the case of a void agreement, no contract comes into existence. An agreement with a minor is void. But in the case of void contract, a contract does come into existence but subsequently ceases to be enforceable by law. An agreement which is void never matures into a contract. An

agreement which becomes illegal in the course of performance is a case of a void contract, while an agreement which is null and void *ab initio* is a case of a void agreement.

3. **Voidable contract:** According to Section 2(i), "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". Thus, a voidable contract is one which is enforceable by law at the option of one of the parties. Until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.

Usually a contract becomes voidable when the consent of one of the parties to the contract is obtained by coercion, undue influence, misrepresentation or fraud. Such a contract is voidable at the option of the aggrieved party i.e., the party whose consent was so caused (Section 19 and 19A). But the aggrieved party must exercise his option of rejecting the contract (i) within a reasonable time, and (ii) before the rights of third parties intervene, otherwise the contract cannot be repudiated.

**Example:** A threatens to shoot B if he does not sell his new Hero motor cycle to A for ₹2,000. B agrees. The contract has been brought about by coercion and is voidable at the option of B.

4. **Unenforceable contract:** It is a contract which is otherwise valid, but cannot be enforced because of some technical defect like absence of a written form or absence of a proper stamp. Such contracts must be sued upon by one or both of the parties. Such contracts cannot be proved in the court. Such contracts will not be enforced by the courts until and unless the defect is rectified.

**Other circumstances under which a contract becomes voidable:** The Indian Contract Act has laid down certain other situations also under which a contract becomes voidable. For example,

(i) When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, then the contract becomes voidable at the option of the party so prevented (Sec. 53).

**Example:** A contracts with B that A shall whitewash B's house for ₹1000. A is ready and willing to execute the work accordingly, but B prevents him from doing so. The contract becomes voidable at the option of A.

(ii) When a party to the contract promises to do a certain thing within a specified time, but fails to do it, then the contract becomes voidable at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract (Sec. 55).

**Example:** X agrees to sell and deliver 10 bags of wheat to Y for ₹2,500 within one week. But X does not supply the wheat within the specified time. The contract becomes voidable at the option of Y.

**Consequences of rescission of voidable contract:** Section 64 lays down the rights and obligations of the parties to a voidable contract after it is rescinded. The Section states that 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 a promisor. If the party rescinding a voidable contract has received any benefit from another party to such contract, he must restore such benefit, so far as may be, to the person from whom it was received. For example, when a contract for the sale of a house is avoided on the ground of undue influence, any money received on account of the price must be refunded. Notice that the Section aims at placing both the parties to a voidable contract, after its rescission, on the same footing as for there had been no contract at all. But it must be remembered that the benefit which is to be restored must have been received under the contract.

5. **Illegal Contract:** A contract which is either prohibited by law or otherwise against the policy of law is an illegal contract. It is void *ab initio*. Thus, a contract to commit dacoity is an illegal contract and cannot be enforced at law. An illegal contract should be distinguished from a void contract. Both are unenforceable at law but there is something more in an illegal contract. Every illegal contract is a void contract but every void contract may not be illegal contract e.g. a wagering agreement is void but not illegal or an agreement with a minor is void but not illegal. Every void contract is not illegal unless its object or consideration is (a) immoral or (b) opposed to public policy etc. A void contract does not affect a collateral contract.

**Difference between voidable contract and void agreement**

1. A void agreement has from the very beginning no legal effects. It is unenforceable at law. A voidable contract is one in which one of the parties may affirm or reject at his option. It is valid and enforceable till it is repudiated or rescinded.

2. The defect in the case of voidable contract is curable and may be condoned. But a void agreement is void *ab initio* and its defects are incurable.

3. In the case of a void agreement, even a third party cannot acquire any right from person claiming under such contract while in the case of voidable contract, a third party can acquire a valid title from a person claiming under such a contract.

4. Since a void agreement is unenforceable at law, there does not arise any question of compensation on account of the non-performance of the agreement. But in case of a voidable contract, a person is entitled to compensation for loss or damages suffered by him on account of the non-performance of the contract.

5. A voidable contract does not affect the collateral transaction. But where the agreement is void on account of illegality of the object, the collateral transaction will also become void.

**Contracts Classified on the basis of performance**

1. **Unilateral Contract:** A unilateral contract is one in which a promise on one side is exchanged for an act on the other wide. In such contracts, one party to the contract has performed his part and an obligation is outstanding against the other party. Thus, where a doctor in a private clinic, examines a patient and gives the medicine, the patient alone remains liable to pay the fees. It is a case of unilateral contract.

2. **Bilateral Contract:** In such a contract, a promise on one side is exchanged for a promise on the other. It is a contract in which there is an obligation on the part of both the parties to do or to refrain from doing a particular act. A promises to paint a picture in return for which B promises to pay ₹500. Here a promises to paint the picture and B promises to pay. Each party is thus both a promisor and a promisee.

3. **Executed contract:** A contract is said to be executed when one party to the contract has performed his share of the obligation and the other party is still to perform his share of the promise. In executed contracts, the contract does not come into existence until one party to it has done all that he can be required to do. Thus, where A advertises a reward of ₹500 to anyone who finds his missing dog, and when B knowing the offer brings the missing dog, A becomes liable to pay ₹500.

4. **Executory contract:** It is a contract where some future act is to be done. It is one which is either wholly unperformed, or there remains something to be one of both the sides. Thus, where an agreement is made to build a house in six months, it is an executory contract.

**Kinds of Contracts from the Point of View of Mode of Creation**

From the point of view of mode of creation, a contract may be anyone of the following types:

1. **Express Contract:** Where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, it is an express contract. For example A tells B on telephone

that he offers to sell his car for ₹1,00,000 and B in reply informs A that he accepts the offer, there is an express contract.

2. **Implied Contract:** Where both the offer and acceptance constituting an agreement enforceable at law are made otherwise than in words i.e., by acts and conduct of the parties, it is an implied contract. Thus, where A, coolie in uniform takes up the luggage of B to be carried out of the railway station without being asked by B, and B allows him to do so, then the law implies that B agrees to pay for the services of A, and there is an implied contract. Similarly, where M, a professional shoe shiner starts polishing the shoes of N without being requested to do so, and N allows M to polish his shoes knowing that M expects to be paid for the service, there comes into existence an implied contract and N is under obligation to pay to M.

3. **Constructive or quasi-Contract:** It is a contract in which there is no intention on either side to make a contract, but the law imposes a contract. In such a contract, rights and obligations arise not by any agreement between the parties but by operations of law. Thus, a finder of lost goods is under an obligation to find out the true owner and return the goods. Similarly, where certain books are delivered to a wrong addressee, the addressee is under an

## 1.3 MEANING OF AN OFFER

An offer is also called a proposal. According to Section 2(a) proposal is defined as person "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 person to such act or abstinence, he is said to make a proposal."

According to Pollock, "The expression of person's willingness to become according to his expressed views, a party to an agreement is called an offer or proposal."

The person who makes the proposal is called the 'offerer' or promisor and the person to whom the offer is made is called the 'offeree' or promises. The offeree expresses his willingness to do or 'not to do' something with a view to obtain acceptance of the other party. Thus it is clear that there may be 'positive' or 'negative' act.

**Examples**

(i) X offers to sell his T.V. to Y for ' 2,000. This is an offer/proposal. X is the offerer or proposer and Y is the offeree or promisee.

(ii) A offers to sell his car to B for ‘ 70,000. A is making an offer to do something i.e., to sell his car. It is a positive act.

### 1.3.1 CHARACTERISTICS OR ESSENTIALS OF AN OFFER OR PROPOSAL

A proposal must have following essentials in order to constitute a valid proposal:

(**i) There must be two parties:** A party makes proposal to other party. Therefore, a proposal requires minimum two parties. No person can make an offer to himself.

**(ii) For doing a work or for not doing a work:** The proposal may be for doing a work or for not doing a work.

(**iii) With a view to obtain acceptance:** The offer must be made with a view to obtain the acceptance of the other party, then only it can be said to be an offer.

### 1.3.2 LEGAL RULES REGARDING OFFER

Following are the essential rules as to offer:

(i) Clear, Complete, Definite and Final: An offer must be clear, complete, definite and final. It should not be vague. All the material terms must be clear. No contract can come into existence if the terms of the offer are vague or loose and indefinite. Both the parties could be clear about the legal consequences arising out of a contract. A vague offer does not convey what it exactly means. Thus, an offer by X to Y to pay the latter a certain the latter marrying X’s daughter is no offer, because the amount to be paid is not certain.

**(ii) Creating Legal Obligation:** An offer must create legal obligations. Due to it offers to domestic nature and social offers are not binding. An offer must create legal relationship between the parties.

**(iii) Offer may be Specific or General:** When offer is made to general public, it in called general offer. It can be accepted by any one satisfying the terms of offer. A specific offer is one which is made to a particular person. It can be accepted by the person to whom it has been made.

**Example:** X offers to sell his car to Y for ‘ 1,00,000. This is a specific offer made to Y. It is Y alone who can accept this offer.

A general offer is made to the world at large and can be accepted by any person.

**Example:** X advertised in a newspaper that he would give ‘ 500 to anyone who finds and returns his lost cow.

**(iv) Communication of Special Condition of an Offer:** No body can make an offer to himself. It must always be communicated to the offeree. If there is no communication there is no acceptance resulting in the agreement or contract.

No body can accept an offer about which he is not aware. For example, B finds A's lost cow but has not seen the advertisement offering the reward and has proceeded to return the cow to A, B cannot claim the reward as he is unaware about it.

**(v) Offer must be in the form of request, not an order:** Offer must be in the form of request and not as an order.

**Example:** X offers Y to sell his cow for ' 3,000 and says if reply is not received within 10 days, it shall be assumed that you are not interested. It is not a legal offer.

**(vi) Proposal must be made with a view to obtain assent:** The offer must be made with an intension to obtain the consent of the other party to do or to abstain from doing the act.

**Example:** X says Y, "I may sell my car if I can get ₹80,000 for it". It is not an offer.

**(vii) Proposal may be Express or Implied:** An offer may be express or implied from the conduct of the parties or circumstances. An express offer is made by words spoken or written. An implied offer is considered to be implied from the conduct of the parties or from the circumstances.

**Example of express offer**

(i) X says to Y, "will you buy my cow ₹5,000? It is an express offer.

(ii) X by a letter asks Y to purchase his horse for ' 70,000. It is a written offer.

**Examples of implied offer**

(i) Public transport, like, Railways, Haryana Roadways in Haryana

(ii) Public Telephones or Weighing Machines in public places like Railway Stations. These all offer their services for a certain amount, which is implied.

**(viii) Invitation to make Proposal is not a Proposal:** A proposal must be distinguished from an invitation to proposal. In the case of an "Invitation to proposal" the aim is merely to circulate information to negotiate business with anybody. Such invitations are not proposals and do not become promises.

The display of goods in a shop is an invitation to proposal. Catalogues held for sale at the price quoted are not proposals. It is an attempt to induce and not a proposal in itself. The display of goods on the shelves of a self service shop is an invitation to offer. Advertisement for sale or auction of goods, notice for tender, railway time table are only an invitation to proposal and not the proposals.

**(ix) Offer should not impose an unnecessary obligation to communicate non-acceptance:** An offer cannot say that if acceptance is not communicated by next Monday the offer would be considered as accepted.

**(x) Offer must be distinguished from a mere declaration of intention:** A declaration of intention to make an offer is regarded as an invitation to offer.

**Example:** An advertisement for sale of car in a newspaper is an offer for sale.

### 1.3.3 MEANING OF ACCEPTANCE

A contract is created on the acceptance of a proposal. Acceptance indicates the willing ness of the party to whom the offer has been made to agree to the terms of offer. According to Section 2 (b) of the Indian Contract Act, 1872, "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted."

On the basis of above definition, it can be concluded that acceptance is the act of providing consent to the offer. An offer when accepted becomes a promise and creates an agreement. According to Section 2 (e), "The person making the proposal is called the promisor and the person accepting the proposal is called the promise". An acceptance must be communicated to the offeror in order to complete the acceptance. The acceptor should do something to signify his intention to accept. Fall of the hammer in the case of an auction sale is amounted to acceptance.

**Effect of Acceptance:** When an offeree agrees to an offer, it is said to be his acceptance. Acceptance is the readiness of offeree to abide by the terms of offer. When an offer is accepted it becomes an agreement and a contract. Thus, an acceptance forms an agreement and a contract. When an offer is accepted, it creates legal rights and obligations on both the parties.

**Types of Acceptance or How it is Made:** Following are the types of acceptance:

**1. Express Acceptance:** The assent may be express or implied. It is express when it is communicated in writing or by words of mouth.

**2. Implied Acceptance:** When offer in accepted by performance of some required act or by conduct, it is known as implied acceptance. Implied acceptance is also called as acceptance by conduct or mental acceptance. It is also a valid acceptance and forms a valid agreement.

### 1.3.4 RELATIONSHIP BETWEEN OFFER AND ACCEPTANCE

In the view of Sir William Amsan, an acceptance is to offer what a lighted match is to train of gun powder. He exemplified the relationship between an offer and acceptance with a train of gun powder and a lighted match. Sir William Amsan viewed that a train of gun powder cannot do explosion unless a lighted match is brought in contract with a train of gun power, the gun powder explodes and once it has exploded, it cannot be undone. However, the man who is leading the train may remove the gun powder before match is brought to its contract.

An offer has not meaning in itself unless it is accepted. Acceptance makes an offer meaningful and converts it into a promise or an agreement. Once the offer is accepted, it cannot be withdrawn. An offeror can revoke his offer before its acceptance.

**Who any Accept?** Who can accept an offer, it is an important question. In this connection, nature of proposal should be considered.

**1. In case of General Offer:** When an offer in made to the world at large, it is known as general or ordinary offer. It can be accepted by anyone by complying with the terms of the offer. For example, Ram loses his cow and announces a reward of ‘ 1000 to anyone who will bring his cow to him. This offer can be accepted by anybody. One who will find the cow and will give it to Ram, he will get the reward as he accepted the offer.

**2. In case of Specific Offer:** An offer which can be accepted only by the person to whom the offer is made, it is called as specific offer. This can be accepted only by the person to whom it is made.

### 1.3.5 ESSENTIALS OF A VALID ACCEPTANCE

There are some rules which make the acceptance effective so as to give rise to a valid contract. Section 6 to 7 provide the following essential elements of a valid acceptance:

**1. Acceptance must be absolute and unqualified [Section (7) (1)]:** To convert an offer into promise, an acceptance must be absolute and unqualified. Therefore, this is the first rule regarding the valid acceptance that “acceptance must be absolute and unqualified.” It must be according to the exact terms of the offer. An acceptance with a variation or alternation however slight, it may be not an acceptance

and it will make the acceptance of this kind invalid. A qualified and conditional acceptance amounts to a counter offer and rejection of the original offer.

**Example:** A offers to B to sell his scooter for ‘ 10,000. In response B says yes. It is a legal acceptance.

But if in the above case B replies “I can pay ¹ 8,000 for it.” It is counter offer, not acceptance.

**2. Acceptance must be in accordance to prescribed Manner [Section 7(2)]:** Where the offeror has prescribed a particular mode of acceptance, then the acceptor should follow the mode. If no mode is prescribed by the proposer, then the acceptance must be provided according to some usual and reasonable mode.

**Example:** X sends an offer to Y through post and asks for an acceptance over telephone. Y should accept the offer over telephone. However, if Y accepts the offer by a letter, then X may insist that the acceptance should be in the prescribed mode. But if X does not insist then X is bound by the acceptance.

**3. Acceptance must be within the prescribed time and in the absence of a prescribed time, it must be within reasonable time:** A proposal must be accepted within the prescribed time or within a reasonable time, if no time is fixed. What is reasonable time will depend upon facts and circumstances of each and every case.

**Example:** X offers his car for ‘ 70,000 to Y upto Monday next by 5 p.m. Y does not accept the offer upto Monday next by 6 p.m. There is no acceptance.

**4. Acceptance must be made before the offer expires or it revoked:** The offer should be accepted before it expires or is revoked or withdrawn by the party making the offer. If an offer has lapsed, it lapses forever unless it has been revived again.

**Example:** X made an offer to Y on Sunday which was to be accepted within the next five days. Y accepted the offer on sixth day. There is not a valid acceptance as the offer had lapsed.

**5. Proposal must be accepted to whom it is made:** Acceptance can be provided by the person to whom the proposal is made. However, in the case of a general offer, acceptance can be given by any member of the public.

**Example:** X offers Y to sell his cow. It cannot be accepted by any one except Y because it is specific offer.

**6. Acceptor must be aware of the proposal:** An acceptor must be aware of proposal. Unless an offerer has been made aware of or communicated about the proposal, it cannot be accepted.

In one case, a person had traced the cow without knowing of the reward. Later on he could not claim the reward as he was not aware of the reward. Therefore, acceptance without an offer is not a valid acceptance.

**7. Communication of acceptance:** Acceptance must be communicated like an offer. Here mental acceptance not evidenced by words or conduct is, in the eyes of law, no acceptance. Making one's mind cannot be enough but one should make up one's mind and inform the offerer that he has done so.

**Example:** P was appointed as a principal of a school. One of the members of the Governing Body privately informed him that he had been appointed as a Principal. But no official communication was sent. Later, the Governing Body did not appoint him as the Principal. P filed a suit against the Governing Body, the court held that P could not do so as there was no communication of acceptance.

**8. Silence cannot be a mode of acceptance:** Silence cannot amount to acceptance.

**Example:** X writes to Y, "I offer you my T.V. for ₹5,000. If I do not hear from you by Wednesday next, I shall presume that you have accepted my offer." Even if Y does not reply, there cannot be a binding contract as law does not impose unnecessary burden on the acceptor to communicate his non-acceptance.

Acceptance of an offer may sometimes be inferred from silence. Although as a rule silence is not an acceptance, but in the following cases silence may be indicative of assent:

(i) Where the offeree having reasonable opportunity to reject the offered goods takes the benefit of them.

**Example:** K landlord served a noticed on the tenant demanding enhancement of rent of house. The tenant did not protest and continued to occupy the premises. The conduct of the tenant amounts to acceptance of the proposal to pay the rent at a higher rate.

(ii) Where because of previous dealings, the offeree has given the offeror reason to understand that the silence was intended by the offeree as a manifestation of assent.

**9. Acceptance must be made with an intention to fulfil the terms:** Acceptance of offer must be made in such circumstances as to show an intention on the part of the acceptor to fulfil the terms of the promise.

**10. Acceptance subject to formal contract:** Acceptance subject to formal contract is valid only when the formal contract has been signed by both the parties.

**11. An agreement to enter into an agreement in future is not contract:** An agreement to enter into an agreement in future does not create obligations.

In the case of Lofus Vs. Reberts (1902) 18 T.L.R. 532 an actress was employed to give some performances. The agreement provided that if the play was performed in London, she would be employed at a salary to be mutually agreed upon. The court held that there was no contract.

**12. Acceptance by performing condition or receiving consideration:** An acceptance become complete when conditions are performed or consideration is received.

**13. Acceptor should be ready and competent to fulfil the contract:** Acceptance should be provided in such circumstances which show that acceptor is ready and competent to fulfil the promise.

**14. Proposal through Agent:** If an offeror present his offer through his agent, acceptor can provide his acceptance to the agent.

### 1.3.6 COMMUNICATION OF OFFER AND ACCEPTANCE

According to Section 3 of Indian Contract Act, "The communication of proposals, the acceptance of proposals and the revocation of proposals and acceptances, respectively, are deemed to be made by any act or omission of the party proposing accepting or revoking by which he intends to communicate such proposal, acceptance or revocation or which has the effect of communicating it". Thus, there are two modes of communication: Communication by an act, and communication by omission of an act. Communication by an act includes words, in writing as well as oral and a conduct of communicator, communication by omission of an act implies such conduct or abstinence which conveys his willingness.

Communication of all offers (except general offer) and acceptances in essential. If the parties are physically present and negotiate, an agreement comes into existence the moment, the offereee gives his absolute and unqualified acceptance. If the parties are at a distance and the offer and acceptance are sent and received through post, rules contained in Sections 4 and 5 will apply.

**Communication of Offer [Section 4]:** The communication of a proposal is complete upon it when to the knowledge of the person to whom it is made.

Section 4 indicates that actual communication of the offer is not essential. It is sufficient if the offer comes to the knowledge of the offeror.

It an offer is sent by post, its communication will be complete when the letter making the offer reaches the offeree. The offer is completed at the place where it was received.

**Example:** X and Y are talking face to face. X offers to sell his horse to Y for a certain price. Communication of offer is complete as soon as Y listens to it.

**Communication of Acceptance [Section 4]:** The completion of communication of acceptance has following two aspects:

**(a) As against the proposer:** 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 the acceptor.

**(b) As against Acceptor:** The communication of acceptance is complete against the acceptor when it comes to the knowledge of the proposer.

**Example:** A proposes by a letter to sell his scooter to B at a certain price. B accept A's proposal by letter sent through post. The communication of acceptance is complete as agreement when the letter is posted in the letter box duly stamped and addressed, as against B and when the letter is received by A.

**Communication of Acceptance based on Different Court Decisions:** Following things is important regarding the communication of acceptance based on different decisions:

**1. Acceptance or Contract over Telephone or Telex:** When offer and acceptance are made over teleprinter or telephone, the question arises as to

when in such cases the contract is concluded. In the case of Entores Ltd. Vs. Miles for East Corporation (1955) 2 All E.R. 493, the court held that communication made by means of telephones or telex are virtually instantaneous and stand on a different footing. The contract will be complete when the acceptance is received by the offeror and the contract is made at the place where the acceptance is received.

Contracts over telephone or teleprinter have the same effect as oral agreements. However, the offeror may not properly hear the acceptance on telephone because of some defect in communication.

In case of Kahhiyalal Vs. Dineshwarehandre (1955) 1, All E.R. 493, it was held that if the words of acceptance are inaudible and are not heard by the offeror, then the acceptance is incomplete and no contract would be formed until the acceptor repeats his acceptance so that offeror can hear and understand it.

**Example:** X makes a proposal from the third floor of the house to Y who is standing on the roadside. Y replies back accepting X's offer but because of the noise Y's acceptance is not clearly heard by X. There is no contract at the moment. However, if Y wants to make a contract he should repeat his acceptance so that X can hear and understand. The contract will be complete only when X has clearly heard and understood Y's reply.

**2. Acceptance by post:** When acceptance is sent by post, it is complete as against the offeror, when the letter is dropped in the letter box. In this case it is assumed the post office is like an agent of the proposer.

**3. Delay in post office:** If acceptor has posted his letter of acceptance but was delayed in post office, the posting of the letter shall be treated as an acceptance.

**4. Wrong Address on the letter of acceptance:** If acceptor has furnished wrong address, he will be bound.

**5. Communication of acceptance in the case of an agent:** If an offeror presents his offer through his agent and acceptor provides his acceptance to the agent, this acceptance shall be treated as communication to the offeror.

**6. Place of Contract:** Place of contract is very important because jurisdiction of the court is decided on the base of it. Place of contract shall be determined as under:

(i) If proposal and acceptance is done on a specific place.

(ii) If acceptance is given over telephone or telex at place of proposer.

(iii) If acceptance is given through post-place of acceptor.

**Difference between English Law and Indian Law:** The English law on communication of offer, acceptance and revocation by post differs in some respects. In England, post offer is treated as agent of the party making an offer to take the offer to the offeree and to bring back the acceptance. Therefore,

acceptance cannot be revoked in the English Law. But in India post office is treated as the agent of both parties i.e. offeror and offeree.

**Communication of revocation of proposal and Acceptance [Section 4]**

**(a) Against the person who makes it:** The communication of a revocation of an offer or an acceptance is complete as against the person who made it, when it is put into a course of transmission to the person to whom it is made, and when it comes to his knowledge.

**Examples**

(i) V offer by letter, to sell a house to P at a certain price. P accepts the proposal by a letter sent by post.

(ii) V revokes his offer by telegram. The revocation is complete as against V, when the telegram is dispatched, and as against V, when it reaches him.

**Revocation of Proposal and Acceptance [Section 5 and 6]**

**Revocation of proposal:** According to Section 5 of the Act, "A proposal may be revoked at any time before the communication of its acceptance is complete as against proposal, but not afterwards.

An offer can be revoked at any time before acceptance. Letter revoking the proposal must be received before the letter of acceptance in posted.

In the case of N. Sesharatanam V. Sub-Collector, (1992) SC 132, a landlord named N' had offered land for acquisition if a certain lumpsum amount was paid. Before the acquisition officer could accept it, he withdrew his offer, in this case revocation was held valid.

**Revocation of offer at Auction sale:** A bid is an offer and an acceptance of a bigger bid indicates rejection of the preceding lower bid. A bid is not binding on either side till it is consented to. Any bid may be withdrawn at any time before the fall of the hammer.

**Revocation of standing offer:** Standing offer or tender is deemed as an invitation to offer. Tender is treated as a contract only when the other party places as actual order for the supply of goods. A continuous or standing offer may be revoked as to future orders but an order already placed cannot be revoked.

**1.3.7 REVOCATION OF OFFER AND ACCEPTANCE**

**(a) Revocation of an offer**

An offer may come to an end by revocation or rejection or lapse. According to Section 6, revocation of proposal may be made in the following modes:

**1. By Notice of Revocation: [Section 6(1)]:** A proposal may be revoked by the communication notice of revocation before acceptance is complete as against the proposer. An offer made in writing may be revoked by words or mouth. A notice of revocation must be communication to the offeree. It will be effective only when that the offeree has actual knowledge of the revocation.

**Case Study:** The case of Joravarmuli Champa Lal v. Jeygo Paldus Ghanshamdas AIE 1992 Mad 486 is important in this regard.

At an auction sale, J made the highest bid for G's goods. He withdrew the bid before the fall of the hammer. G knocked down the goods in favour of J. G sued J for the price of goods. In this case it was held that J's bid was no more than offer and he was entitled to withdraw the same before it was accepted.

**2. By the Lapse of Specified time: [Section 6(2)]:** Section 6(2) of the Act says that if time is prescribed for the acceptance of the proposal, it will lapse by not being accepted within the time prescribed or if no time is so prescribed by the lapse or reasonable time. What is a reasonable time, it will depend upon the facts and circumstances of each case.

**Case Study:** In the case of Head v. Diggen (1828) 3 M & R 97, D offered to sell goods to H on Wednesday and agreed to give him three days time to accept. H accepted the offer on Sunday, but by that time D had sold the goods. In this case, it was held that the offer had lapsed.

**3. By making a counter offer:** An offer comes to an end when the offeree makes a counter offer. Where an offer is accepted with some modification or with some condition not forming part of the offer, such acceptance amounts to a counter offer. An offer once rejected cannot be reconsidered.

**4. By the non-fulfilment of a condition precedent to acceptance:** An acceptance must be absolute, i.e. all the conditions of the offer must be fulfilled.

**Example:** X applied for 500 shares of a company on the condition that he should be appointed as a manager of the company. The company allotted him shares but did not appoint him as a manager. The offer in this case lapsed as the company did not fulfil the condition precedent to acceptance.

**5. By Death or Insanity of the propose:** An offer is revoked by the death or insanity of the offerer if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance. Under

English law, death of the proposer revokes an offer even if acceptance is made in ignorance of the death.

**Example:** A makes an offer to B. B comes to the knowledge that A has died, in this case proposal is revoked.

**6. Revocation by not accepting the proposal in the made prescribed:** If a proposal is not accepted according to the mode prescribed, the offeror can reject such acceptance. Such acceptance must be rejected by giving notice to the offeree within a reasonable time. However, if offeror does not raise any objection he is deemed to have accepted the proposal.

**7. By the non-acceptance of the offer according to the prescribed or usual mode:** The offer will also be treated as revoked if it has not been accepted according to the mode prescribed or if mode is not prescribed according to the usual mode.

**8. By destruction of subject matter or by subsequent illegality:** A proposal lapses if subject matter of it gets destroyed or becomes illegal after it is made and before it is accepted.

**Example:** A offer B to sell his cow for ‘ 5,000. Cow dies before making an acceptance of proposal. It shall be treated as revocation of proposal.

**(b) Revocation of Acceptance (Section 5)**

According to Section 5 of the Act an acceptance can be revoked at any time before the communication of acceptance is complete as against the acceptor and not afterwards.

**Example:** X proposes, by a letter sent by post, to sell his car to Y. Y accepts the proposal by a letter sent by post. After it reaches, the same day Y revokes his acceptance through telegram.

X receives telegram before opening the letter. But the letter reaches before telegram due to this reason, acceptance may not be revoked.

## 1.4 CHECK YOUR PROGRESS

Answer the following questions on the basis of your knowledge about this chapter:

1. The Indian Contract Act 1872 was enacted on _____.
2. When there is an offer from one party and acceptance by another party, it is called _____.
3. The party who gives offer to other party, is known as _____ and the party who accepts

that offer is known as _____.

4. When the agreement between two parties creates a legal relationship, it is called as _____.
5. Reciprocal contract can be named as _____.

## 1.5 SUMMARY

A contract is an agreement enforceable by law. 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. 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', 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'.

A contract is an agreement enforceable by law. 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 or offer. Offer may be expressly made or may even be implied in conduct of the offeror, but it must be capable of creating legal relations and must intend to create legal relations. The terms of offer must be certain or at least be capable of being 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.

## 1.6 KEYWORDS

**Contract**: A contract is an agreement creating and defining obligations between the parties.

**Agreement**: An agreement is the sum total of offer and acceptance.

**Valid Contract**: A valid contract is one, which satisfied all the requirements prescribed by the law for the validity of a contract.

**Void Contract**: It is one which was legal and enforceable which it was entered into but has subsequently become void because of certain reasons.

**Voidable Contract**: A voidable contract is a contract which can be avoided or set aside at the option of one of the parties to the contract.

**Implied Contract**: Where the proposal or acceptance is made otherwise than in words, it is an implied contract.

**Offer:** A communication by one person to another of his willingness to do or abstain from doing with the objective of getting the acceptance of the other.

**Acceptance:** The consent of the parties to whom the offer has been made.

**Revocation:** Taking back of an offer or acceptance.

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

## 1.7 SELF ASSESSMENT TEST

1. "An agreement enforceable by law is a contract". Discuss the definition and bring out clearly the essentials of a valid contract.
2. "All contracts are agreements, but all agreements are not contracts". Discuss the statement explaining the essential elements of a valid contract.
3. What do you understand by the terms 'void' and 'voidable' contracts? Discuss the rights and obligations of the parties to a void contract and to a voidable contract after its rescission.
4. Distinguish between:
   (a) Void and Voidable contracts
   (b) Void agreements and Void contracts
   (c) Void and Illegal agreements
5. X invited Y and his family to dinner on a certain night. Y accepted X's invitation. On the date fixed Y drove with his family from Sector 13 to Industrial Area and found his house locked. They waited upto 9.30 p.m. but the host did not turn up. They left the place and had their meals in Piccadilly in Sector 17. The cost of meal came to Rs. 5000. Can Y recover the amount?
6. Define the term ‘offer’. What are the rules regarding a valid offer?
7. Define the term ‘acceptance’. Discuss legal formalities relating to a valid acceptance.

8. Give the meaning and different types of acceptance. Also discuss the relationship of offer and acceptance.
9. "A contract is formed when the acceptor has done something to signify his intention to accept, not when he has made up his mind to do so." Discuss the statement.
10. Discuss the meaning of offer and acceptance. When is communication of an offer and acceptance complete? How and when can a proposal be revoked?
11. How and on what grounds does an offer stand revoked? Is there any time limit after which a revocation of an offer cannot be made?

## 1.8 ANSWER TO CHECK YOUR PROGRESS

1. 25th April 1872
2. Agreement
3. Offerer and Accepter
4. Contract
5. Bilateral Contract

## 1.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 2 | |

# FREE CONSENT, CONSIDERATION AND CAPACITY OF PARTIES

## STRUCTURE



## 2.0 LEARNING OBJECTIVES

A careful study of this lesson will enable you to:

a) Understand the meaning of consent and identify the cases where the consent is not said to be

free;

b) Explain the meaning of consideration and identify the cases where consideration of an agreement is unlawful; and

c) Identify the persons who are not competent to enter into contracts.

## 2.1 INTRODUCTION

According to Section 13, 'Two or more persons are said to have consented when they agree upon the same upon the same thing in the same sense'. A contract which is regular in all other respects may still fail because there is no real consent to it by one or both of the parties. There is no consensus ad idem or meeting of the minds. According to Section 10 of Indian Contract Act, 'Consideration' is one of the essential elements of a valid contract. The fact of its existence serves to distinguish those promises by which the promisor intends to be legally bound from those which are not seriously meant.

An essential element of a valid contract according to Section 10, is that the contracting parties must be 'competent to contract'. Section 11 lays down that "Every person is competent to contract who is of the agr of majority according to the law to ehich he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject". Thus a person is competent to contract under:

(a) if he is not a minor, according to the law to which he is subject,

(b) if he is not of unsound mind, and

(c) if he is not disqualified from contracting by any law to which he is subject.

## 2.2 FREE CONSENT

The term 'free consent' may be defined as the consent which is obtained by the free will of the parties, and neither party was forced or induced to give his consent. If the consent is there but it is not free or real, then the contract will be voidable at the option of the party whose consent is not free. The term 'free consent' is defined in Section 14 of the Indian Contract Act, which reads as under:

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.

Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake."

### 2.2.1 ELEMENTS WHICH AFFECT THE CONSENT OF THE PARTIES

According to Section 14, the following elements affect the consent of the parties:

1. Coercion

2. Undue influence

3. Fraud

4. Misrepresentation

5. Mistake

The consent obtained by any of the above elements is not free consent. It may be noted that in the first four elements mention above (i.e., coercion, undue influence, fraud and misrepresentation), the consent is there but it is not free. But in the last element (i.e., mistake), there is no consent at all because there is no identity of minds. The effect of 'no free consent' and 'no consent at all' on the contract may be stated as under:

a) When the consent is not free, then the contract is voidable at the option of the party whose consent is not free. A voidable contract is enforceable at the option of the party whose consent was not free.

b) When there is no consent, then the contract is void ab initio (i.e., from the very beginning). In fact, no contract will come into existence in such a case. A void contract being void ab initio, is not enforceable at the option of either party.

Thus, there is lot of difference between 'no free consent' and 'no consent at all'. In the following cases, there is complete absence of consent (a) when there is error as to the nature of the contract itself, (b) when there is error as to the identity of the parties, (c) when there is error as to the subject-matter of contract.

**1. COERCION:**

What is coercion in India is 'duress' under English law, but coercion covers much wider field. Duress is limited to actual violence or threats of violence to the person, or imprisonment or the threat of criminal proceeding to the person coerced or those near or dear to him, such as his wife, children or parents. Threats to property are not duress. Coercion, on the other hand, may be against person or property, and the person coerced may be any person, not necessarily the party to the contract or his wife, parent or child.

In Multhiah Chettiar v. Karuppan Chetti (1927 50 Mad. 786), an agent refused to hand over the account books, bonds etc., of the business to his successor agent unless the principal gave him a release of all liabilities during the term of his agency. The principal did so but later succeeded in the suit to declare the release deed as vitiated by coercion.

It should, however, be noted that mere threat by one person to another to prosecute him does not amount to coercion. There must be a contract made under the threat, and that contract should be one sought to be avoided because of coercion (Ramchandra v. Bank of Kohlapur, 1952 Bom. 715). It may be noted that coercion may proceed from any person, and may be directed against any person, even a stranger, and also against goods e.g., by unlawful detention of goods.

**2. UNDUE INFLUENCE:**

Section 16 of our Contract Act states that a contract is induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

It further states that a person is deemed to be in a position to dominate the will of another (i) where he holds a real or apparent authority over the other, or (ii) where he stands in a fiduciary relation to the other; or (iii) he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress.

It is clear from this definition that contracts which may be rescinded for undue influence fall into two categories. *Firstly*, those where is no special relationship between the parties. *Secondly*, those where a special relationship exists.

Undue influence is a kind of "mental coercion", it destroys the free agency of one and constrains him to do which is against his will, and which he would not have done if left to his own judgement and volition, so that his act becomes the act of the one exercising the influence, rather than his own act.

*Where no relationship between parties exists.* Where no special relationship exists between the contracting parties, the plaintiff (i.e. the party influenced) must prove two things: (i) that the other party was in a position to dominate his will, (ii) that the contract was substantially unfair giving the dominant party unfair advantage.

*Where special relationship exists.* In the second class of cases, undue influence is presumed either because of an exceptional authority one has over the other or he stands in a fiduciary position to the other and owes a duty to give that other a disinterested advice. The possibility that he may put his own interest uppermost is so obvious that he comes under a duty to prove that he has not abused the position.

Whether fiduciary or confidential relationship exists or not, the question is always the same - was undue influence used to procure the contract or gift? But the burden of proof is different. If B seeks to avoid a contract with A, then in the absence of any confidential relationship, the entire onus is on B to prove undue influence, but if he shows the existence of such relationship, the onus is on A to prove that undue influence was not used. A must rebut the presumption of undue influence.

To discharge the onus that he did not employ undue influence, the party must show that the other party to whom he owed the duty in fact acted voluntarily, in the sense that he was free to make an independent and informed estimate of the expediency of the contract or other transaction. The other party received independent advice before he completed the contract.

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

**Purda Nishin Woman**

The law throws around a Purda Nishin woman a special cloak of protection, and demands that person who deals with her must show affirmatively and conclusively that the deed was not only executed by, but was explained to, and was really understood by the lady. It must also be proved that no coercion or undue influence was exercised on her, either by the party to the transaction or by a third party, and that she had executed the document of her free will. The reason is that the ordinary presumption that a person understands the document to which he has affixed his name does not apply in the case of Purda Nishin Woman. But a lady, whether Hindu or Muslim, who is claiming to be Purda Nishin must prove complete seclusion; and some degree of seclusion is not sufficient to entitle her to get special protection.

**Difference between Coercion and Undue Influence**

Following are the differences between coercion and undue influence:

(i) *Moral and Physical Force.* In undue influence, the influence is due to moral pressure whereas in coercion it is due to physical force. Undue influence is sometimes marked as 'moral coercion' which is distinct from 'physical coercion' or coercion in true sense.

(ii) *Relationship between Parties.* In the case of undue influence, there must be certain relationship between the parties which places one party in a position to dominate the will of the other i.e. undue influence is between the parties to the transaction, the promise procures the promisor's constant by undue influence. Coercion need not proceed from the promisee nor need it be directly against the promisor, that is, existence of certain relationship is not necessary in case of coercion.

(iii) *Way of obtaining consent.* In undue influence, the consent is obtained by dominating the will of the giver and the consent is freely given under the belief that he is not to be put to any loss by giving such consent. In case of coercion, the consent is obtained by committing or threatening to commit an offence, and the person is forced to give his consent.

(iv) *Legal consequences.* Where the consent of the promisor is procured by coercion, the contract is voidable at his option but where the promisor's consent is procured by undue influence, the contract is either voidable or court may enforce it in a modified form.

(v) *Character of the consent.* Briefly, undue in influence is of a moral character and is more subtle and intangible; coercion is chiefly of a physical character and is of an avowedly violent character.

**3. FRAUD:**

1. the suggestion as to 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; and

5. any such act or omission as the law specially declares to be fraudulent.

But mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak or unless his silence is, in itself, equivalent to speech.

In the words of Lord Herschel, Fraud is an untrue statement made knowingly, or without belief in its truth, or recklessly, careless whether it be true or false with intent to deceive.

In simple terms, fraud is false statement or wilful concealment of a material fact with intent to deceive another party. The party deceived or defrauded can avoid the contract and also claim damages.

**Characteristics of Fraud.** The essential characteristic of fraud are following:

(a) There must be representation or assertion and it must be false, or there must be active or wilful concealment of a material fact. If there is an actual false statement, the case is simple. A, intending to deceive B, falsely represent that the television set he is offering for sale is German made, when it is in fact a locally made set. If concealment is alleged mere non-disclosure of material facts, however morally censurable, does not render a contract voidable. Mere silence is not misrepresentation, unless silence is in itself equivalent to speech, or where it is the duty of person keeping silence to speak; as where a fiduciary relation exists between the contracting parties or the contract requires utmost good faith. Disclosure is also essential where part-truth amounts to falsehood. If part only of facts is disclosed, and the undisclosed part so modifies the part disclosed as to render it, by itself, substantially untrue, there is a duty to disclose the full facts. Non-disclosure will amount to fraud.

(b) The representation must be of fact. The assertion must be of fact and not a mere expression of opinion, or hearsay, or puffery of flourishing description.

Thus, if A, who is about to sell a horse to B, says that the horse is a beauty and is worth ₹10,000 that is A's opinion and B is at liberty to reject it. But if in fact he paid only ₹5000 for it, then A has misstated a fact, and if B has been induced by that statement to buy the horse, he may rescind the contract on the ground of fraud.

(c) There must be knowledge of the falsehood of the representation or a reckless disregard as to its being true or false. In a reckless misstatement, the person is not sure as to the fact in his own mind; he feels a doubt, yet he represents to the other party, as if he is certain about the truth of the fact represented by him. Such misrepresentation is fraud. Also a promise made without an intention of

performing it is fraud. To buy goods with the preconceived idea of getting goods without paying for them is fraud.

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(e) The representation must be made with the object of inducing the party deceived to act upon it. The assertion must be made with the intention of inducing one to act on the assertion who does so act. This means that there is an inducement in fact and the assertion is one which necessarily influenced and induced the party to act. The party misled must not have exercised his own skill of judgement.

(f) The representation must in fact deceive. The representation must be acted upon as it was intended to be acted upon so that the party misled is actually deceived. A deceit which does not deceive is not fraud.

(g) The plaintiff must be thereby damnified. It is a common saying that "there is no fraud without damage", for an action being one of deceit, and unless the plaintiff and sustained damage or injury, no action will lie. The damage may consist of actual and temporal injury, that is, some losses of money or money's worth, or some tangible detriment capable of assessment.

**4. MISREPRESENTATION:**

An untrue statement or misrepresentation may be either (i) Innocent, or (ii) Wilful or Deliberate with intention to deceive and is called Fraud.

**Innocent Misrepresentation:** Innocent misrepresentation is a misstatement made innocently and with an honest belief as to its truth. It is sometimes called "Invalidating Misrepresentation". The effect of innocent misrepresentation of fact is that the party misled by it may repudiated the contract and (i) raise the misrepresentation as defence to any action the other party may bring against him, or (ii) sue for rescission of the contract and restitution of anything he has transferred to the misrepresenter.

**Damages of Misrepresentation:** Generally, the injured party cannot get damages for innocent misrepresentation. But in the following exceptional cases he can get damages:

(a) From promoters or directors who made such misrepresentation in a prospectus under Company Law;

(b) Against an agent who commits a breach of warranty of authority;

(c) From a person who (at the Court's discretion) is stopped from denying a statement he has made where (i) he made a positive statement intending that it should be relied on, and (ii) the innocent party did rely on it, and thereby suffered damage.

**What to be proved?:** It should be remembered that in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that (i) there was a representation or assertion, (ii) such representation induced the party aggrieved to enter into contract, (iii) the assertion was of fact (and not of law, as ignorance of law is no excuse); (iv) the statement was not a mere opinion, or hearsay, or commendation (i.e. reasonable praise) or tradesman's "puff", (v) the statement, which has become or turned out to be untrue, was made with an honest belief in its truth.

**Effect:** In an innocent misrepresentation, the party aggrieved may avoid the agreement, even though the statement was true at the time it was made but became untrue later by reason of change of circumstances.

**Difference between Misrepresentation and Fraud**

The main difference between fraud and misrepresentation is that in fraud the person making misrepresentation does believe it to be true and in misrepresentation he does not believe it to be true. In both the cases, it is a misstatement of facts which mislead the promisor. Misrepresentation (often called innocent misrepresentation) differs form fraud (often called fraud or wilful misrepresentation) in following respects:

(i) *Intention of the Party.* Fraud generally implies that there is an intention to deceive whereas misrepresentation may be innocent. Thus both in fraud and misrepresentation, there is statement which is false, but the distinction between them mainly turns round the intention of the party. A false statement without any intention to deceive would be misrepresentation but a false statement deliberately or recklessly made to deceive another is a case of fraud.

(ii) *Additional action for damages.* Fraud gives right to an action for deceit, in addition to its effects of avoidance of the contract, and the party aggrieved can recover damages if he has sustained any in consequence of fraud practised upon him by the other party. Misrepresentation merely goes to avoid the

contract.

(iii) *Discovery of truth by ordinary diligence.* If consent to an agreement is caused by passive fraud (fraudulent silence) or innocent misrepresentation, the contract is not voidable if the representee had the means of discovering truth with ordinary diligence. But where consent to an agreement is caused by active fraud, the contract is truly voidable even though the party defrauded had the means of discovering with ordinary diligence.

## 5. MISTAKE:

The general common law rule is that mistake made by one or both parties in making a contract has no effect on the validity of contract. For example, an error of judgement is not an operative mistake and does not affect the validity of the contract. If A buys an article thinking it is worth ₹10, when in fact it is worth only ₹5, the contract is good and A must bear the loss if there has been no misrepresentation by the seller.

### Mistake of fact

Section 20 of the Contract Act provides: "When both the parties to an agreement are under a mistake as to a matter of fact essential to agreement, the agreement is void". Thus, to be operative (so as to render the contract void) the mistake must be (i) on the part of both the parties, (ii) of fact and not of law or opinion, and (iii) so fundamental as to negate mistake of fact, the contract would be void. Such a mistake prevents the formation of any contract at all, and the court will declare it void. But as Section 22 provides unilateral mistake of fact will not render the contract voidable.

### Mistake of law

If there is mistake of law of land, the contract is binding because everyone is deemed to have knowledge of his own law, and ignorance of law is no excuse. But mistake of foreign law and mistake of private rights are treated as mistakes of fact, and are excusable. The laws of a foreign country require to be proved in Indian courts as ordinary fact, and so a mistake of foreign law makes the contract void. Similarly, if a contract is made in ignorance of private rights, it would be void, e.g. where A buys property which already belongs to him.

### Operative Mistake of Fact

Operative mistakes may be classified into the following categories:

a) Mistake as to the nature of the contract itself.

b) Unilateral mistake, i.e. mistake made by one party only.

c) Bilateral mistake, where both parties make a mistake, which may be either

(i) Common Mistake, or (ii) Mutual Mistake.

Common mistake occurs where both parties have made the same mistake and may also be designed as identical bilateral mistake. Mutual Mistake occurs where both parties make a different mistake and may also be called non-identical bilateral mistake. These are clearly differentiated in following paragraphs between themselves and contrasted with unilateral mistake.

**a) Mistake as to a nature of contract**

The general rule is that a person who signs as instrument is bound by its terms even if he has not read it. But if a person signs a contract in the mistaken belief that he is signing a document of a different nature, there will be a mistake which avoids the contract. The mistake must be as to the nature of the contract and not merely as to the contents of the document, and also the mistake must be due to either (a) the blindness, illiteracy, or senility of the person signing, or (b) a trick or fraudulent misrepresentation by the other party as to the nature of the document.

**b) Unilateral Mistake**

Unilateral mistake occurs when one of the parties to a contract is mistaken as to some fundamental fact concerning the contract and the other party knows this. This latter requirement is important because if B does not know that A is mistaken, the contract is good. Unilateral mistakes may be of two types: (i) regarding identity of party and (ii) unilateral mistake of offeror.

(i) Identity of party: The cases of unilateral mistake are mainly concerned with mistake by one party as to the identity of the other party. It is rule of law that if a person intends to contract with A, B cannot give himself if any rights under if. Here, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and adopt the contract.

For example, where M intends to contract only with A but enters into contract with B, believing him to be A, the contract is vitiated by mistake, as there is no Consensus ad idem.

Remember that mistake as to identity of the person with whom the contract is made will operate to nullify the contract only if:

(a) the identity is of material importance to the contract, and

(b) the mistake is known to the other party, i.e. he knows that it is not intended that he should become a party to the contract but some other person is intended.

In Cundy V. Lindsay (1878 3 A.C.459), one Blenkarn by imitating the signature of a reputable firm called Blenkarn and Son, induced Lindsay to supply him with goods on credit, which he afterwards sold to Cundy, an innocent purchaser. Lindsay claimed the recovery of the goods, or their value from Cundy. It was held that the contract between Blenkarn and Lindsay was void for mistake, and that no property passed to Cundy. Cundy was liable to Lindsay from the value of the goods.

(ii) Unilateral mistake of offeror where the offeror makes a material mistake in expressing his intention, and the offeree knows, or is deemed to know of the error, the mistake is operative and the contract is void.

In Hartog v. Colin Shields (1939 3 E.R.566). H claimed damages for breach of contract, alleging that C had agreed to sell him 30,000 Argentinian hare skins and had failed to deliver them. C contended that there was a material mistake in the offer and that H was well aware of this mistake when he accepted the offer. The mistake alleged by C was the skins were offered at certain prices per pound instead of per piece. In the negotiations preceding the agreement, reference had always been made to prices per piece, and it was also the custom of the trade. Held, the contract was void expressed C's real intention; H must have known that is was made under a mistake.

**c) Bilateral Mistake**

A bilateral mistake, as observed earlier, arises when both parties to a contract are mistaken as regards a fact essential to the contract. They may have made a common or identical mistake; or a mutual or non-identical mistake.

Following may be cases of bilateral mistakes:

**(i) Common mistake as to the existence of the subject-matter**. Where both parties believe the subject matter of the contract to be in existence at the time of the contract but in fact it is not in existence, there is operative mistake and the contract is void.

If A agrees to sell his car to B, and unknown to them both the car had at the time of the sale been destroyed by fire, then the contract will be void because A has innocently undertaken an obligation which he cannot fulfil.

But where the circumstances are such that the seller is deemed to have warranted the existence of the goods, the seller is probably liable to the buyer for breach of contract if the goods are non-existent.

**(ii) Common mistake as to a fact fundamental to the agreement.** Where the parties have made a contract based on a common misapprehension relating to the fundamental subject matter of the contract there is 'operative mistake'. This means that the contract actually made is essentially different from the contract the parties intend to make.

**(iii) Mutual or non-identical mistake as to the identity of the subject-matter.** Where the parties are both mistaken as to a fundamental fact concerning the contract but each party has made a different mistake, there is a mutual or non-identical mistake.

Thus, if A offers to sell his Ambassador Car, and B agrees to buy thinking A means his Fiat Car, there is a bilateral mistake which is mutual or non-identical. The contract does not come into existence under such a mistake, because there is no consensus ad idem. The parties have negotiated completely at cross-purposes and they were never in agreement.

**(iv) Mistake as to quality of subject-matter or promise.** Mistake as to the quality raises difficult question. If the mistake is bilateral and because of the mistake the thing does not possess the quality bargained for the contract is obviously void. But if the mistake is only unilateral difficulty arises. Mere mistake as to quality of the subject matter of a contract does not invalidate it, but mistake of one party to the promise of the other party as to quality of subject matter, known to that other party, does invalidate the contract. Such a question generally arises in cases of sale of goods. The principle commonly applicable is caveat emptor-Let the buyer beware. There is generally no obligation on a contracting party to enlighten the other party even where he knows or suspects there is a misapprehension.

For example, A offers to sell a watch to B, and B thinking it is a gold watch, offers Rs. 5000 for it. A knowing the watch is not gold, accepts B's offer without enlightening him. The contract is binding, provided A made no representation in the matter.

But where a party knowing that the other was labouring under a mistake "snatches a bargain" by hurriedly closing the transaction, this unilateral mistake will enable the party to avoid the contract.

**(v) Mistake through non-disclosure in contracts of utmost good faith or uberrimae fidei.** A contract uberrimae fidei is a contract of utmost good faith. In such a contract, the law imposes a special duty to act with the utmost good faith, i.e. to disclose all material information. Failure so to disclose all

facts truthfully renders the contract voidable at the option of the party. Here silencer can amount to misrepresentation.

Contracts *unberrimae fidei* **(utmost good faith)** are-

(a) Contracts of insurance of all kinds. The assured must disclose to the insurer all material facts; and non-disclosure or misstatement will render the contract of insurance void (Ratan Lal v. Metropolitan Co., 1959 Pat. 413).

(b) Contracts to take shares in a company under a prospectus. When a company invites the public to subscribe for its shares by means of a prospectus, it is under statutory obligation to disclose truthfully the various matters set out in the Companies Act. Any person responsible for the non-disclosure of any of these matters is liable to damages. Also, the contract to take shares is voidable where there is a material non-disclosure in the prospectus.

(c) Contracts for the sale of land. The vender is under a duty to purchaser to show good title to the land he has contracted to sell. He must, therefore, disclose all defects in title. This duty does not extend to physical defects in the property itself.

(d) Contracts of family arrangements. When members of a family make agreements or arrangements for the settlement of the family property, each member of the family must make full disclosure of every material fact within his knowledge.

(e) Suretyship and partnership contracts. Contracts of suretyship and contracts of partnership, though often described as contracts unberrimae fidei, are not properly so described; they do not require utmost good faith at their formation. In both cases, after the contract has been made there is a duty of utmost good faith on the parties to disclose to each other all material facts coming to light after the making of the contract.

## 2.3 MEANING OF CONSIDERATION

It may be defined as the price for which the promise of the other is bought. It is something which is of some value in the eyes of law. It may be some benefit to the plaintiff or some detriment to the defendant. It is also used in the sense of *quid pro quo* i.e. something in return.

Section 2(d) of the Indian Contract Act defines consideration as:

(a) when at the desire of the promisor,

(b) the promisee or any other person,

(c) has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing,

(d) something, such act or abstinence or promise is called a consideration for the promise.

The definition of consideration as given in Section 2(d) is a simple and practical definition. It is something of value which the promisee has given, gives or promises to give in return for the promise. It does not mean payment of money only. Forbearance to sue is good consideration. A promise can be a consideration for another promise. A single consideration may support more than one promise. It can also consist in performance. Settlement of dispute can be a good consideration for the promise. Similarly, if the promisee gives up any legal right, he gives sufficient consideration to support the other party's promise. Thus, refraining from smoking, gambling or drinking would supply the consideration needed to support another person's promise to pay a certain sum of money to the one who refrained. But the mere doing of a thing which a person is already legally bound to do is no consideration for a new promise in his favour.

**Example:** X agrees to sell his horse to Y for ₹10,000. Here X's promise to sell his horse is for Y's consideration to pay ₹10,000. Similarly, Y's promise to pay ₹10,000 is for X's consideration to sell his horse to Y.

### 2.3.1 ESSENTIALS OF VALID CONSIDERATION

The essentials of a valid consideration are discussed as follows:

**1. It must move at the desire of the promisor**: In order to constitute legal consideration, the act or abstinence forming the consideration for the promise must be done at the desire or request of the promisor. Thus acts done or services rendered voluntarily, or at the desire of third party, will not amount to valid consideration so as to support a contract. The logic for this may be found in the worry and expense to which every one might be subjected, if he were obliged to pay for services, which he does not need or require.

**Example:** A advanced money to B on an undertaking given by his father and obtain promissory notes for the amount advanced. On a suit to recover the amount, it was held that these pronotes were without consideration in as much as the advances were not made at the request of B. (Raja of Venkatagiri v.

Krishnaya AIR 1948 P.C. 150).

A promise to subscriber to a public or a charitable object is unenforceable because there is not benefit to the promisor. But where the other party has undertaken a liability on the faith of the promise made by the promisor, it is enforceable.

**The leading case on this point is *Kedar Nath v. Gori Mahomed (1886)***

*Decision* : An Act done at the request of the promisor is a good consideration to supply the promise.

*Facts on the case are:* X had agreed to subscribe ₹100 towards the construction of a Town Hall at Hawrah. Y the secretary of the committee, on the faith of the promise called for plans and entrusted the work to contractors and undertook liability to pay them. X refused to pay the promised amount and Y brought a suit against him. It was held that though the promise was to subscribe to a charitable institutions and there was no benefit to X, yet it was supported by consideration in that Y, the promisor suffered a detriment in having undertaken a liability to the contractors on the faith of the promise made by X.

But where nothing has been done in furtherance of the object of the fund raised, a promised subscription is not legally recoverable.

**2. Consideration may move from the promisee or any other person:** The important feature of the definition of consideration in Section 2 (d) is that the act which is to constitute a consideration may be done by the promise or any other person. It means that as long as there is a consideration for a promise, it is immaterial who has given it. It may move from the promisee, or if the promisor has no objection, from any other person. This is wider than the concept of England, where consideration can move only from the promisee. Consideration moving from a third party who is minor is no consideration.

**Example:** X, Y and Z enter into an agreement under which X pays ₹1,000 to Y and Y agreed to build a house for Z. Here Z is a party to the contract but stranger to consideration and can enforce the contract.

**3. Consideration may be past, present or future:**

When something is done or suffered before the date of the agreement, at the desire of the promisor, it is called 'past consideration'. It must be noted that past consideration is good consideration only if it is given by the promisee, 'at the desire of the promisor'.

**Example:** A teaches the son of B at B's request in the month of January, and in February B promises to pay A a sum of ₹500 for his services. The services of A will be past consideration.

When the consideration for a promise is given simultaneously with the promise, it is called present consideration. A present consideration consists in doing or abstaining from doing something. A promise to give time to a debtor is good consideration. Present consideration arises where there is a promise to pay for goods sold and delivered.

A future or executory consideration is a promise to do or give something in return in future for the promise then made. It is also called a promise for the promise. Mutual promises to marry, a promise to do working return of promise of payment are examples of future consideration.

**Example:** A promises to deliver goods to B when the ship arrives and B promises to pay A ₹1000 against the receipt of goods. This is a case of future consideration, which is to be performed by both the parties when the ship arrives.

**4. It need not to be adequate:** The law of contract nowhere laid down that consideration should be adequate to the promise. What is required is that there must be some consideration for the promise. Adequacy is for the parties to decide at the time of making the agreement. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence of fraud. It should be of some value in the eyes of law. Even a smallest consideration is sufficient provided it has some value. If a man gets what he contracted for, the court will not inquire whether it was an equivalent to the promise which he gave in return. Where in an agreement the consent of the promisor has been freely given, an inadequacy of the consideration will not render it unenforceable. For example, A agrees to sell his house worth ₹90,000 to B for ₹9,000. A's consent to the agreement was freely given, the agreement is a contract not withstanding the inadequacy of the consideration.

*Consideration must be real:* Though consideration need not be adequate, it must be of some value in the eyes of law, i.e., it must be real and competent. Where consideration is physically impossible, illegal, uncertain or illusory, it is not real and therefore shall not be a valid consideration.

(i) *Physically impossible:* A promise to do something which is physically impossible, e.g., to make a dead man alive or to run at a speed of 200 kilometres per hour, does not form valid consideration.

(ii) *Legally impossible:* A promise to do something which is illegal, e.g., a promise for illegal cohabitation does not amount to good consideration.

(iii) *Uncertain consideration:* A promise to do something which is too vague and uncertain, e.g., a promise to pay such remuneration "as shall be deemed right", is no consideration in the eye of law.

(iv) *Illusory consideration:* Again, an illusory or deceptive consideration does not amount to a valid consideration. Consideration is illusory if it consists in a promise to perform a public duty, or to perform a contract already made with the promisor.

**Example:** A (the plaintiff) received a subpoena (a kind of summon) to appear at a trail as a witness on behalf of B (the defendant). B promised him a sum of money for his trouble. On default by B, A filed the suit for the recovery of the promised sum. It was held that A being under a public duty to attend and give evidence, there was no consideration for the promise and hence the promise is unenforceable (Callins vs Godefroy).

### 2.3.2 EXCEPTIONS: NO CONSIDERATION, NO CONTRACT

Consideration being one of the essential elements of a valid contract, the general rule is that "an agreement made without consideration is void". But there are a few exceptions to the rule where an agreement without consideration will be perfectly valid and binding. These exceptions are as follows:

**1. Agreement made on account of natural love and affection:** An agreement made without consideration is enforceable if, it is (i) expressed in writing, and (ii) registered under the law for the time being in force for the registration of documents, and is (iii) made on account of natural love and affection, (iv) between parties standing in a near relation to each other. Thus there are four essential requirements which must be complied with to enforce an agreement made without consideration, as per Section 25(1).

**Example:** A for natural love and affection, promises to give his son B, ₹1,000. A puts his promise to B into writing and registers it. This is a valid contract.

It should, however, be noted that mere existence of a near relation between the parties does not necessarily import natural love and affection. Thus where a Hindu husband, after referring to quarrels and disagreement between him and his wife, executed a registered document in favour of his wife, agreeing to pay for separate residence and maintenance, it was held that the agreement was void for want of consideration because it was not made out of natural love and affection. [Rajlakhi Devi vs Bhootnath) (1990), 4,C.W. N. 488].

**2. Compensation for services rendered:** According to Section 25(2), agreement made without

consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something of the promisor or something which the promisor was legally compliable to do. To apply this rule, the following essentials must exist:

(a) the act must have been done voluntarily;

(b) for the promisor or it must be something which was the legal obligation of the promisor;

(c) the promisor must be in existence at the time when the act was done';

(d) the promisor must agree now to compensate the promisee.

A promise to pay for past services voluntarily rendered would be enforceable under this rule. If, however, something has not been done voluntarily, this clause will not apply. Thus, where the services were rendered by the advocate on request and were not voluntarily it was held that this clause had no application. The promisor should be in existence at the time when the service is rendered. Work done by the promoters of a company before its formation cannot be said to have been done for the company. Such a clause in the articles of association is not binding unless it is subsequently confirmed by the company.

**3. Agreement to pay a time-barred debt:** Sec. 25 (3) expressed that where there is an agreement, made in writing and signed by the debtor or by his authorised agent, to pay wholly or impart a debt barred by the law of limitation, the agreement is valid even though it is not supported by any consideration. A time barred debt cannot be recovered and therefore a promise to repay such a debt is without consideration, hence the importance of the present exception.

But before the exception can apply, it is necessary that:

(i) the debt must be such of which the creditor might have enforced payment but for the law for the limitation of suits [Sec. 25(3)];

(ii) the promisor himself must be liable for the debt;

(iii) there must be an 'express promise to pay' a time barred debt as distinguished from a mere 'acknowledgement of a liability' in respect of a debt; and

(iv) the promise must be in writing and signed by the debtor or his agent.

**Example:** A owes B ₹1,000, but the debt is barred by the Limitation Act. A signs a written promise to pay B ₹500 on account of the debt. This is a contract.

4. **Completed gifts:** Explanation 1 to Section 25 provides that the rule 'No consideration, no contract' shall not affect validity of any gifts actually made between the donor and the donee. Thus if a person gives certain properties to another according to the provisions of the Transfer of Property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

5. **Agency:** There is one more exception to the general rule. It is given in Section 185 which says that no consideration is needed to create on agency. Consideration is defined to be the price for which the promise of the other is bought.

## 2.4 CAPACITY OF CONTRACTING PARTIES

Capacity to contract implies competence of the parties to contract. Section 11 of the Contract Act specifies that "Every person is competent to contract, who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject". Thus, following persons are incapable of contracting:

(1) A minor.

(2) A person of unsound mind.

(3) Persons disqualified from contracting by any other law.

### 2.4.1 MINOR

A minor is a person who is not a major. According to The Indian Majority Act, 1875, a minor is one who has not completed his or her 18th year of age. A person attains majority on completing his 18th year in India. In the following two cases, a person continues to be a minor until he completes the age of 21 years.

(a) Where a guardian of a minor person or property has been appointed under the Guardians and Wards Act, 1890; or

(b) Where the superintendence of a minor's property is assumed by a Court of Words.

**Law relating to minor's agreements**

A minor has an immature mind and cannot think what is good or bad for him. Minors are often exploited and their properties stolen. As such he must be protected by law from any exploitation or ill design. But at the same time, law should not cause unnecessary hardship to persons who deal with minors. A minor's agreement being void is wholly devoid of all effects. When there is no contract there

should be no contractual obligation on either side. The various rules regarding minor's agreement are discussed below.

**1. An agreement with or by a minor is void:** Section 10 of the Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not competent. But neither section makes it clear whether the contract entered into by a minor is void or voidable. Till 1903, courts in India were not unanimous on this point. The Privy Council made it perfectly clear that a minor is not competent to contract and that a contract by a minor is void *ab initio*.

**2. No ratification:** An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent to authorise an act cannot give it validity by ratifying it. Thus, where a minor borrowed a sum of money by executing a simple pronote for it and after attaining majority executed a second pronote in respect of the original loan plus interest thereon, a suit upon the second pronote was not maintainable.

If on coming of age, a minor makes a new promise and not merely an affirmation of the old promise, for a fresh consideration, the new promise will be binding.

**3. Beneficial agreements are valid contracts:** Any agreement which is of some benefit to the minor and under which he is required to bear no obligation, is valid. In other words, a minor can be a beneficiary e.g., a payee, an endorsee of a promise under a contract. Thus money advanced by a minor can be recovered by him by a suit because he can take benefit under a contract. The Hindu Minority and Guardianship Act, 1956, also provides to the same effect, namely a natural guardian is empowered to enter into a contract on behalf of the minor and the contract would be binding and enforceable if the contract is for the benefit of the minor.

**Example:** A duly executed transfer by way of sale or mortgage in favour of a minor, who has paid the whole of the consideration money, is enforceable by him or by any other person on his behalf.

**Contracts of apprenticeship and service by a minor:** A contract of apprenticeship stands on a different footing than an agreement of service by a minor. A contract of apprenticeship is valid and binding upon a minor because such a contract is protected by the Apprentices Act, 1961, provided the case falls within the terms of that Act. The Act, inter alia, provides that the minor must not be less than fourteen years of age and the contract must be entered into on behalf of the minor by his guardian. The

Act was passed with a view to enabling children to learn trades, crafts and employment, by which, when they come to full age, they may gain a livelihood. So far as an agreement of service by a minor is concerned, it is void because a minor's promise to serve would supply no consideration for the promise of the defendant to pay him/her a salary.

**4. Liability for necessaries:** The case of necessaries supplied to a minor or to any person whom such minor is legally bound to support is governed by Section 68 of the Indian contract Act. A claim for necessaries supplied to a minor is enforceable at law. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor, but only his property is liable. A minor is also liable for the value of necessaries supplied to his wife.

"What is a necessary article", is to be determined with reference to the status and circumstances of the particular minor. Objects of mere luxury are not necessaries, nor are objects, which though of real use are excessively costly. Food and clothing may be taken as simple examples of necessaries. The necessaries would also include the infant's lodging expense, medical attendance, cost of defending a minor in civil and criminal proceedings. Loans taken by a minor to obtain necessaries also bind him. But where a minor is engaged in trade, contracts entered into by him for trading purposes are not for necessaries and are not binding on him.

Not only must the goods supplied be such as are suitable to the minor's status, they must also be actually necessary. Ten suits of clothes are necessaries for a minor whereas even three suits may not be deemed necessary for another.

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

**Example:** Inman an infant undergraduate in Cambridge bought eleven fancy waistcoats from Nash. He was at the time adequately provided with clothing. Held the waistcoats were not necessary and the price could not be recovered.

The following have been held to be necessaries:

(i) Livery for an officer's servant.

(ii) Horse, when doctor ordered riding exercise.

(iii) Goods supplied to a minor's wife for her support.

(iv) Rings purchased as gifts to the minor's fiancee.

(v) A racing bicycle.

On the other hand, following have been held not to be necessaries:

(i) Goods supplied for the purpose of trading.

(ii) A silver-gift goblet.

(iii) Cigars and tobacoo.

(iv) Refreshment to an undergraduate for entertaining.

**5. The rule of estoppel does not apply to a minor:** Where a minor by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor. In other words, a minor is not estoppled from pleading his infancy in order to avoid a contract. It has been held by a Full Bench of the Bombay High Court in the case of Gadigeppa v. Balangowda (A.I.R. 193, BOM 561) that where an infant represents fraudulently that he is of majority age and thereby induces another to enter into a contract with him, then in an action founded on the contract, the infant is not estopped from setting up infancy. The court may, however, require the minor to compensate the other party on the ground of equity. This is based on the rule that a minor can have no privilege to cheat men.

Fraudulent misrepresentation as to age by an infant will operate against him in certain cases. If a minor obtains property or goods by misrepresenting his age, he can be compelled to restore it but only so long as the same is traceable in his possession.

If by misrepresenting himself to be of full age, has obtained money from a trustee and given release, the release is good and he cannot compel the trustee to make payment a second time.

**6. No Specific performance:** A minor's contract being absolutely void, there can be no question of the specific performance of such a contract. A guardian of minor cannot bind the minor by an agreement for the purchase of immovable property; so the minor cannot ask for the specific performance of the contract which the guardian had no power to enter into.

**7. Liability for torts:** A minor is liable in tort. Thus, where a minor borrowed a horse for riding only he was held liable when he let 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 passed on to a friend. But a minor cannot be made liable for a breach of contract by framing the action

on tort. You cannot convert a contract into a tort to enable you to sue an infant.

**8. 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.

**9. Minor agent:** A minor can be an agent (Sec. 184). He shall bind the principal by his acts done in the course of such an agency, but he cannot be held personally liable for negligence or breach of duty. Thus in appointing a minor as an agent, the principal runs a great risk.

**10. Minor and insolvency:** A minor cannot be adjudicated as an insolvent, for, he is incapable of contracting debts. Even for necessaries supplied to him, he is not personally liable, only his property is liable (Sec. 68).

**11. Contract by minor and adult jointly:** Where a minor and an adult jointly enter into an agreement with another person, the minor has no liability but the contract as a whole can be enforced against the adult.

**12. Minor shareholder.** A minor, being incompetent to contract, cannot be a shareholder of the company. A company can also refuse to register transfer or transmission of shares in favour of a minor unless the shares are fully paid. It follows from it that a minor, acting through his lawful guardian, may become a shareholder of the company, in case of transfer or transmission of fully paid shares to him. Logically also, if a minor could legally hold property in his name, it would be wrong to debar him from holding fully paid up shares in his own name.

### 2.4.2 PERSONS OF UNSOUND MIND

Section 11 disqualifies a person who is not of sound mind from entering into a contract. Contracts made by persons of unsound mind like a minor's contract are void. The reason is that a contract requires assent of two minds but a person of unsound mind has nothing which the law recognises as a mind.

Section 12 deals with the question as to what is sound mind for the purpose of entering into a contract. It lays down that, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it he is capable of understanding it and of forming a rational judgement as to its effect upon his interests".

The Section further states that:

(i) "A person who is usually of unsound mind, but occasionally of sound mind, may make a

contract when he is of sound mind." Thus a patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

(ii) "A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind". Thus, a sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgement as to its effect on his interest, cannot contract while such delirium or drunkenness lasts.

Unsoundness of mind may arise from: (a) *Idiocy* – It is God given and permanent, with no intervals of saneness. The mental powers of an idiot are completely absent because of lack of development of the brain; (b) *Lunacy or Insanity* – It is a disease of the brain. A lunatic loses the use of his reason due to some mental strain or disease. Of course he may have lucid intervals of sanity: (c) *Drunkenness* – It produces temporary incapacity, till the drunkard is under the effect of intoxication, provided it is so excessive as to suspend the reason for a time and create impotence of mind; (d) *Hypnotism* – It also produces temporary incapacity, till the person is under the impact of artificially induced sleep; (e) *Mental decay on account of old age*, etc.

**Effects of agreements made by persons of unsound mind:** An agreement entered into by a person of unsound mind is treated on the same footing as that of minor's and therefore an agreement by a person of unsound mind is absolutely void and inoperative as against him but he can derive benefit under it (Jugal Kishore vs Cheddu, 1903, ALL L.J.43). The property of a person of unsound mind is, however, always liable for necessaries supplied to him or to any one whom he is legally bound to support, under Section 68 of the Act.

### 2.4.3 DISQUALIFIED PERSONS

The third type of incompetent persons, as per Section 11, are those who are "disqualified from contracting by any law to which they are subject". These are:

**1. Alien enemies:** An alien living in India is competent to contract with citizens of India. He can maintain an action on a contract entered into by him during peace time. But if a war is declared, an alien enemy cannot enter into any contract with an Indian citizen. Contracts entered into before the declaration of war are either stayed or terminated but contracts entered into during the war are unenforceable.

**2. Foreign sovereigns and ambassadors:** These persons are immune from the jurisdiction of local

courts, unless they voluntarily submit to its jurisdiction. These persons have right to contract but can claim the privilege of not being sued. The rules regarding suits by or against foreign sovereigns are laid down in Sections 84 to 87 of Civil Procedure Code.

**Example:** E, who was a diplomat and was on the staff of a foreign embassy rented a house belonging to M.M sued him for arrears of rent. It was held that no action could be brought against him as he was protected by diplomatic privileges. [Engelke v. Musman (1928) A.C. 433].

**3. Convict:** A convict is one who is found guilty and is imprisioned. During the period of imprisonment, a convict is incompetent (a) to enter into contracts, and (b) to sue on contracts made before conviction. On the expiry of the sentence, he is at liberty to institute a suit and the Law of Limitation is held in abeyance during the period of his sentence.

**4. Married women:** Married women are competent to enter into contracts with respect to their separate properties (*Stridhan*) provided they are major and are of sound mind. They cannot enter into contracts with respect to their husbands' properties. A married woman can, however, act as an agent of her husband and bind her husband's property for necessaries supplied to her, if he fails to provide her with these.

**5. Insolvents:** An insolvent cannot enter into a contract as his property vests in the official receiver or official assignee. This disqualification of an insolvent is removed after he is discharged.

**6. Joint-stock company and corporation incorporated under a special Act:** A company/corporation is an artificial person created by law. It cannot enter into contracts outside the powers conferred upon it by its Memorandum of Association or by the provisions of its special Act as the case may be. Again, being an artificial person (and not a natural person) it cannot enter into contracts of a strictly personal nature e.g. marriage.

## 2.5 CHECK YOUR PROGESS

Answer the following questions on the basis of your knowledge regarding this chapter:

1. Free consent is _____ element of contract.
2. Free consent is defined in section____ of the Contract Act.
3. The consideration or object of an agreement is lawful unless it is _____.
4. Agreeing on same thing in the same sense is called _____.
5. Capacity to contract has been defined in section ____.

## 2.6 SUMMARY

Mistake, misrepresentation, fraud, coercion and undue influence are the elements which affect the consent of the parties. Mistake generally takes place where the concerned parties are not fully aware of the terms of the agreement and they take the terms in a different sense. In an innocent misrepresentation, the party aggrieved may avoid the agreement, even though the statement was true at the time it was made but became untrue latter by reason of change of circumstances. An agreement, in which the consent is caused by coercion, is voidable at the option of the party whose consent was so obtained. When a party enters into a contract under any kind of mental pressure, unfair influence or persuasion by the superior party, the undue influence is said to be employed.

Section 2(d) of the Contract act defines consideration as "When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promise is called a consideration for the promise. Essentials of valid consideration are (i) it must at the desire of promisor, (ii) it may move from the promisee or any other person, (iii) it may be past, present or future, (iv) it need not be adequate, (v) it must be real and (vi) It must be lawful. No one but the parties to a contract can sue or be sued under it. A third person cannot demand performance of a duty or obligation under it even though he has a direct interest in such performance except in certain recognised cases. An agreement made without consideration is void.

An agreement will be a contract if it is entered into by parties who are competent to contract. 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. An infant or a minor is a person who is not a major.

Section 11 disqualifies a person who is not of sound mind from entering into a contract. A person is said to be of sound mind for the purpose of aiming a contract if, at the time when he makes it he is capable of understanding it and of forming a rational judgement as to its effect upon his interests.

Unsoundness of mind does not mean weakness of mind or loss of memory. It means not only lack of capacity to understand the terms of the contract but also lack of understanding to realise the effect of the terms of the contract. There is always a presumption in favour of sanity.

The third type of incompetent persons, as per Section 11, are those who are "disqualified from contracting by any law to which they are subject". These include Alient enemies, foreign sovereigns

and ambassadors, convict, married women, insolvents and joint-stock company and corporation incorporated under a special act.

## 2.7 KEYWORDS

**Mistake**: Mistake may be defined as incorrect belief about something.

**Misrepresentation**: Misrepresentation is a false representation which is made innocently.

**Free Consent**: Free consent is the consent which is obtained by the free will of the parties, and neither party was forced or induced to give his consent.

**Coercion**: It means forcibly compelling a person to enter into a contract.

**Undue Influence**: It means the unfair use of one's superior power in order to obtain the consent of a person who is in a weaker position.

**Minor**: A minor is a person who has not attained the age of majority.

**Estoppel**: It means prevention of a claim or ascertain by law.

**Persons of Unsound Mind**: A person of unsound mind is one who is not of sound mind.

**Alien**: An alien is a person who is foreigner to the land.

## 2.8 SELF-ASSESSMENT TEST

1. State when a consent is not said to be free. What is effect of such consent on the formation of a contract?
2. A contract caused by mistake is void. Explain with illustrations.
3. What is fraud? Distinguish it with misrepresentation.
4. What remedies are available to a person induced to enter into a contract by (a) misrepresentation which is not fraudulent, (b) fraud.
5. "Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud". Explain.

## 2.9 ANSWER TO CHECK YOUR PROGESS

1. An Essential
2. Section 14

3. Forbidden by Law

4. Consent

5. Section 11

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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| Lesson No.: 3 | |

# LEGALITY OF OBJECT

## STRUCTURE



## 3.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the concept of legality of object.
- Make a distinction between illegal, unlawful and void agreements.
- Enumerate the considerations and objects which are unlawful.

## 3.1 INTRODUCTION

Section 10 of the Contract Act lays dawn that all agreements are contracts if they are made for a lawful consideration and with a lawful object. It implies that if the consideration or object of any agreement is not lawful, such agreement cannot be enforced by law.

Both the object and the consideration of an agreement must be lawful. Consideration means '*quid pro quo'*, i.e., something for something. On the other hand, object means the purpose or design of a contract. In some cases, consideration may be lawful but the object for which the agreement is entered into may be unlawful. In such cases the agreement will be void. It may be that in certain cases consideration and object may be the same. For example, X had borrowed ₹5,000 from Y. After some time, X became insolvent. Then, he transferred his house to Y in consideration of loan. Here the consideration is lawful, but the object is not lawful because it debars other creditors in preference to Y, which is not legal. This agreement will be void. Thus, for an agreement to be valid both consideration and object must be lawful.

## 3.2 CONCEPT OF LEGALITY OF OBJECT

An individual generally has the right to adjust his claims and obligations according to his own wish. This is known as his contractual freedom. However, there is a limitation on the contractual freedom of an individual. The limits to or restrictions on contractual freedom have been laid down in Section 23 of the Contract Act. This Section brings out as to what considerations and objects are lawful and what are not lawful. This section provides that "The consideration or object of an agreement is lawful, unless – (i) It is forbidden by law, or (ii) it is of such nature that, if permitted, it would defeat the provisions of any law, or (iii) it is fraudulent, or (iv) it involves or implies injury to the person or property of another, or (v) the court regards it as immoral, or (vi) the Court regards it as opposed to public policy. In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful, is void."

### 3.2.1 DISTINCTION BETWEEN ILLEGAL, UNLAWFUL AND VOID AGREEMENTS

Void agreements are those which are void *ab initio* or become subsequently void. Such agreements are devoid of any legal effect. Void agreement is a generic term and includes all agreements which are void due to various reasons, for example, incompetency of parties, agreements opposed to public policy, illegal, unlawful agreements etc. Illegal agreements on the other hand are only those agreements, wherein the object or consideration is illegal. Illegality in this context relates to sexual immorality or heinous crime. Such agreements and their collateral transactions are void being taint with illegality.

**Illustration:** A agrees to pay ₹10,000 to B, if B murders C. B murders C and demands ₹10,000 from A. A borrows ₹10,000 from X telling him the purpose for which he needs the money. X cannot recover the money. Here even the collateral transaction is illegal.

Sometimes, the two terms unlawful and illegal agreements are used interchangeably. Strictly speaking, there is a fundamental difference between the two. While illegal agreement refers to sexual immorality or crime, agreements which are opposed to any law are unlawful. Again, transactions collateral to illegal agreements are also void but transactions collateral to an unlawful agreement may be enforced.

**Illustration:** A agrees to give his son to B in adoption and demands ₹**5.000** from C. This agreement is opposed to Hindu Law which frowns at money consideration in adoption. B may borrow ₹5,000 from C telling him the purpose for which he needs money. This is a collateral transaction to an unlawful agreement, but C can recover the amount.

All illegal agreements are void but all void agreements are not illegal. For example, a contract may be void because one of the parties is a minor. But such a contract is neither illegal nor unlawful.

### 3.2.2 UNLAWFUL CONSIDERATIONS AND OBJECTS

In the following cases or circumstances, consideration or object is unlawful:

**1. If it is forbidden by law:** Acts forbidden by law are those which are punishable by the criminal law of the country. For example, the Indian Penal Code, or those which are prohibited by regulations or orders made by competent authority having powers conferred by the legislature (i.e., the law-making body, for example, the Parliament in India). If the consideration or object of an agreement is the doing of an act forbidden by law, the agreement is void. For example, X has a licence to deal in cotton. Y has no licence to do so. X and Y enter into an agreement of partnership to do the business of cotton in Punjab. Section 23 of the Cotton Control Order prohibits doing business of cotton without a licence. Such partnership between X and Y is illegal and void.

It should be noted that if some restriction of prohibition is not made obligatory under a special legislation and is designed merely for administrative convenience, the breach of such condition does not amount to be unlawful. For example, a licence to cut grass is given to me by the Forest Department under the Forest Act. One of the terms of licence is that the licence should not assign his interest under the licence without the permission of the Forest Officer and a fine is prescribed for a breach of this condition. But the observance of the conditions of licence is not obligatory under the Forest Act. If X in

breach of the condition, agrees .to assign his interest under the licence to Y, that agreement will be valid, because here the assignment is not prohibited by law, and the condition against assignment has been imposed only for administrative convenience or purpose, or solely for the protection of revenue. On the other hand, an agreement to sub-lease a licence for manufacture and sale of country liquor under the Akbar Act is void because such prohibition is imposed by the Act and is designed for the protection of the public.

Similarly, if the doing of some act is not prohibited by a special legislation, but any kind of assistance provided for such an act is made punishable, then such act cannot be treated as unlawful. For example, under the Child Marriage Restraint Act, 1929, marriage between two minors is not prohibited, but the parties who arrange such marriage are punishable. A joint Hindu family took loan for the marriage of two minors. It has been held that the loan is binding on the family as the Act does not make the marriage between two minors illegal, but it aims at restraining such marriage. This Act imposes penalty on the major persons who arrange for such marriage.

**2. If it defeats the provisions of any law:** Law here means written or unwritten law and includes three things – (in) the provisions of any legislative enactment, i.e., the Acts passed by the Parliament, (ii) the rules of Hindu and Mohammedan laws, and (iii) other rules of law in force in India, such as Civil Procedure Code, 1908, etc. If the object or consideration of an agreement is of such a nature that if permitted it will defeat the provisions of the law, though such object or consideration is not directly forbidden by law, the agreement is void.

**Examples**: (a) An agreement by a debtor not to plead limitation, will defeat the provisions of the Limitation Act, and hence void.

(b) An agreement to pay an annual allowance (i.e., annuity) to the natural father of a boy who is taken in adoption by the payer, will defeat the provisions of the Hindu law, and hence void.

(c) An agreement before marriage between wife and her husband who are Muslims, that the wife shall be at liberty to live with her parents after the marriage, will defeat the provisions of the Muslim law, and hence void.

(d) An offer to stand a surety for an accused after receiving as deposit from him an amount equal to the amount of bail, will defeat the provisions of the Criminal Procedure Code, and hence void.

**3. If it is fraudulent:** An agreement which is made with a view to defrauding others is void. For example, X and Y enter into an agreement to share equally the gains to be acquired by them by deceiving a bank. This agreement is void because its object is fraudulent.

**4. If it involves or implies injury to the person or property of another:** 'Injury' as a general term means criminal of wrongful harm or damage. If the object of an agreement is to cause injury to the person or property of another, it is void.

**Examples:** (a) X promises to repay his debt to R by daily attendance and manual labour for a certain period and to pay interest at an exorbitant rate in case of the default. Here the consideration involves injury to the person of X, and hence it is illegal. Further, hence the object seeks to impose slavery which is opposed to public policy, and hence the object is also not enforceable. Therefore, the agreement is void.

(b) D agrees to buy a scooter from J fully knowing that J had previously agreed to sell it to K. This agreement is void because its object is to cause injury to the property of K.

(c) An agreement is entered into between two companies that they shall not, without the written consent of the other, at any time employ any person who during the then past five years will have been a servant of the other company. This agreement is unlawful because it is to cause injury to the old employees of either company.

**5. If it is immoral:** The term 'immoral' means an act which is against the principles or standards of morality (i.e., good behaviour). If the consideration or object of an agreement is immoral in the eyes of the Court, the agreement is void. The Indian Courts have dealt with many cases of sexual immorality involving illicit co-habitation, prostitution, etc. Thus, here the doctrine of immorality is generally confined to sexual immorality.

**Examples:** (a) G let out his lodgings to Mahdi knowingly that she will carry on her vocation of prostitution there. X cannot recover the rent of lodgings.

(b) B lent certain money to G, a prostitute expressly to enable her to carry on her trade. It cannot be recovered.

(c) Allah, a brothel-keeper, lent some ornaments to Chunia, a prostitute, for attracting men and encouraging prostitution. Ornaments cannot be recovered back.

(d) Mohan advanced money to Rani, a married woman, to enable her to obtain a divorce from her husband. Mohan agreed to marry her as soon as she could obtain a divorce. Here, Mohan is not entitled to recover back the amount as the object of the agreement was divorce from the husband and the consideration in the form of promise of marriage under such circumstances was against the principles of morality.

(e) M agrees to pay money to R upon the consideration that R will give favourable evidence in a civil suit on behalf of M. This agreement cannot be enforced by R because the consideration is immoral.

**6. If it is opposed to public policy:** If the consideration or object of an agreement is opposed to public policy in the eyes of the Court, the agreement is void. This point has been fully discussed below, under a separate heading.

**Partial illegality**

An agreement may consist of legal as well as illegal promises, which may be separable. Section 24 of the Contract Act provides for the cases where the legal promise cannot be separated from the illegal promise. It lays down that if consideration or object of an agreement is unlawful in part, the agreement is void. For example, M manufactures both genuine and duplicate electric fans in his factory. J promises to supervise M's factory. M agrees to pay him a salary of ₹5,000 per month. This agreement is void because it is partly legal (i.e., for genuine fans) and partly illegal (i.e., for duplicate fans), and the legal part cannot be separated because the salary is paid for both the promises.

Sections 57 and 58 of the Act provide for separable promises which may be of two types (in) reciprocal promises, and (ii) alternative promises. According to Section 57, where there is a reciprocal promise, firstly to do certain things which are legal, and secondly to do certain other things which are illegal, and the legal part can be separated from the illegal part, the legal part is a contract and the illegal part is void agreement. For example, X and Y agree that X will sell a house to T for ₹20,000 but that, if Y uses it as a gambling house, he will pay X ₹60,000 for it. The first part of the agreement, namely, to sell the house for ₹20,000 is a contract, and the second part is for an unlawful object, namely gambling. The second part is void and illegal agreement.

According to Section 58 of the Act, where there is an alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced. For example, X and Y agree that X will

pay ₹5,000 to Y, for which Y will later on deliver to X either electric kettles or smuggled shirts. This is a valid contract to deliver electric kettles, and a void agreement as to the smuggled shirts.

**Agreements Opposed to Public Policy**

The Contract Act does not define the expression 'public policy' or 'opposed to public policy'. Section 23, however, leaves it open to the Court to hold any contract as unlawful on the ground of being opposed to public policy.

Recently, the Supreme Court made certain fundamental observations on the question of public policy. According to the Supreme Court, the expression public policy is incapable of precise definition. It varies from time to time. Transactions which were once considered against public policy are now being upheld. Similarly, where there has been a well-recognised head of public policy, Courts will extend it to new transactions and changed circumstances. A Court may invent a new head of public policy in consonance with public conscience and public good and certainly it can be guided in this regard by the light of the preamble to the Constitution, the fundamental rights and the directive principles of state policy as contained in the Constitution. Public policy, however, is not the policy of a particular government.

It may be pointed out that an attempt to enlarge the scope of the doctrine of public policy is bound to result in the curtailment of the individual's freedom of contract. It has, therefore been held that the said doctrine should be involved only in cases where the damage to the public is substantially incontrovertible and does not depend upon the idiosyncratic or whimsical inference of a judicial mind. An unfettered application of the doctrine of public policy may frustrate the very objective it seeks to achieve. A judge may commit a blunder and thereby defeat the ends of justice if he is permitted to go beyond the recognised bounds of public policy. Owing to such nature of public policy, it has been described as an unruly horse which, if not properly bridled, may carry its rider he knows not where. Lord Davey has said, 'public policy is always an unsafe and treacherous ground for legal decision." Hence, the application of the doctrine of public policy should be involved within the prescribed limits described below.

**Heads of Public Policy**

An agreement which tends to be injurious to the public or to be against the public conscience and public good is known as opposed to public policy, and it is void. Like any other branch of common law, the

doctrine of public policy is governed by precedents. The principles have been crystallised under different heads. Though it is permissible for Courts to explain and apply such heads to different situations, it should only be invoked in clear and undisputed cases of harm to the public. Theoretically, it may be permissible to evolve a new head under exceptional circumstances of a changing world, however, it is advisable in the interest of stability of society and of the reasonable individual freedom for contract not to make any attempt to discover new heads of public policy these days. The agreements which have been declared against public policy by Courts can be described under the following heads:

**1. Agreements for trading with enemy:** All agreements made with an alien (foreign) enemy, unless made with the permission of the Government, are illegal on the ground of public policy. Agreements which are entered into before the outbreak of war are either dissolved or suspended till the end of the hostilities as per the intentions of the parties.

**2. Agreements for stifling (suppressing) prosecution:** There are mainly two types of litigation in India: (in) civil, and (ii) criminal. In case of civil litigation, compromise is allowed and encouraged. The criminal offences are of two types – (in) compoundable, and (ii) non-compoundable. In cases of compoundable offences, compromises are allowed by the Court. Under the Code of Criminal Procedure, 1973 in a Table of Section 320, a list of compoundable offences and persons by whom such compromise can be made has been laid down. It contains offences such as causing hurt, assault, mischief, criminal, trespass, house trespass, adultery, defamation, insult, criminal intimidation, wrongful confinement, theft, cheating, etc. In such cases criminal prosecution can be compounded. On the other hand, there are some criminal offences which cannot be compounded. In such cases, public policy requires that the accused should be tried in the law court and if found guilty be punished according to law. In such cases the principle is that "you shall not make a trade of a felony (major serious crime, for example, murder, armed robbery, arson etc.)" It has been observed by the Court that no court of law can approve or give effect to an agreement which attempts to take the administration of law out of the hands of the judges and put it in the hands of private individuals. Thus, an agreement to stifle (suppress) prosecution is void on the ground of being against public policy. For example, X promises to drop a prosecution which has been instituted against Y for a murder and Y agrees to compensate for the murder by paying to X ₹50,000. This agreement is to stifle prosecution (of a non-compoundable offence) and hence void. For another example, N withdrew a criminal complaint lodged

against K and agreed to put it for the arbitration. Thus, the complaint was not prosecuted. It was held that the agreement is opposed to public policy and void.

**3. Agreements of champers and maintenance:** 'Maintenance' means the act of promoting that litigation in which a person has no interest of his own. In other words, where a person agrees to maintain a suit in which he has no personal interest, such proceeding is known as maintenance. Thus, maintenance tends to encourage speculation. On the other hand, 'champers' is a bargain whereby one party agrees to assist the other in recovering property and, in turn, is to share in the proceeds of the action. In England, both these agreements are declared illegal and void. However, in India, the position is quite different. Here, all agreements of maintenance and champerty are not void, and only those agreements which are opposed to public policy are void. It has been held by the Privy Council in India that champerty and maintenance are not illegal in India. The Courts will refuse to enforce such agreements only when they are found to be extortionate (i.e., demanding much too great or high) and unconscionable (i.e., unreasonable or shocking) and not made with the bonafide (genuine) object of assisting the claims of the person unable to carry on litigation himself. In other words, only those agreements which appear to be made for purposes of gambling in litigation and for injuring or oppressing others by encouraging unrighteous litigation so as to the contrary to public policy shall not be enforced.

Thus, other such agreements (which are not of the said nature) can be enforced. (Raja Venkata vs. Shri Venkatapathi Raju, 1924, 48 Mad. 230 and Amrita vs. Pratap, 1931, 52 CU 492).

**Examples:** (a) Agreement between a legal practitioner and his client in which remuneration of the legal practitioner is made dependent to any extent whatever on the result of the case in which he is engaged, is illegal as being opposed to public policy.

(b) A claim was of a simple nature and in fact no suit was necessary to settle the claim. An agreement was made to pay ₹30,000 to the plaintiff (i.e., the person who brought an action at law) for assisting in the recovery of the claim. It was held to be extortionate and inequitable and hence void.

(c) X promised to transfer a part of his estate to a financier Y. The value of the part amounted to ₹64,000. The financier, in return, was to spend a sum of ₹12,000 on the prosecution of an appeal in the Privy Council on behalf of X. It was held that although the agreement was bonafide, however, it could not be enforced because the reward to the financier being extortionate and unconscionable.

(d) An agreement to assist a litigant so as to delay execution of a decree against him is opposed to public policy and cannot be enforced.

(e) X agrees to pay 50% of the amount recovered through Court to Y in consideration of the services to be rendered by Y for the conduct of litigation on behalf of X. This will be legally enforceable.

**4. Agreements interfering with course of justice:** Any agreement whose purpose or effect is to use improper influence of any kind with judges or officers of justice is void. In other words, an agreement whose object is to induce any judicial officer of the Judiciary so as to make him act partially or corruptly is not enforceable because it is opposed to public policy.

**For examples:** (a) R agrees to pay ₹500 to K who is intended witness in a suit against R. K. promises, in return, for absenting himself from the trial. This is a void agreement.

(b) J promises to pay a very good reward amounting to ₹10,000 to C, an influential officer in the Court for the purpose of influencing the judge in a case to be heard against J. The agreement is void.

However, an agreement to pay a fee to a holy man for prayers for the success of a suit is not an interference with the course of justice.

**5. Agreement for marriage brokerage:** A reward for negotiating marriage is known as marriage brokerage. An agreement to pay money in consideration of producing or bringing out a marriage is void. Thus, dowry is a marriage brokerage and hence unlawful and void. For example, an agreement to pay money to the parent or guardian of a minor in consideration of his (parent's or guardian's) consenting to give the minor in marriage is void as being opposed to public policy. Similarly, an agreement to pay penalty if a minor daughter is not given in marriage to a particular person is void. Again, an agreement by a person to pay money to a stranger hired to procure a wife is opposed to public policy and will not be enforced by any of the Indian Courts.

**6. Agreements tending to create interest against obligation, i.e., duty:** An agreement to reward a person for an act which is obligatory on his part, i.e., which is the duty of the person to perform it, is opposed to public policy and hence void.

**Examples:** (a) An agreement to reward parents for giving their children in marriage is contrary to public policy.

(b) An agreement by an agent to receive without his principal's consent some compensation from a third party for the performance of his agency is invalid.

(c) A promise by an officer to do something in violation of his duty on the reciprocal promise by the other party to reward the officer, is opposed to public policy and hence void.

(d) M is the manager of a firm having a duty to pass tenders of items to be purchased. He agrees to pass the tender of P if P pays to him ₹1,000 privately. This agreement is void.

**7. Agreements for sale for public officer, titles and appointments:** An agreement to traffic (i.e., do unlawful trading) in public offices (i.e. vacant posts in government officers or enterprises, or religious officers, or public initiations) is opposed to public policy because it interferes with and debars or prevents the appointment of a person best qualified for the service of the public. The public policy requires that there should be no money etc. consideration for the appointment to an office in which the public is interested and which is the property of the public. Sale of public titles like Padma Vibhushan, Padma Shri etc. is also invalid.

**Examples:** (a) The sale of office of the Temple Management Committee is invalid.

(b) An agreement to pay money to a public servant to induce him to retire and thus make way for the appointment of the prayer (promisor) is virtually a trafficking with reference to an office and is void.

(c) An agreement to procure Padma Shri or Param Veer Chakra award in consideration of a house to the procurer is void.

(d) X pays money to Y who promises to use his influence and to secure for the son of X an appointment in Home Ministry. The son does not secure the appointment because Y fails to use his pulls and pressures. X cannot recover the money from Y because the agreement is void being opposed to public policy.

**8. Agreement tending to create monopolies:** The agreements tending to create monopolies or exclusive personal rights are void as being opposed to public policy. For example, a local grant to Mohan an absolute right to sell vegetables in a particular locality. This is void.

**9. Agreements not to bid:** An agreement between two parties not to bid against one another at an auction sale, with the object to defraud a rival decreeholder is unlawful. However, if the object of such an agreement is merely to make a good bargain, it is not unlawful.

**10. Agreements waiving an illegality:** Agreement which seeks to waive an illegality are void on the ground of public policy. Whenever an illegality appears, whether from the evidence given by one side

or the other, the disclosure is fatal to the case. An agreement in any form to waive the objection will be illegal and void.

**11. Agreements to commit a crime or to indemnify a person for his criminal act:** An agreement whose consideration is to commit a crime or to indemnify (i.e., to compensate) against the consequence of his criminal act, is opposed to public policy and hence void. For example, X promises to pay ₹5,000 to Y in consideration of his (X) assaulting Z. This is void. For further example, K promises to indemnify a firm of printers and publishers against the consequences of any statement damaging the reputation of M which is published in their daily paper Public Herald'. The firm was compelled to pay damages for the published libel (i.e., statement damaging reputation). Here, K's promise cannot be enforced by the Court as it is opposed to public policy.

**12. Agreements restraining personal liberty:** An agreement which unduly restrains the personal liberty or freedom of the parties to the agreement, is void as being against public policy. For example, X borrowed money from Y, the moneylender on the promise that X will not, without the written consent of Y, leave his job, not borrow money from any other source, not dispose of his property, not change his residence, or not spend money lavishly on his luxuries. Here, the agreement is void as it unduly restricts the personal freedom of X.

**13. Agreements in restraint of parental rights:** A father, and in his absence the mother, is a legal guardian of a minor child. The right of guardianship over the children cannot be exchanged for money by any agreement. Any agreement purporting to do so is void. For example, a father having two minor sons agreed to transfer their guardianship in favour of Mrs. Annie Besant and also agreed not to revoke the transfer. Subsequently, he filed a suit for the recovery of the children and filed a declaration that he was the rightful guardian. The Court held that he had the right to revoke the transfer of guardianship's authority and to get back the children.

**14. Agreements interfering with marital duties:** An agreement which interferes with the performance of a marital duty is opposed to public policy and hence void. For example, a promise by a married person to marry, during the lifetime or after the death of spouse, i.e., the life-partners is void. For another example, an agreement that the husband and wife shall always stay at the wife's parents house and that the wife will never leave her parental house is void.

**15. Agreements to influence public servants to act opposed to their duty:** Where an agreement discloses a tendency to corrupt public servants to decide matters otherwise than on merits of the case, the agreement is void. The public servants in such cases are included to violate rules and regulations and to act in contradiction to their professional duty. Owing to their unwarranted favour to one party, the other meritorious cases are spoiled. This is against public policy. For example, X agrees to pay ₹2,000 to an Excise Officer for not reporting an irregularity production records to higher authorities. The agreement is void and the Excise Officer cannot realise the money through the Court. For further example, an agreement to pay ₹50,000 to the Secretary of a Medical Board to secure a seat against merit in a Medical College is against public policy and void.

**16. Agreements in restraint of marriage:** An agreement in restraint of marriage of any person other than a minor is void.

**17. Agreements in restraint of trade:** An agreement in total or partial restraint of trade is void.

**18. Agreement in restraint of legal proceedings:** An agreement which restraints in any way a legal proceeding is void.

**19. Other agreements opposed to Public Policy:** The following agreements are treated as opposed to public policy and are void:

(a) An agreement which is to change the period of limitation to make it different from what is prescribed in the Limitation Act.

(b) An agreement to defraud revenue authorities.

(c) An agreement to defraud creditors. For example, to give preference to a friend creditor to the prejudice of other creditors in case of insolvency proceedings

(d) An agreement to influence election to public officer. For example, to influence voters by money or other indirect means, such as threats etc.

(e) An agreement to waive a natural legal benefit attached to an action or thing. For example, to waive benefit of transfer by a railway servant in consideration of some favour by his officer.

(f) An agreement to sub-let a right without proper written permission from the concerned authorities in this regard. For example, to sub-let a telephone connection or to sub-let a licence for production of liquor without the required permission.

**Instances of Agreements Not Opposed to Public Policy**

The Courts in India have held the following agreements as not opposed to public policy:

**1. Suicide:** It is neither a crime nor opposed to public policy to enforce a contract of insurance where the assured has committed suicide

**2. Absolving a party from liabilities:** An agreement to absolve a party from all liabilities or to extinguish all the rights of a party, if a specified action is not taken by one party against the other within a stipulated period in the contract, is not opposed to public policy.

**3. Agreement to avoid competition:** An agreement between two firms to avoid competition included that one firm will submit tender for a higher amount and the other for a lower amount and in case the letter's offer is accepted, it will pay the former a certain amount. Such agreement is neither fraudulent nor opposed to public policy.

**4. Exempting carrier from liability:** Air ticket which exempts the carrier or the pilot or other staff or employees or agents of the carrier from liability on account of their negligence, default, etc., is not opposed to public policy.

**5. Maintenance in lump sum:** An agreement by wife not to claim maintenance in consideration of lump sum payment is not opposed to public policy.

**6. Agreement for present separation:** An agreement between husband and wife to live separately for the present is not opposed to public policy. However, an agreement for future separation is bad.

**7. Choice of forum:** An agreement between the parties to institute suit concerning disputes between them in one court only out of two competent courts having territorial jurisdiction over the subject-matter of the disputes is valid and not opposed to public policy.

**8. Champerty:** An agreement to pay the agent appearing in a case before the Supreme Court his out of pocket expenses and a fixed sum if the case comes out successful is not void.

## 3.3 CHECK YOUR PROGRESS

1. An agreement which opposed public policy is known as _____.
2. An agreement forbidden by _____ is known an illegal agreement.
3. _____ influence make a contract void.
4. Agreement without _____ is void.

5. Agreement to murder a person cannot be _____.

## 3.4 SUMMARY

A contract can be enforced only if its object is lawful. A contract whose object or consideration is unlawful is void and not enforceable. An object is unlawful if it is forbidden by law, if is of such a nature that, if permitted, it would defeat the provisions of any law, if it is fraudulent, if it involves or implies injury to the person or property of another and if the court regards it as immoral, or opposed to public policy. An agreement which is against the welfare or interest of the society is said to be opposed to public policy.

## 3.5 KEYWORDS

**Immoral:** An act which is against the principles or standards of morality.

**Void Agreements:** These are those which are void *ab initio* or become subsequently void.

**Maintenance:** It means the act of promoting that litigation in which a person has no interest of his own.

**Marriage Brokerage:** A reward for negotiating marriage is known as marriage brokerage.

**Champerty:** An agreement whereby one party agrees to assist another in recovering property in a suit and share such proceeds.

## 3.6 SELF-ASSESSMENT TEST

1. Under what circumstances is the consideration or object of an agreement deemed unlawful? Give illustrations in support of your answer.
2. "An agreement cannot be enforced if it is immoral". Explain with examples.
3. Briefly describe the doctrine of public policy. Give examples of the agreements which are opposed to public policy.
4. What are the agreements of champerty and maintenance? Support your answer with suitable examples.
5. Give five instances where agreements are not opposed to public policy.
6. X promises to pay Y, an editor of a newspaper, ₹1,000 in consideration of his publishing a defamatory article against Z. On refusal by X for payment of the amount, Y files a suit against him. Will he succeed?

7. R promises to obtain for S employment in the Agricultural Ministry and S promises to pay ₹5,000 to R for the purpose. R gets the post of a clerk for 5, but S refuses to pay the amount. Can R realise the money through Court of Law?

## 3.7 ANSWERS TO CHECK YOUR PROGRESS

1. Void Agreement
2. Law
3. Undue influence
4. Consideration
5. Enforceable by Law

## 3.8 REFERENCES / SUGGESTED READINGS

1. M.C. Shukla, A Manual of Mercantile Laws; Sultan Chand & Company, New Delhi.
2. N.D. Kapoor, Mercantile Law; Sultan Chand & Co., New Delhi.
3. M.C. Kuchhal, Mercantile Law; Vikas Publishing House, New Delhi.
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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 4 | |

# VOID AGREEMENTS

## STRUCTURE



## 4.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the concept of void agreements and make a distinction between illegal and void agreements.
- Describe in detail the various cases of void agreements.

## 4.1 INTRODUCTION

It is the essential element of a void contract that it must not have been expressly declared void by law. Any void agreement is not enforceable. Thus all agreements may not be enforceable. Only those agreements can be enforced which fulfil the essentials laid down in Section 10 of the Indian Contract Act. This Act expressly declares certain agreements to be void. Section 2(g) of the Act says that an agreement not enforceable by law is void. Such agreements are void ab initio.

## 4.2 MEANING OF VOID AGREEMENTS

It means that void agreements are void ab initio. Therefore, they are not enforceable by law. Void agreement does not create any legal relationship between the parties. Hence it is useful to differentiate between illegal and void agreements.

**Difference between Illegal and Void Agreements**

| S. No. | Basis of Difference | Illegal Agreement | Void Agreement |
|---|---|---|---|
| 1. | Forbidden by law | An illegal or unlawful agreement is one which is actually forbidden by law. | A void agreement is not forbidden by law as in the case of mirror. |
| 2. | Enforceability and forbidden by law | An illegal agreement is both unenforceable and forbidden. | A void agreement is only unenforceable but not illegal. |

The difference between an illegal and void agreement is also related to their effect upon the collateral transactions. If the main transaction is forbidden by law, for example, smuggling, a collateral transaction like financial assistance given to enable person to smuggle the diamond, will also be illegal and money provided in financial assistance will be irrecoverable. However, if the main transaction is void, only (as in the case of wagering agreement) its collateral transaction will remain enforceable.

Following agreements have been expressly declared as void by the Indian Contract Act:

1. Agreement made by or with incompetent parties [Sec. 11]

2. Agreement made under a mutual mistake of fact between the parties [Sec. 20].

3. Agreement, the consideration or object of which is unlawful in full [Sec. 23].

4 Agreements the consideration or object of which is unlawful in part [Sec. 24].

5. Agreements made without consideration [Sec. 25].

All above points have already been discussed in earlier lessons. Therefore, only the following agreements shall be discussed -

6. Agreements in restraint of marriage [Sec. 26].

7. Agreements in restraint of trade [Sec. 27].

8. Agreements in restraint of legal proceedings [Sec. 28].

9. Agreements the meaning of which is uncertain [Sec. 29].

10. Agreements by way of wager [Sec. 30].

11. Agreements, of impossible events [Sec. 56].

### 4.2.1 AGREEMENTS IN RESTRAINT OF MARRIAGE

According to Section 26 of the Indian Contract Act, "Every agreement in restraint of the marriage of any person, other than a minor, is void."

An agreement in restraint of the marriage of a minor cannot be void, as it is considered to be in the interest of the minor. Every person is free to marry. Anybody cannot be bound by law to marry; but an agreement restraining a person not to marry is illegal. Any agreement restraining a person from marrying anybody or from marrying anybody except a particular person is void agreement.

In the case of Lawe Vs. Peem (1768) Burr 225 X promised to marry none else except Miss Y and in default to pay her a sum of £ 2,000. X married some one else and Miss y sued for the recovery of that sum on the ground. Court held that the agreement was in restraint of marriage and as such void.

You should understand that in India any restraint of marriage whether total or partial is opposed to public policy, hence not permitted and void. In English law, however, only an absolute restraint is void.

### 4.2.2 AGREEMENTS IN RESTRAINT OF TRADE

According to Section 27 of the Indian Contract Act, "Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void."

All agreement in restraint of trade, whether general or partial, qualified or unqualified, are void. It is, therefore, not open to the Courts to enter into any question of reasonableness or otherwise of the restraint of trade. Courts do not allow any tendency to impose restrictions upon the freedom of person to carry on any trade.

An agreement seeking to restraint a person from exercising a lawful profession, trade or business is void to that extent. Public policy requires that every person should have freedom to work for himself.'

In England, all agreements were declared as void which placed any restrictions upon a man's right to his trade or profession. But now partial restraint or a restraint confined to a limited space and time is valid. Slowly new trends crept in with the rapid expansion of trade. The test of partial restraint was given up and the test of reasonableness was substituted, In *Nordenfelt* Vs. *Maxim Nordenfelt*, etc., Co. (1893). A.C. 535, the House of Lords held that "the real test for determining the validity of agreements in restraint of trade was, whether the restraint imposed was reasonable, for good consideration, not prejudicial to the interests of the public, and not more onerous than necessary for the protection of the party imposing the restraint."

The Indian contract Act as stated in Section 27 prevents a partial as well as a total restraint of trade. All agreements in restraint of trade whether general or partial, qualified or unqualified are void. For example, the restraint in trade is taboo even if it is partial unless it comes within the exceptions laid down in the Section 27 of the Act. An agreement to close a factory for 4 months in a year, and an agreement that one person would sell ice for 28 days in a month and the other for the rest of the month are void.

In the case of *Fraser* Co. Vs. *Bombay Ice* Co. (1905) 299 Bam. 107, it was held that every man shall be at liberty to work for himself. And shall not be at liberty to deprive himself or the State of his skill, labour or talent by any contract that be enters into.

**Example:** A consultancy firm employs Y a young engineer as his assistant who as part of the bargain promises not to engage in the practice of engineering within the city after the termination of his employment. Although firm's practice extends in the city, the convenant is illegal since it imposes undue hardship upon his assistant.

**Exceptions or Case in which restraint of trade is valid:** The rule that an agreement in restraint of trade is void is not true in all cases. There are following two types of exceptions

1. Statutory exceptions:

(a) Sale of goodwill

(b) Partner's competing business

(c) Rights of outgoing partner

(d) Partners similar business on dissolutions.

(e) Agreement in restraint of trade.

2. Other exceptions:

(a) Service agreements

(b) Sole selling agreement

(c) Trade combinations

**1. Statutory Exceptions**

**(a) Sale of Goodwill:** The exception contained in Section 27 related to the sale of goodwill. On the sale of the goodwill, it is certain the seller of goodwill may agree not to carry on similar business within certain local limits.

The exception says that one who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein provided that such limits appear to the Court reasonable, regard being made to the nature of the business.

**Example:** X agrees to sell to Y the goodwill of a business. X then sets up a similar business close-by Y's showroom and solicits his customers. This is contrary to the agreement and Y may obtain an injuction to restrain X.

Case of *Golds oll* Vs. *Gold mand* (1915) 1. Ch. D. 292 is important in this case D a seller of jewellery, sells his business to P and promises not to carry on similar business, it was held that the restraint with regard to jewellery was valid.

**(b) Partner' Competing Business:** Section 11 (2) of the Partnership. Act, 1932 says that a partner of a firm may be restrained 'from carrying on a similar business independently, so long as he remains a partner. It shall not be void as being in restraint of trade.

**(c) Rights of outgoing partner:** An outgoing partner may agree with other partners that on ceasing to be a partner, he will not carry on a similar business within a specified period or within specified local limits.

This agreement shall not be void if the restrictions are reasonable. [Sec. 36 (2) of the Partnership Act.]

**(d) Partners Similar Business on Dissolution:** In this case partners may, agree that ill or any of them shall not carry on similar business within a specified period or within specified local limits [Sec. 54 of the Partnership Act., 1932]

**(e) Agreement in Restraint of Trade:** Any partner upon the sale of the goodwill of a firm, with the buyer of goodwill that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such agreement shall be void if the restrictions imposed are not reasonable. [Sec 55 (3) of the Partnership Act.]

**2. Other Exceptions or Exceptions under the common Law:** These are some other exceptions recognized by the courts:

**(a) Service Agreements**

**During the Term of Employment:** Any agreement of service restraining an employee, during employment, not to compete with his employer is valid. Service agreements often contain a clause by which the employee is restricted from working anywhere else during the agreement. An agreement by which person binds himself during the term of the agreement not to compete with his employer by carrying on similar business, or accepting any other employment during the term of his agreement is not in restraint of trade. The employer can prohibit the employees from working elsewhere during the term of service.

Now-a-days it is in practice to appoint management and other technical trainees. A lot of time and money is spent in training the candidates. So, it will be a waste for the organization if these persons left for other organizations immediately after training. Therefore, a service bond is normally got signed whereby the trainees (employees) agree to serve the organization for an agreed period. Such agreements, if reasonable, do not amount to restraint of trade and hence are not void.

**Example:** Y an engineer agrees to employ a fresh engineering graduate as his assistant on the condition that he will not carry on his practice during his employment with X. It is not a void agreement.

**After the Termination of Employment:** A restraint by the employer, on an employee not to engage in a similar business or not to accept a similar engagement after the termination of service is void and so not enforceable.

An agreement restraining an employee to compete even after the termination of employment (service) should be void.

**Example:** A bank appoints a cashier subject to the condition that after ceasing to be in service he would not join the service of any other bank for a period of 3 years, this agreement is void.

**(b) Sole selling agreement:** Where restraint is to protect the employer against an employee making use of secrets of business, the restraint is valid.

A producer may agree to sell the whole of his production to a particular seller. This is enforceable.

In the case of *Niranjan Shankar Golikari Century* Vs. *Spinning and Manufacturing Co. LTD*. Air 1967 SC 1098. agreement was held to be valid and the employee was restrained from serving anywhere else during the currency of the agreement.

In this case *CMSC Co. Ltd*. Manufacturing special yarn was offered collaboration by a foreign producer. It was the condition that the company shall maintain secrecy of all the technical information and that it should receive corresponding secrecy arrangement from its workers and employees. One employees named N was appointed for 5 years on the condition that during this period he would not take employment anywhere even if he left this employment.

This agreement was held enforceable. Although a master is not entitled to prohibit his servant after the termination of employment but he is entitled to reasonable protection against exploitation of trade secrets by the previous employee.

**(c) Trade Combinations:** An agreement entered into between different business firms in the nature of a trade combination in .order to maintain a price level and avoid underselling is legal. An agreement between firms not to sell their products below a certain price, acquire profits and to divide the business and profits in a certain proportion is not illegal. Where mutual benefit is not the purpose of trade combination but an out and out monopoly is sought to be created, then the agreement is void.

Thus, if combinations are not in the nature of monopoly, they are not void. Trade combinations in the nature of trade regulations are perfectly valid.

In the case of *Fraser* & *Co. Vs. Bombay Ice Mfg. Co*. (1905) Bom. 107, agreement to regulate trade was held not void. In this case an agreement between certain ice manufactures fixed the minimum price for sale. It was also agreed in what proportion ice manufactures will manufacture the ice and receive the

profits. Some of the ice manufactures were also prohibited from selling at Poona and some others at Steamers.

In this case the Court held that the agreement was not hit by Section 27 of the Indian Contract Act as the whole object being to regulate business and not to restrain it.

### 4.2.3 AGREEMENTS IN RESTRAINT OF LEGAL PROCEEDING

This section provides that an agreement which tends to prevent the process of justice is void.

Every agreement by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce Ms rights, is void to that extent. If a servant agrees not to sue for wrongful dismissal is void.

Section 28 of the Act says that every agreement:

(i) by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce Ms rights, or.

(ii) Which abolishes the rights of any party thereto, or discharges any party thereto from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to that extent.

Following are the exceptions to this rule:

**1. Saving of contract to refer to arbitration dispute they may arise:** Section 28 shall not render illegal a contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration, and that only the amount awarded in such arbitration shall be recoverable in respect of the dispute so referred. Thus, an agreement to refer future disputes in relation to contract for arbitration is valid.

**2. Saving of contract to refer questions that have already arisen:** Section 28 shall not render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration.

### 4.2.4 AGREEMENTS MEANING OF WHICH IS UNCERTAIN

According to this section agreements, the meaning of which is not certain, or capable of being made certain, are void,

Where there is ambiguity in the wording of the agreement, it is not possible to read the exact intention of the parties. If the term in an agreement is vague and might be interpreted in as many ways a there are' interpretations, thereof, the agreement shall be void, for scope an agreement to sell goods at a concessional rate is void. Similarly, an agreement to pay rent in cash without the rate being definitely fixed shall be void.

**Examples:** (i)X agrees to sell to Y "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

(ii) X agrees to sell to Y one hundred tons of oil of a specified description, known as an article of trade. This agreement is not void as there is no uncertainty here to make the agreement void.

(iii) X who is a dealer of coconut oil only, agrees to sell to Y "one hundred tons of oil". The nature of X's trade affords an indication of the meaning of the words, and X has entered into an agreement for the sale of one hundred tons of coconut oil.

(iv) X agrees to sell to Y 'all the grain in my grainary at Kanpur". There is no uncertainty here to make the agreement void. Thus, contract is enforceable.

Where the price given in agreement is based on luck or an uncertain event it is void for uncertainty. Similarly an agreement to agree in future is also void for there is uncertainty whether the parties will be able to agree or not.

### 4.2.5 WAGERING AGREEMENTS

This section says that agreements by way of wager are void and no suit shall be brought for recovering anything alleged to be won on any wager or, entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made. The Act has not defined a wagering agreement. Now, a question arises, what is a wager? A wager is an agreement to pay money or money's worth upon the determination of an uncertain event.

Wager means a bet. A wager is a game of chance in which the chance of either winning or losing is wholly dependent on an uncertain event. The parties to a wagering agreement must agree that upon the ascertainment of the uncertain event, one should win. Each of both party stands equally to win or lose the bet. The chance of gain or the risk of loss is of both sides. The essence of a wagering agreement

is that neither of the parties should have any interest in the agreement other than the sum which he will lose or win.

A comprehensive definition of the term 'wager' has been given by the court of law in the case of *Carlill* Vs. *Carbolic Smoke Ball Co*. (1893) 1 Q B 256, "A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent on the determination of that event, one shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract that the sum Or stake he will so win or lose. There being no other real consideration for the making of such contract by either of the parties. It is essential to wagering contract that each dependent on this issue of the event, and therefore, remaining uncertain until that issue is known If either of the parties may win but cannot lose, it is not a wagering contract."

In the view of Sir William Anson, "Is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event."

In the view of Cockburn C. J., "A contract by 'A' to pay money to 'B' on the happening of a given event in consideration of 'B's promise to pay money to 'A' on the event not happening."

Thus, it can be concluded that a wagering agreement is an agreement under which money or money's worth is payable by one person tO another on the happening or non-happening of an uncertain event.

The essence of wagering is that one party is to win and the other to lose upon an uncertain event.

**Example:** 1. X bets with Y As to whether it would rain on Sunday or not. X promising to pay ₹500 to Y if it rained and Y promising an equal amount to X, if it did not. This agreement is wager.

2. X and Y agree to deal with the differences in prices of a rice. Such an agreement is a wager.

3. A lottery is a wagering agreement (–) it depends upon chance.

**ESSENTIALS OF A WAGERING AGREEMENT**

Following are the essentials of wagering agreement:

1. There must be a promise to pay money or money's worth.
2. Promise must be conditional and must depend on the happening of or not happening of an uncertain event.
3. The uncertain event may be past, present of future.

4. There must be two parties and each party must stand to win or lose.
5. There must be mutual chance of gain or loss.
6. There must be a common intention to bet at the time of making such an agreement.
7. Neither party should have any interest and control over the happening of the event other than the sum or stake he will win or lose.

   If any party has any proprietary interest in the subject matter, the same ceases to be a wagering agreement. Wagering agreement is distinguished from a contract of insurance.
8. Stake money should come out of pockets of the partners themselves. If it is subscribed by the outsiders, it is not a wagering agreement.

**Examples**

1. X promises Y to pay him ₹1,100 if the C cricket team beats B team, in consideration of which Y promises X to pay ₹600 if the B team beats the C team. The agreement is a wager.

2. There is an agreement between X and Y which provides that if it rains on Monday X will pay Y ₹1,000 and if it does not rain Y will pay the same amount to X. It is a wagering agreement.

**EFFECTS OF WAGERING TRANSACTIONS OR AGREEMENTS**

Agreement by way of wager is void. Hence, such agreement cannot be enforced. Amount won on a wager cannot be recovered in any court of law. In the case of *Badridas Kothari* Vs. *Maghraj Kothari AIR* 1967 Cal. 25, P & D entered into wagering transactions in securities and one became indebted to another. A promissory note was executed for the payment of debt. The promissory note was held to be not enforceable.

Section 30 of the Act provides "Agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made". Thus, all agreements by way of wager are void.

**Effects of transacti6n collateral to wager:** Wagering agreement are void and not illegal. However, in the case of States of Maharashtra and Gujarat, it was held that the wagering agreements are not only void but also illegal. In these States the collateral transactions to wagering agreements become tainted with illegality.

According to Section 30 of the Act, "Nothing in this section shall be deemed to legalize any transaction connected with horse racing. To which the provisions of Section 394-A of the Indian Penal Code (XLV of 1850) apply."

Unless wager amounts to a lottery, which is a crime according to Section 294-A of the IPC it is not illegal but void. Thus, except in case of lotteries the collateral transactions remain enforceable and will be enforced at law.

**Case Law:** In the case of Leicester & Co. V.S.P. Mullick (1923) cal. 444, defendant lost ₹8,500 to plaintiff on horse races. Defendant made a Hundi to prevent plantiff from declaring him a defaulter.

In his club Plantiff filed a suit, defendant pleaded that it was a wagering contract and the consideration was not lawful. In this case the court held that a wagering agreement is void. A wagering agreement does nt affect the collateral agreement.

**Examples**

(1) A broker can recover his brokerage from the principal even if the contract entered into on behalf of the principal was a wagering contract.

(2) Losses paid by an agent on behalf of the principal on a wagering agreement can be enforced.

(3) Money lent for the purpose of gambling is recoverable even though lent with the knowledge of it purpose.

**Kinds of wagering agreements:** Following are the kinds of wagering agreements:

**1. Lotteries:** A lottery is a game of chance and an agreement to purchase lottery ticket is a wagering agreement. The person conducting the lottery can not be punished.

**2. Crossword Puzzles:** A crossword competition in which prizes depend upon the

competitor's solution matching with a previously prepared solution is a lottery and, therefore, it is wagering transaction.

**3. Prize competition agreements:** Although prize competitions in games of skills are not wagering agreement. However, Prize Competition 'Act, 1955 has declared as void prize competitions in games of skill of ₹1,000 or more.

**4. Gambling:** It is restricted by law. It is a threat or danger to the peace of the society.

**5. Horse Race:** According to Section 30, a subscription or contribution or agreement to subscribe or contribute a sum of ₹500 or more as a prize to the winner of horse race is valid. However, below ₹500 shall be void.

**EXCEPTIONS OF WAGER AGREEMENTS**

Following are the exceptions of wager agreements:

**1. Commercial Transactions:** Any contract for actual purchase and sale is not a wagering contract. But in some cases it becomes difficult to decide whether a particular transaction was in fact a contract of purchase and sale or a wagering contract for the payment of difference of purchase and sale. For example A and B, contract for the sale and

purchase of fifty tins of ghee to be delivered 2 months after at ₹700 per tin. Here it maybe difficult to determine whether it is a perfectly commercial or whether the two traders are really speculating and wagering upon the prices. To bring a case within the provisions of Section 30, a common intention to pay and receive differences is required. The intention to wager must be on the part of both the parties.

**2. Horse Race:** Section 30 of the Act makes an exception in favour of certain prizes for horses' races. It provides that an agreement to contribute or subscribe for or towards only prize or a sum of money of the value of amount of ₹500 or upwards to be awarded to the winner of only horse race is valid agreement and not a wager.

**3. Crossword Puzzles:** The literary competitions involving applications of skill are not wagers. In such competitions efforts, are made to find out the best and skilful competitor.

**4. Chit Funds:** A contribution to chit fund is not a wager. Some gain does come to some members, but none of them stands to lose his money. Contribution made by the members are repaid by draw of lots.

**5. Contracts of Insurance:** A contract of insurance, is not a wager though it is performable upon an uncertain event. It is so because therein the parties have an interest in the contract. A contract of insurance is a contract by which a person in consideration of certain sum agrees to bear the loss of property or life in which such other person has insurable interest. A person has an insurable interest in his own life.

**Example:** A general insurance company promises to pay X ₹50,000 if his car is destroyed by an accident within a year on payment of a premium of ₹4,000.

**Difference between Wagering Agreements and Insurance Contracts**

| S. No. | Basis of Difference | Wagering Agreement | Contract of Insurance |
|---|---|---|---|
| 1. | Meaning | A wagering agreement is an agreement, under which money or money's worth is payable on the happening or non happening of a future uncertain event. | A contract of insurance is a contract to make good the loss of life or property of another person against some consideration. |
| 2. | Insurable Interest | In the case of wagering agreement, insurable interest is not necessary. Thus, the holder of an insurance policy must have an insurable interest. | In the contract of insurance the insured must have insurable interest. |
| 3. | Encouragement | Wagering agreement, are considered to be against public policy. | Insurance contracts are regarded as beneficial to the society and are therefore, encouraged. |
| 4. | Nature of Contracts | A wagering agreement is a conditional contract. | Insurance contracts are contracts, of indemnity except life insurance contract, which is a contingent contract. |
| 5. | Mutuality of Interest | In a wagering agreement there is a conflict of interest. In reality there is no interest at all to protect. | In a contract of insurance both the parties are interested in the protection of the subject matter. It is a mutuality of interest. |
| 6. | Validity | Wagering agreement is void being expressly declared by law. | A contract of insurance is a valid and enforceable. |
| 7. | Risk computation | Wagering agreement is a gamble without any scientific calculation | Insurance contract is based on scientific and actual calculation of |

| | | | |
|---|---|---|---|
| | | of risk, | risk. |
| 8. | Number of Parties | In a wagering agreement, there are two parties. | There may be two or three parties in an insurance contract. |
| 9. | Based on Good Faith | In the case of wagering agreement, there is no good faith. | An insurance contract is based on utmost good faith. |

**6. Agreement of Speculation:** Speculation is the practice of buying and selling goods for future delivery at a price agreed upon. It includes a sale or purchase in future in the expectation of earning a profit from a change in price in the meantime. It has been decided in some decisions that speculative transaction is not a wagering agreement.

**Difference between Wagering Agreement and Speculative Agreement**

| S. No. | Basis of Difference | Wagering Agreement | Speculative Agreement |
|---|---|---|---|
| 1. | Origin | It originates from the point where foresightedness ends. | Speculative transaction begin from the point where foresightedness begins. |
| 2. | Nature of Agreement | These are of non commercial nature. | These are of commercial nature. |
| 3. | Legality | These are void. | These are valid. |
| 4. | Base | There is no concrete base of wagering agreement. | These are based on material thinking. |
| 5. | Origin of Risk | Risk is created knowingly. | In it risk arses due to natural causes. |
| 6. | Practicability | There is no practicability in the wagering agreements. | There is found practical utility in these transactions. |
| 7. | Contribution in Production process | Wagering agreement does not contribute in production process. | Speculative transactions contribute in production process. |

**7. Teji-Mandi Dealing:** It is also a form of speculative transaction. Therefore, they cannot be void unless they are not to earn profit by difference of rates.

### 4.2.6 AGREEMENTS OF DOING IMPOSSIBLE ACTS

Section 56 of the Act says that an agreement to do impossible act is void. An agreement to do an act impossible in itself is void. The law does not compel anybody to do an impossible act. Where a contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

If one person has promised to do something, which he knew, or with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non performance of the promise.

**Examples**

1. X agrees with Y to discover treasure by magic. The agreement is void.

2. X and Y contract to marry each other. Before the time fixed for the marriage, X goes mad. The contract becomes void.

3. X contracts to marry, Y, being already married to Z, and being forbidden by the law to which he is subject to practice polygamy. X must make compensation to Y for the loss caused to her by the non-performance of his promise.

If a suit can be filed to recover the presents or Jewelleries given, if the marriage does not take place; But if the marriage has taken place, neither a suit can be filed to recover the consideration nor the party paying the consideration can get it back. A contract may become void due to a number of reasons.

The set of Reciprocal Promises which is Illegal, is a void Agreement. (Section 57)

Where persons reciprocally promise, firstly, 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 contract and enforceable but the second is a void agreement and unenforceable.

**Example:** X and Y agree that X will sell Y a plot for ₹1,50,000 but that, if Y uses it as a gambling place, he shall pay X ₹2,00,000 for it.

The first set of reciprocal promises, namely, to sell the plot and to pay 1,50,000 for it, is a contract.

The second set is for an unlawful object, namely, that .Y may use the plot as a gambling place and is a void agreement.

**In the case of an Alternative Promise that branch of it which is illegal, is a void agreement**

Where an alternative promise, one branch of which is legal and the other is illegal, the legal branch alone can be enforced.

**Example:** X and Y agree that X shall pay ₹1,00,000 for which Y shall afterwards deliver to X either wheat or smuggled wine.

This is a valid contract to deliver wheat and a void agreement as to the wine.

## 4.3 RESTITUTION

Restitution implies restoration or return. Thus, restitution means giving back something to its proper owner. When a contract becomes void, it is fair that the party who has taken any benefit under it must restore it to the other party and if restoration is impossible it must compensate the other party.

According to 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." This rule is based on the noble principle of Equity and Justice. If a person has been unjustly enriched at the expense of the other party, he should give back the benefit received.

The base of the principle is that no person should be allowed to enrich himself unjustly at the expense of other party. Therefore, if any party has received any undue benefit at the expense of other, he should restore it. If restoration is not possible he should compensate the other party.

The law relating to restitutions is found in Section 64 and 65. According to Section 64, "When 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 promisor. The party rescinding a voidable 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."

**Examples**

1. X pays Y 5,000 rupees in consideration of Y's promising to marry Z, X's daughter, Z is dead at the time of the promise. The agreement is void, but Y must repay X the 5,000 rupees.

2. X contracts to sing for Y at a concert for 5,000 rupees, which are paid in advance. X is too ill to sing. X is not bound to make compensation to Y for the loss of the profits which y would have made if X had been able to sing, but must refund to Y the 5,000 rupees.

**Enforceability of the Rule:** Section 65 of the Act promotes a right of restitution under the following two circumstances:

**1. Where an agreement is found to be Void:** Where there is no contract at, all a party who has received any advantage under an agreement must return it to the other party or compensate him.

**Example:** X agrees to sell his T.V. to Y. Y has paid an advance of ₹5,000 to X, unknown to both the parties, the T.V. had already been destroyed before the date of agreement. The agreement is void, but X must return ₹5,000 to Y.

**2. Where a contract becomes Subsequently Void:** When a contract becomes void after its formation due to becoming it impossible or illegal, the party who has received any advantage should restore it to the other party from whom the advantage was received.

**Example:** (1) X agrees to sell his car for ₹1,00,000 to Y. Y pays an advance of ₹50,000 to X. Before the sale takes place, the car is destroyed. The contract becomes impossible and hence void. X should return ₹50,000 paid by Y.

(2) X agrees to sell one ton of wheat to Y. Y pays an advance of ₹2,000 to X before the sale takes place, later on Government prohibits sale of wheat. The agreement becomes illegal and hence void. X should return ₹2,000 to Y.

**Essentials of the Rule of Restitution:** Following are the important features of the rule of restitution:

**1. Applicability in the Two Circumstance:** This rule applies in the following two agreements and contracts: (i) When an agreement is discovered to be void subsequently, (ii) When a contract subsequently becomes void due to supervening impossibility or any illegality or repudiation of a voidable contract or subsequent impossibility of any contingent event.

**2. Agreement should be found to be Void:** Agreement is taken to be void when concerned party finds out that the agreement is void.

**3. Compensation:** There are two alternatives available to the person who has acquired some benefit. He can restore the benefit or make compensation for it to be valued in money.

**4. Partially Performed Contract:** Where a contract has been performed in part and is discovered to be void at a later stage, the court may order to restore in part.

**Example:** X, a singer, contracts with Y, the owner of a theatre, to sing at his theatre for three nights in every week during the next three months, and Y engages to pay her five hundred rupees for each night's performance. On the seventh night, X wilfully absents herself from the theatre, and Y, in consequence, rescinds the contract, Y must pay X for the six nights on which she had sung.

**5. Mutual Advantages to be Restituted:** Where both the parties have received some benefit, the advantage, received by one party cannot be set off by the benefit received by another party. The rule is that both the benefits must be restituted.

**6. Any Person:** The rule of restitution is not confined to the parties of agreement only. If any third party has received any benefit under an agreement, it must be restituted.

**Case Law:** In the case of the *Orissa State Electricity Board* Vs. *M/s Indian Metals* and *Ferro Alloys Ltd*. AIR 1991 Orissa 59 it was held that when agreement becomes void and impossible the defendant should refund to the plaintiff the amount received as part payment of consideration.

**Exceptions to the Law of Restitution:** Following are the exceptions to the rule of restitution:

**1. Persons not competent to Contract:** Rule of restitution does not apply to the persons who are wholly not competent to enter into contracts e.g., minors. For example, in the case of Mohiri Bibi v. Dharamodas Ghosh, the minor was not asked to return ₹8,000 obtained by him against the mortgage, although the mortgage was declared void.

However, where a minor has misrepresented his age, the court may ask him to restore the benefit. On equitable grounds, the Court may ask the minor to restore the benefit if he has misrepresented his age.

**2. Agreements which are void-ab-initio:** If an agreement is void since beginning and both the parties know this fact, Section 65 i.e., rule of restitution does not apply. Law of restitution may not apply to agreements which were known to be void when they were entered into.

**Example:** X promises Y to produce diamond by magic. Y pays an advance of ₹50,000 Y can neither recover ₹50,000 nor compel X to produce diamond by magic as X and y know ought to know that the act is not possible.

**3. Breach of Warranty by a Party:** Where a warranty is rescinded by one of the parties, the other party shall be discharged from the performance of contract. Rule of restitution does not apply here.

**4. Void under the Negotiable Instrument Act:** Section 87 of Negotiable Instrument Acts says that where the promise makes some material alteration in the instrument without the consent of promisor, the rule of restitution does not apply.

## 4.4 CHECK YOUR PROGRESS

1. The term void agreement is defined under which section of the Indian Contract Act, 1872.
2. Under which section, Negotiable Instrument Act says that where the promise makes some material alteration in the instrument without the consent of promisor, the rule of restitution does not apply.
3. ---------- is the practice of buying and selling goods for future delivery at a price agreed upon.
4. Under which section, the set of Reciprocal Promises which is Illegal, is a void Agreement?
5. Which Section of the Act says that an agreement to do impossible act is void?

## 4.5 SUMMARY

In public interest certain agreements have been expressly declared void. As such, these are not enforceable. Agreements in restrain of marriage other than by a minor are void as everybody has a right to get himself married. Everybody is free to carry on any lawful trade, business or profession of his choice. Any agreement restraining a party from seeking Court's help is void. Agreements the meaning of which is uncertain are void. An agreement to pay money or money's worth on the happening of uncertain event is void. An agreement to do an act impossible in itself is void. When a contract becomes void, it is fair that the party who has received any benefit under it must restore it to the other party who has received any benefit under it must restore it to other party and if restoration is not possible it must compensate the other party.

## 4.6 KEYWORDS

**Void Agreement:** This type of an agreement does not create any legal relationship between the parties.

**Wagering Agreement:** It is a promise to give money or money's worth upon the determination of an uncertain event.

**Lottery:** It is a game of chance.

**Restitution:** It implies restoration or return.

## 4.7 SELF-ASSESSMENT QUESTIONS

1. What is void agreement. Describe the various agreements that are expressly declared void.
2. "Agreements in restraint of trade are void." Explain this statement. Are there exceptions to this rule?
3. According to Sec. 26 of the Indian Contract Act. "Agreement in restraint to marriage are void". Explain, and also discuss exceptions to this general rule, if any.
4. What is a wager? Is a wagering agreement void or illegal? How would you distinguish between a commercial transaction and a wagering transaction?
5. What is an agreement by way of wager? Is such an agreement void or illegal? Is a contract of insurance a wagering contract?
6. What are agreements in restraint of legal proceedings? Why have these been declared void?
7. "Impossibility of performance cannot be pleaded as an excuse for non-performance." Comment the statement.
8. In what cases the consideration and object of an agreement are said to be unlawful? Describe in detail.

## 4.8 ANSWERS TO CHECK YOUR PROGRESS

1. Section 2 (g)
2. Section 87
3. Speculation
4. Section 57
5. Section 56

## 4.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 5 | |

# PERFORMANCE OF CONTRACT

## STRUCTURE



## 5.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Explain the performance of contract and its types.
- Describe a valid tender and its effect on a contract.
- Enumerate the contracts which need not to perform.
- Discuss the rules regarding performance of a joint promise.

## 5.1 INTRODUCTION

Performance of a contract is one of the methods of discharge of a contract. The performance of a contract may be of two types namely actual performance and attempted performance. The actual performance discharges the contract and also discharges the parties. It is known as the natural method of discharge of the contract. An attempted performance means the promisor has made an offer to perform a promise to the promise but it has not been accepted.

## 5.2 MEANING OF PERFORMANCE OF CONTRACTS

A legal contract creates obligation between the parties. These obligations cannot be separated from the contract. When these obligations are carried out, the contract will be performed. Thus, performance of a contract means the carrying out of the obligations. A contract is entered into with the object that it will be performed by the parties. By performance is meant that the parties have done whatever they had agreed to do or have fulfilled their obligations. As per 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...." An obligation continues till the contract has been discharged by actual performance. Performance of contract consists in doing or causing to be done what the promisor has promised. According to Section 37, the parties must either (a) perform their respective promises or (b) offer to perform the same, unless (c) such performance is dispensed with or (d) excused under any statute.

The 'performance' means to do what should be done. Performance of a contract means fulfilment of legal obligations by all the parties of a contract. Thus, performance means that the parties to a contract have carried out their respective obligations. When a contract is duly performed, it comes to a happy end and nothing more remains. It is a normal and natural way of terminating a contract.

The contract is completely terminated or discharged when both parties to a contract completely and precisely carried out their exact thing which each has agreed to do. Where one party only carried out his promise or obligation he alone is discharged and he acquires a right of action.

### 5.2.1 EFFECT OF PERFORMANCE

Performance of a contract has following two effects:

1. When a party who wishes to enforce the other party's obligation may have to express that he has performed or is willing to perform his own promise:
2. When a party who performs, performance is thereby performed from his promises.

### 5.2.2 TYPES OF PERFORMANCE

Performance may be of two types i.e., actual or attempted performance. If a party has done his obligation to do there is nothing left for him to do. Then he is said to have performed. The performance in order to be complete must, however, be made in accordance with the terms of the agreement.

Types of performance can be discussed as under:

**1. Actual Performance:** When all the parties to a contract have done what they had undertaken under a contract, the contract is said to have been actually performed the contract.

**Example:** A agrees to sell his T.V. to B for ₹8000. A delivers the T.V. and B makes the payment for it. It is an actual performance.

**2. Attempted Performance or Offer to Perform or Tender:** When one party to the contract offers to perform the contract at proper time and place and in proper manner but the other party does not accept it, there is attempted performance or offer of performance or tender.

**Example:** A agrees to sell his mobile set to B for ₹2,500 A offers to deliver the mobile set but B does not accept it. It is an attempted performance by A.

### 5.2.3 TENDER

In technical sense an attempted performance is known as 'Tender'. However, Section 38 has not used the terms 'Tender'. Oftenly, the promisor offers performance of his obligation at the proper time and place but the promisee refuses to accept the performance. This is called as attempted performance or 'tender'. As per Section 38, if a legal tender is made and is not accepted by the promisee, the promisor shall not be responsible for ion-performance nor shall he lose his rights.

If the promisor to the contract has made an offer of performance and the offer has been refused, the promisor shall not be responsible for non-performance. Offer of performance can also be called as tender. A party who has entered into a contract for the delivery of goods or to pay money to another person will be deemed to have performed it, if he has offered the said goods or money to the party. A

valid offer of performance is deemed to be performance itself. When an offeror produces goods of the genuine quality and quantity, the rejection of his offer discharges him from further obligation. When a debtor tenders money -by way of payment of interest, the effect of such a tender is to stop the running of interest payable but the debt is not discharged by the payment of interest.

A tender or offer of performance to be valid should adequately satisfy the following conditions, which are laid down in Section 38 of the Act:

**1. It must be unconditional:** A conditional offer of performance or tender is not valid and the promisor shall not be relieved thereby. If 'tender' is not in accordance with the terms of the contract, it shall be conditional. Tender must be without any condition and must be in accordance with the terms of the contract. Where it is conditional, the other party is entitled to reject it.

If an offer of performance is conditional, the other party is under no obligation to accept it. For example anybody is not bound to accept a tender of R/R that is made subject to demurrage. But a tender with a request for a receipt is legal.

**Example**

(i) A offers to B the principal amount of the-loan. This is not a valid tender since the whole principal amount and interest is not offered.

(ii) A sold his bike to B. A offers to deliver the bike to B provided his (A's) wife permits. It is a conditional offer and, therefore not a valid tender.

**2. It must be made at the fixed or proper time and place:** Where a particular time and place have been agreed the tender must be made at that time and place. If no such time and place has been agreed by the parties, then it should be made during business hours and at the place of business.

If the place is not mentioned, the rule is that the debtor of the debt must find the creditor. But if no time is fixed then it is valid to make the tender at the reasonable time. Proper time and place is question of fact depending on the circumstances. However, a tender before due date cannot be valid. Thus, it can be concluded that offer of performance must be made within prescribed or reasonable time and also at a fixed or proper place. It should be made within business hours and at the place of business.

**Example:** X owes Y ₹10,000 payable on 1st May with interest. Y offers to pay on Ist April the amount with interest upto Ist April. It is not a valid tender because it is not made at the mentioned time.

**3. Proper Opportunity of Inspection:** Section 38 (2) provides that a reasonable opportunity should be given to other party to ascertain that the offer is being made in accordance with the terms of contract. A person to whom the tender is made, must be provided a reasonable opportunity of inspection of goods. With the inspection he can satisfy himself as to whether the good offered is what has promised. There is no valid tender where goods are locked in a box and the buyer is not allowed to open and inspect it. The usual place of inspection will be the place of delivery of goods.

**Example:** A contracts to deliver to B at his warehouse on the 1st March 2008, 100 bales of cotton of a particular quality. In order to make a valid offer of performance, A must bring the cotton to B's warehouse on the appointed day under such Circumstances that B may have a reasonable opportunity of satisfying himself that the thing offered is cotton of the quality contracted for and that there are 100 bales.

**4. The Tender must be whole:** The tender must be whole and not of the Part. Offer of performance must be made for the whole obligation because tender in part is no tender. For example creditor need not accept a smaller sum. Similarly a tender by instalments is invalid unless the contract so indicates. Thus, a tender of a lesser amount cannot stop the running of interest on the entire amount.

**5. It must be made to Proper Person:** It must be made to a proper person an offer of performance must be made to the proper promise or his authorized agent but not to a stranger. If there are joint promises, it can be made to any of them.

**6. It must be made by a person who is able and willing:** An offer of performance must be made under such circumstances that the person to whom it is made may ascertain that the person making the tender is able and willing then and there to do the whole of what he is bound. The person making an offer of performance must be capable and Willing to perform his obligation what he is bound by his promise to do.

**7. It must be Made in Proper From:** If the payment is made in money, the tender must be made in legal tender money only. An offer to pay in foreign currency can not be valid. But if it is accepted by the offeree, it can be valid. Similarly an offer to pay by cheque will be valid, only if the offeree is agree to accept it. In the case of tender of money, the payment must be made in legal tender money. Tender of money should be in the current coins. A tender by cheque can be Valid only when the person to whom it is tendered (offeree) is ready to accept it.

Thus, the creditor is not bound to accept payment by cheque. A tender of money cannot be amounted as discharge of contract. However, the debtor cannot be liable to pay interest from the date of the tender. Where the creditor files a suit against the debtor to recover the amount, the debtor can take the plea of the tender.

**8. Tender of goods must be for the quality and quantity agreed upon:** In case of tender of goods buyer cannot be bound to accept the delivery of goods in instalments. Similarly, where the goods are less or more than the quantity agreed, the buyer will not accept the goods.

The party making the tender must be ready to fulfil the obligation. In the case of tender of cash payment, actual cash must be available. A mere offer by post to pay the amount cannot be a valid tender as there is no readiness in this case to pay the money then and there.

**Effect of refusal to accept offer of performance**

Where a promisor in the contract has made an offer of performance to the promisee and the offer has not been accepted:

(i) The promisor cannot be responsible for the non performance;

(ii) He cannot thereby lose his rights.

**Contracts which need not be performed (Section 62-67):** The following contracts need not be performed:

(1) If the parties agree to novation, rescission on alternation of contract, the original contract need not be performed (Section 62).

(2) The every promise may dispense with or remit performance by the promise wholly or in part or may extend the time for the performance or may accept any satisfaction. (Section 63)

(3) If a voidable contract is rescinded, the other party of the contract need not' perform his promise. (Section 64)

(4) If the failure of performance has been due to the promisee's neglect or refusal, the promisor is excused. (Section 67)

**Effect of Refusal of Party to Perform Promise Wholly**

According to Section 39 of the Act, "When a party has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance."

**Examples** (i) X, a singer, enters into a contract with Y, the manager of a theatre, to sing at his theatre three nights in every week during the next three months, and Y engages to pay her ₹1,000 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.

(ii) X, a singer, enters into a contract with Y, the manager of a theatre, to sing at his theatre three nights in every week during the next four months, and Y engages to pay her at the rate of ₹1,000 for each night. On the fifth night, X wilfully absents herself. With the assent of Y. X, sings on the sixth night. Y has signified his acquiescence in the continuance of the contract, and cannot now put an end to it, but is entitled to compensation for the damage sustained by him through X's failure to sing on the sixth night.

### 5.2.4 WHO MUST PERFORM THE PROMISE?

Now a question arises, who must perform the promise. According to Section 40 of Indian Contract Act, "If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases, the promisor or his representative may employ a competent person to perform it". Thus, a contract may be performed by following persons:

**1. By the Promisor Himself:** Where the nature of a contract requires that the promise contained in contract should be performed by promisor himself, it must be performed by the promisor himself. A contract involving the personal skill and qualification of promisor is of such nature. Section 40 of the Act says that if it appears that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor.

It is general rule that a contract must be performed by the promisor, either personally or through any other competent person. But where personal considerations are the foundation, it has to be performed by the promisor himself.

**Example:** (i) X an author promises, to write a book for Y a publisher. X dies before the completion of book. The contract cannot be enforced.

(ii) X promises to paint a picture for Y. X must perform this promise personally.

For example, A promises to pay B a sum of money. A may perform this promise. Either by personally paying the money to B, or by causing it to be paid to B by another; and, if A dies before the time appointed for payment, his representatives must perform the promise, or employ some proper person to do so.

**2. By the Agent:** If personal skill is not demanded and the work could be done by any one, the promisor or his representative may employ a competent person to perform. The promise. For example a contract to sell general goods can be assigned by the seller to his agent.

According to Section 40, "the promisor or his representative may employ a competent person to perform promise. Such contracts which are not of a personal nature be performed by the promisor himself or may be assigned to his agent.

**Example:** X promises to pay Y ₹5,000. X may perform this promise, either by personally paying ₹5,000 to Y or paying it through his cashier.

**3. Legal Representative:** Where a contract does not involve personal skill of promisor, it can be performed by any legal representative of promisor after his death. Thus, in the case of the death of the promisor before performance of the contract the representative is bound by the promises, unless personal skills are the foundation of the contract. The deceased promisor's legal representative cannot be required to perform contract involving personal skill. On the death of a promisor the benefits and burdens pass to the legal representative.

As per Section 37 of the Act, promise bind the representatives of the promisor in case of the death of such promisor, before performance, unless a contrary intention appears from the contract.

Generally, contracts of personal nature come to an end with the death of the promisor. For example, A engages a singer to sing a song on his marriage. The singer dies before the day of the marriage, the legal representatives are not liable to sing. But, if contracts are not dependent upon the personal experience or skill of the promisor do not come to an end with the death of the promisor. Legal representative of the: deceased promisor is bound to perform the contract. However, the liability of them is limited to the value of the property left by the deceased promisor.

**Examples:** (i) X borrowed a sum of ₹50,000 from Y. X dies before the loan, is repaid. X left an estate whose value is ₹30,000. X's representatives are liable to the extent of ₹30,000 only.

(ii) X promises to paint a picture for Y by a certain day at a certain price. X dies before the day. The contract cannot be enforced either by X's representative or by Y.

(iii) X promises to deliver goods to Y on a certain day on payment of ₹5000. X dies before that day. X's representatives are bound to deliver the goods to Y, and Y is bound to pay ₹5,000 to X's representatives.

**4. Third Party (A stranger to the contract):** Section 41 of Indian Contract Act that if a promisee accepts performance of a promise from a third person, he cannot afterwards enforce it against the promisor". Thus, a promise may be performed by a third party.'

When the third party performs the contract, and that is accepted by the promisee there is an end of the matter, For example where a person has accepted a part payment from a third person in hill and final satisfaction he cannot claim the debtor for the balance.

**5. Performance by Joint Promisors or Devolution of Joint Rights and Liabilities:** When two or more persons enter into a contract jointly with one or more persons, the promises are known as joint promises. In the case of joint promises the promisors are jointly as well severally liable to fulfil their promises.

**For example:** X and Y jointly promise to pay ₹10,000 to A and B. In such cases, the / question arises as to who is liable to perform the promise and who can demand performance of such promise? The rights and liabilities of joint promisors and joint promises have been laid down in Sections 42 to 45.

**(i) Devolution of Joint Liabilities:** According to Section 42 of the Indian Contract Act, 'When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivors, and, after the death of the last survivor, the representatives jointly, must fulfil the promise."

Thus, if two or more persons have made a joint promise, and there is no contrary intention to it all the joint promisors must fulfil the promise, if any joint promisor has died, legal representative of such promisors must fulfil the promise jointly with survivors and when all joint promisors have died, legal representatives of the promisors must fulfil the promise jointly.

Thus, the following must perform the promise:

1. When two or more persons have made a joint promise, all of them jointly.

2. In the case of death of any of the joint promisors, his legal representatives jointly along with the surviving promisor or promisors.
3. In the case of death of all the original promisors, legal representatives of all such promisors jointly.

**(ii) Joint and Several Liability:** Section 43 of the Act lays down the nature of liability of the joint problem vis-à-vis the liability of the joint problem amount themselves. Liability of the joint promisor is joint and several.

**Anyone of Joint Promisors May be Compelled to Perform:** According to Section 43, "When two or more persons make a joint promise, the promise 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."

Promisors are individually and jointly liable. Thus, in a case of suit against the partner-ship firm the plaintiff shall be entitled to proceed against the partnership firm itself or against all the partners or against such partners as he wishes to sue.

**Example:** A, B and C jointly promise to pay D 5,000 rupees. D may compel either A or B or C to pay him 5,000 rupees.

**Right of Equal contribution or Each Promisor May Compel Contribution:** According to Section 43, "Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of promise, unless a contrary intention appears from the contract."

**Example:** X Y and Z make a joint promise to pay ₹6,000 to P. X is compelled by P to pay the whole amount. X makes full payment. Now, he can recover ₹2,000 each from Y and Z.

Thus, when one of several joint promisors has performed the promise, he is entitled to claim equal contribution from the other joint promisors. A person who has discharged a joint liability can seek contribution from co-promisors of the contract.

**Liability to bear the loss due to default of other joint promisors equally or sharing of loss by default in contribution:** According to Section 43 of the Act, "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." Thus, if a joint promisor makes default in such contribution the remaining joint promisors must share the loss arising out of such default equally.

**Example:** A, B and C are under a joint promise to pay D 6,000 rupees. C is unable to pay anything, and A is compelled to pay the whole. A is entitled to receive 3,000 rupees from B.

**Recovery by Surety but no Recovery by Debtor (Section 43):** A surety has right to recover the payment made by him on behalf of principal debtor. However, principal debtor has no right to recover anything from surety on account of payments made by him. Explanation to Section 43 lays down that a surety who makes any payment to the creditor, can recover it from the principal debtor. The right of contribution exists between co-sureties.

**Example:** A, B and C, are under a joint promise to pay D ₹6,000. A and B being only sureties for C, C fails to pay. A and B are compelled to pay the whole sum. They are entitled to recover it from C.

**6. Release of One Joint Promisor:** According to Section 44 of the Indian Contract Act, "Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or promisors; neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors."

Thus, a release of one of the joint promisors by the promise does not discharge the other joint promisors. The joint promisor so released from liability continues to be liable to other joint promisors. A release of one of joint promisors does not discharge the other joint promisors.

**Example:** X, Y and Z are under a joint promise to pay P ₹5,000. P may release Z from liability; but X and Y remain liable to pay to P. Z is not released from the responsibility to X and Y. If P recover the amount from X and Y, they have a right of retable contribution from Z. Under the English law release of one of the joint promisors operate as a discharge of all other promisors.

**7. Devolution of Joint Right:** Section 45 of the Indian Contract Act lays down that where a person has made promise to two or more persons jointly, and there is no 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 one 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.

Thus, Section 45 deals with the devolution of joint rights. In case of a promise between two or more persons jointly, such persons jointly and on the death of any one or all of them, the representations survivors of deceased promises jointly are entitled to claim performance.

**Example:** X, in consideration of ₹10,000 lent to him by Y and Z, promises Y and Z jointly to repay them that sum with interest on a day specified. Y dies. The right to claim performance rests with Y's

representatives jointly with Z during Z's life, and after the death of Z, with the representatives of Y and Z jointly.

### 5.2.5 WHO CAN DEMAND THE PERFORMANCE OF CONTRACT

The following can demand the performance:

**1. Promisee Himself:** The promisee can demand performance of contract normally. Performance can be demanded only by promisee.

**2. Legal Representative:** In case of the death of promisee, his legal representatives can demand performance of contract. If the contract is not of a personal nature, legal representatives can demand performance.

**Example:** X lent a certain sum of money to Y. After X's death, X's legal representative can demand the repayment of debt from Y.

**3. Third Party:** Under some exceptional circumstances a third party (a stranger to the contract) can demand the performance.

**4 Joint Promisees:** Where there are more than one promisees, then the right to demand performance of contract can be exercised jointly by the surviving joint promises and the legal representative of the deceased joint promises. However, if all the promisees die, then the right to demand performance of contract rests with all the legal representatives jointly. Thus, when there are two or more promisees all the promisees jointly or in case of death of any promisees, his representatives jointly with surviving promisees, or in case of death of all promisees, their legal representatives jointly can demand performance of contract.

**Example:** P and Q jointly lend ₹10,000 to R. P dies. The right to claim performance of contract rests with P's representative jointly with Q so long as Q is alive. After Q's death, representatives of P and Q jointly can demand ₹10,000.

### 5.2.6 TIME AND PLACE OF PERFORMANCE

Parties are free to determine the time and place of performance under the terms of contract itself. Legal rules regarding time and place of performance are given in Secs. 46 to 50. These rules are as follows:

**1. Time for Performance of Promise Where no Application is to be Made and no Time is Specified:** According to Section 46 of the Indian Contract Act, 'Where by the contract, a promisor is to

perform his promise without application by the promisee and no time for performance is specified, it must be performed within a reasonable time". In this Section reasonable time, is a question of fact.

When a contract does not specify any time for performance of contract, the promisor must perform it within a reasonable time. The reasonable time is a question of fact. Where there is a failure to perform within a reasonable time it entitles the other party to put an end to the contract. For example, if ornaments were borrowed for attending a marriage function, detaining them after the marriage function did not amount to performance within a reasonable time.

**2. Time and place for performance of promise, where time is specified and no application to be made:** According to 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 at the place at which the promise ought to be performed." Thus, when a contract is to be performed on a particular day or date the promisor may perform contract on that particular day during the usual hours of the business at the place at which promise ought to be performed.

**Example:** A promises to deliver goods at B's warehouse on the first January. On that day A brings the goods to B's warehouse, but after the usual hour for closing it, and they are not received. A has not performed his promise.

**3. Application for Performance on Certain Day to be Made at a Proper Time and Place:** In the above (1) and (2) points, the promisor undertakes to perform the promise without application by the promisee but according to 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 promisee, it is the duty of the promisees to apply for performance at a proper place and within the usual hours of business." Proper time and place, is a question of fact.

**Example:** A is depositor and B is a banker. In case of deposit, it is the duty of A to go to B and make a demand for sum of money. It is not the duty of B to seek out his creditor.

**4. Place for performance of Promise Where no Application is to be Made and no place Fixed for Performance of Promise:** According to Section 49 of the Act, 'When a promise is to be performed without application by promisee, and no place is fixed for the performance of it, it is the duty of the

promisor to apply to appoint a reasonable place for the performance of promise, and to perform it at such place."

**Example:** 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 to him at such place.

Thus, the rule is that the debtor must find the creditor. However, where the creditor has left the country the debtor need not find the debtor.

**5. Performance in Manner or at Time Prescribed or Sanctioned by Promisee:** According to Section 50 of the Indian Contract Act, "The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions." The contract should be performed in the manner and at the time prescribed in the contract by the promisee. A promisor is discharged from his liability when he performs the promise in a manner or at a time sanctioned by the promisee.

**Example:** (i) Y owes X ₹5,000. X desires Y to pay the amount to X's account with Z a banker. Y who also banks with Z, orders the amount to be transferred from his account to X's credit, and this is done by Z. Afterwards, and before X knows of the transfer, Z fails. There has been a good payment by Y.

(ii) X and B are mutually indebted. X and Y settle an account by setting off one item against another, and Y pays X the balance found to be due from him upon such settlement. This amounts to a payment by X and Y respectively, of the sums which they owed to each other.

(iii) X owes Y ₹5,000 Y accepts some of X's goods in reduction of the debt. The delivery of the goods operates as a part payment.

(iv) X desires Y, who owes him ₹1,000 to send him a note for ₹1,000 by post. The debt is discharged as soon as Y puts into the post a letter containing the note duly addressed to X.

**Time as the Essence of the Contract**

In business, time of transactions is important. Where the transaction is not completed in proper time, the promisee may suffer uncertainty and losses. Whether time is of the essence depends upon the intention of the parties to contract. In some contract, the parties agree that the time will be an essential factor. Specific time has been fixed for the performance does not ipso facto mean that time is of the essence. In business transaction, ordinarily time is of the essence of the contract. Hence, transaction or contracts of commercial nature should be performed within the time fixed.

A party of contract may promise to perform within a specified time. The other party expect that it shall be performed by that time. But if the promisor fails to do so, can the promisee rescind the contract? This question can be answered by deciding whether time was the essence. The time is of the essence of the contract means that one party who does not perform his performance within the time specified cannot take any action. The time agreed for the performance be strictly observed. Section 55 deals with this subject.

**When Time is of the Essence of the Contract**

**1. Express Agreement:** When the parties have expressly agreed that time is the essence of contract, it will be obligatory for both the parties to perform their respective promises within specified time only. Therefore, when the parties have so expressly provided, the time is the essence of the contract.

**2. Commercial Transactions Involving Rapid Fluctuations in Prices of Goods:** If the prices of goods fluctuate rapidly in the market, the time of payment and delivery are the essence of the contract. Thus, in the contract of sale and purchase of goods, the prices of which fluctuate quickly, the time of delivery and payment will be essence of contract.

**3. Time of Shipment:** In the case of contract of sale of goods, the time of shipment is of the essence of the contract to perform:

**Case Law:** In case of Wasoo Enterprises Vs. J. J. Oil Mills (1968) Guj. 57, goods were to be shipped by August, 1954. On the failure to ship in the said month time was extended to September 10. 1954 even then the supplier failed. The buyer rescinded the contract. In the case the Court held that time was of the essence. Hence, the supplier himself was guilty.

**4. Auction Sale:** In the case of auction sale, if any amount is to be deposited within a certain time, it must be deposited within that time only. Thus, in the case of auction sale time is essence of contract.

**5. Time for Renewal of lease:** To lease, the application to renewal must be moved before the expiry to term of existing lease.

On the basis of above discussion it can be concluded that time is always considered to be the essence of the contract in the following cases:

1. Where the parties have so expressly provided.
2. Where delay operates as an injury.

3. Where the nature and necessity of contract requires it to be so construed.
4. Commercial transactions involving rapid fluctuations in price of goods.
5. Time of shipment.
6. Auction sale.
7. Time for renewal of lease.

**Example:** X agreed to sell and deliver 10 bales of cotton to Y on 12 th August 2008. But he failed to deliver the cotton by that time. The contract was voidable at the option of Y.

**Cases in Which Time is not the Essence of Contract:** In the case of *Gomathinayatam Pillai* Vs. *Palaniswarni nadan* (1967) I.S.C.R. 227, Supreme Court has held that "It would normally be presumed that time was not of the essence of the contract. Mere incorporation in the written agreement of a clause imposing penalty in case of default does not itself evidence an intention to make time of the essence."

However, renewal of a lease is regarded a contract in which time is of the essence.

**1. Silence of Parties:** When the parties are silent as to the time within which obligations should be performed, for the performance time cannot be the essence of contract.

**2. Contract for Sale of Immovable Property:** The Supreme Court has held in many cases that in case of a contract for the sale of land, house or any other immovable property, normally the time cannot the essence.

It would normally be presumed that time is not the essence of the contract. But the lease renewal is something different. In the case of *Caltex (India) Ltd.* Vs. *Bhagwan Devi Marodia AIR* 1969 SC 409 the lessee of a petrol pump had to apply for the renewal of the lease within a time fixed. But he was late by 10 days in his application for renewal. The landlord refused to renew the lease. The supreme Court held that the time so fixed was of the essence of the Contract.

**3. Clauses for Extension of Time and Penalty:** Where a contract implies some clauses regarding the extension of time in certain contingencies or for the payment of fine for delayed performance, time is not the essence of contract.

**Consequences or Effect of Failure to Perform within the Stipulated Time**

**1. If Time is of the Essence:** If time is an essence in a contract, and the contract is not performed within time, the contract will be voidable at the option of the promisee.

**Example:** X agrees to supply a saree for Y's marriage to take place on 1st May. X fails to supply the saree by the stipulated date, the contract becomes voidable at the option of Y.

**2. When Time is not of the Essence of Contract:** If time is not an essential in a contract and the contract is not performed time, the contract will not become voidable. However, damages or compensation can be recovered. Compensation can be recovered by the promise, if he Las given a notice to recover such compensation at the time of accepting, the delayed performance. Thus, if the promisee accepts performance at any time the promisee cannot claim compensation for non performance of the promise unless at the time of such acceptance, he gives notice to the promisor of his intention to recover compensation.

### 5.2.7 PERFORMANCE OF RECIPROCAL PROMISES

According to Section 2 (1) of the Indian Contract Act, "Promises which from the consideration or part of consideration for each other, are called reciprocal promises." If one party makes an offer and the other party accepts it, the promises made between these two, form reciprocal promises. Thus, reciprocal promises are promise's in return for a promise. Where a contract consists of promise by one party (to do or not to do something in consideration of a similar promise by other party, it will be reciprocal promises.

A promise against a promise may be a good consideration for each other. If one party gives a promise in consideration of the other party's promise, both the promises are reciprocal promises. In this case, each party is promisor and a promisee. Here, there is an obligation on each party to perform his own promise and to accept performance of the other's promise. For example there are promises between X and Y to marry, X's promise is consideration for Y's and for Y's promise is a consideration for X.

In the same way if A promises to deliver his car to B and B promises to pay ₹60,000 for it. Here, the promise of A to deliver his car and the promise of B to pay ₹60,000 are reciprocal promises.

**Rules regarding the Performance of Reciprocal Promises:** Following are the rules as regard to the performance of reciprocal promises:

**1. Performance of Reciprocal and Concurrent Promises or Simultaneous Reciprocal Promises:** According to Section 51 of the Act, "When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise."

In the case of simultaneous reciprocal promises, two promises are to be performed simultaneously. They are also called as mutual and concurrent promises. In case of reciprocal promises, a promisor need not perform his part unless the other side is also ready and willing to perform his part of promise. In a contract of sale of goods for cash on delivery, delivery and payment are concurrent conditions. The performance of one party depends upon the performance of the other party, if promisor fails to performs his part, he cannot claim the performance of the reciprocal promise. He must make compensation to the other party.

**Example:** X and Y contract that X shall deliver goods to Y to be paid for by Y on delivery. X need not deliver the goods unless Y is ready and willing to pay for the goods on delivery. Y need not pay for the goods, unless X is ready to deliver them on payment.

Sections 52, 53 and54 provide for conditional reciprocal promises.

**2. Order of Performance of Reciprocal Promises:** According to Section 52, of the Indian Contract Act, "Where the order in which reciprocal promises are to be performed is expressly fixed by a contract, they shall be performed in that order and where the order is not expressly fixed contract, they shall be performed in that order which the nature of transaction requires." The construction of document depends upon the intention of parties.

**Examples:** X and Y contract that X shall build a shop for Y at a fixed price. X's promise to build the shop must be performed before Y's promise to pay for it.

**3. Liability of the Party Preventing Event on which contract is to Take Effect (Section 53):** According to this Section if 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 which he may sustain in consequence of the non-performance of the contract." Thus, when one party prevents the other, the contract becomes voidable at the option of the party.

**Example:** X and Y contract that Y shall execute some works for X for ₹10,000. Y is ready and willing to execute the work accordingly, but X prevents him from doing so. The contract is voidable at the option of Y: and, if he elects to rescind it, he is entitled to recover from X compensation for any loss.

**4. Effect of Default as to that promise which should be performed in contract:** Section 54 of the Act says that if any contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor last mentioned fails to perform it, such promisor cannot claim the performance and must make compensation to the other party to the contract for any loss.

Thus, if the contract consists of reciprocal promises, such that one of them must be performed. At first and the promisor of the promise last mentioned fails to perform it, he cannot claim the performance of the reciprocal promise, and must make compensation to the other party for any loss caused to the other party due to such non-performance of contract.

**Example:** X hires Y's truck to take in and convey, from Kanpur to Lucknow, a big machine to be provided by X. Y receiving a certain freight for its conveyance. X does not provide any goods for the truck to carry. X cannot claim the performance of Y's promise, and must make compensation to Y for the loss which Y sustains by the non-performance.

**5. Reciprocal promises where Time is Essence of Contract (Section 55):** It has already been discussed at appropriate place in this chapter.

**6. Reciprocal Promise to do things Legal, and also other things Illegal:** According to Section 57 of the Indian Contract Act, "Where persons reciprocally promise, firstly, 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 contract, but the second is a void agreement." Thus, if a contract having two parts, one legal and other illegal and if they are reparable, the court will enforce legal part. If both part is inseparable the whole contract is void.

**Example:** X and Y agree that X shall sell Y shop for ₹50,000 but that, if Y uses it as a gambling outlet, he shall pay X 1,50,000 rupees.

Hence, the first set of reciprocal promises, namely, to sell the shop and to pay ₹50,000 is a contract and the second set is for an unlawful object, namely, that Y may use the shop as a gambling outlet is a void agreement.

**7. Alternative Promise One Branch Being Illegal (Section 58):** In the case of an alternative promise one branch of which is legal and the other illegal, the legal branch alone can be enforced.

**Example:** X and Y agree that K shall pay B. ₹10,000 for which Y shall afterwards deliver to X either gram or smuggled wine. This is a valid contract to deliver gram and a void agreement as to the smuggled wine.

### 5.2.8 APPROPRIATION OF PAYMENTS

In the case when a debtor owes many debts in respect of which the payment must be made to one creditor, the problem may arise as to which of the debts, the payment is to be appropriated. If a debtor owes several debts to the same creditor at one time and he makes only part payment. The question arises as to which particular debt should the payment be applied for. It attracts rules regarding appropriation. Thus, appropriation of payments is the application of an amount to be paid by a debtor against a particular debt.

Appropriation of payment is a right given to the debtor. The debtor can instruct the creditor to which account the money so paid is to be appropriated and the, creditor will be bound by those instructions. But if no such instructions are given by the debtor, the difficulty arises. Relating to appropriation of payments, the English law is laid down in Clayton's case and those principles are embodied in Sections 59 to 61 of the Indian Contract Act.

The rules regarding appropriation of payments are as under:

**1. Application of Payment Where Debt to be Discharged is Indicated or Appropriation by Debtor:** According to Section 59 of the Indian Contract Act, "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."

Thus, when a debtor owes more than one debt to his creditor and pays him a sum of money insufficient to discharge the entire debt, the debtor can appropriate it either expressly or by implication towards any debt due. If there are several debts and it does not apply as only one debt. The debtor has the privilege to choose which debt he will pay and if the creditor accepted the payment he must apply it as instructed by the debtor. The creditor is entitled to appropriate payments. The creditor may insist upon appropriation in the chronological order. Appropriation once made is binding on the creditor and cannot be subsequently altered by the creditor.

**Example:** R obtains two loans of ₹40,000 and ₹20,000 respectively. Loan of ₹40,000 is guaranteed by P. R sends the bank ₹10,000 but does not intimate as to how it is to be appropriated towards the loans. The bank appropriates the whole of ₹10,000 to the loan of ₹20,000 (the loan not guaranteed). The appropriation is valid and cannot be questioned either by R or P.

**3. Appropriation by Law or Application of Payment Where Neither Party Appropriates:** According to Section 61, "Where neither party makes any appropriation, the payment shall be applied in discharge of the debt in order of time, whether they are or are not barred by the law in force for the time being as to the limitations of suits. If the debts are of equal standing, the payment shall be' applied in discharge of each proportionately."

The rule given in Section 61 is applicable in case of running accounts between two parties, money being paid andwithc1rwn from time to time without any specific direction as to appropriation of the payments made. In such a case debits and credits will be set up against one another in order of their dates, leaving only final balance to be recovered from the debtor.

As per Section 61, the payment shall be applied towards one debt after another in the order of time. In the case of running accounts, the payment would go towards the earlier items.

**Example:** A owes two debts of ₹4000 each which are time barred and another debt of ₹8,000 to K. R sends ₹4,000. Nobody makes any appropriation. ₹4,000 would be appropriated equitably against the two debts of ₹4,000 each, which are time barred i.e, ₹2,000 would be appropriated.

Thus, this case lays down the position of a trustee who keeps his own money as well, as the trust money in one bank account. If such a trustee makes a series of deposits and withdrawals and trust funds are misappropriated, the withdrawals will be debited first to his own moneys and then to the trust fund; and the deposits are to be credited first to the trust and next to his own fund.

As per this rule when series of withdrawals and deposits-made and trust funds are misappropriated, the deposits would be credited first to the trust fund and then to trustee fund; the withdrawals are to be debited first to his own money and then to the trust funds. The order of and deposits withdrawals will not be taken into consideration.

**Example:** Krishna, a trustee deposits ₹20,000 being trust money with a bank, and subsequently deposits ₹1,00,000 of his own in the same account. Thereafter, Krishna withdraws ₹20,000 from the bank and

misappropriates it The money withdrawn will not be appropriated against the Trust amount of ₹20,000 but only against his own deposit.

### 5.2.9 ASSIGNMENT OF CONTRACTS

It is the transfer of rights and liabilities arising out of a contract to a third party. Assignment, is riot possible where the contract is of personal nature.

**Example:** X has engaged Y to sing songs in his theatre. Y cannot assign the contract to anyone else.

The term 'assignment' means transfer of right and liabilities. Assignment of contract is used for transfer of contractual rights or liabilities by a party to some other person, who is not a party. An assignee obtains right to bring an action on his own initiative against the other party. Though the Indian Contract Act has no specific provision regarding the assignment of contracts. But the law on the subject is well settled. If the contract is not dependent upon the personal skill, it may be assigned subject to certain conditions.

Contracts assignment can be made in the following ways:

**1. Assignment by Act of Parties**

**(a) A Contract which is not of a Personal Nature:** Any contract which is not of personal nature may be assigned if both the parties agree. It is called novation.

**Example:** X owes Y a sum of ₹5,000. X and Y, by an agreement with Z, can agree that now Z will pay ₹5,000 to Y. By this agreement, liability to pay the debt of ₹5,000 is transferred from X to Z.

**Exceptions:** Following are the exceptions to this rule:

(i) A person cannot become creditor of another person without his consent. For Example, X owes Y ₹2.000. Y assigns his debt to Z. Z cannot recover the amount of ₹2,000 from X as Z cannot becomes X's creditor without the consent, of X.

(ii) A person is under no obligation to accept a stranger (Third party) as his debtor. For Example: X owes ₹5,000 to Y. X cannot ask Y to recover the amount from Z without the consent of Y and Z.

**(b) Where the Contract is not of a Personal Nature:** A party of contract can perform the contract through the agency of a competent person.

**Example:** X asks Y to repair his tap. Y can send a competent plumber to repair the tap.

**(c) Assignment of Actionable Claim:** According to Section 3 of the Transfer of Property Act. An actionable claim is a "Claim to any debt (other than a secured debt) or to any beneficial interest in movable property not in the possession whether such claim or beneficial interest be existent, accruing, conditional or contingent."

**Examples:** (i) Right of action arising out or a contract (ii) Money debts; (iii) Book debts; (iv) A share in a firm.

The following are not actionable claims and so they may be assigned: (i) A decree, (ii) A claim of mesne profit, (iii) A right to recover damages for breach of contract.

An actionable claim can be assigned by an instrument in writing by giving notice of assignment to the debtor, to protect the interest of the assignee.

**2. Assignment by Operation of Law:** Contracts are assignable unless the contract is of personal nature. Thus, the rights and benefits which are not of personal nature can be assigned due to operation of law. It can be in the following cases.

**(i) Insolvency of a party:** Under the law of insolvency rights and liabilities of an insolvent pass on to the official receiver. In some cases receiver or assignee has the right to disclaim onerous property.

**(ii) Death of a party:** In case of death of a party his rights and liabilities pass on to his heirs or legal representatives. Their liability shall be limited to the amount of property inherited.

Any contract of personal skill and experience, comes to an end after the death of the party as it cannot be assigned.

### 5.2.10 CONTACTS WHICH NEEDS NOT BE PERFORMED

**1. When Performance Becomes Impossible:** (Section 56) If an act after the contract is made, becomes impossible, becomes void when the act becomes void or when the act becomes impossible.

**2. Effect of Novation etc. in Contract:** According to Section 62 of the Indian Contract Act. "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."

**3. Release of Performance by Promisee:** According to Section 63 of the Act, "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 think fit."

**Example:** X owes Y ₹10,000. X pays ₹4,000 to Y and he accepts it in full satisfaction of his debt. Whole debt of Y is discharged.

**4. Rescission of Voidable Contract:** According to Section 64 of the Act. If a person at whose option a contract is voidable. Rescinds it, the other party need not perform any promise.

**5. Negligence of Promisee:** Section 67 of the Act says that, if promises neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused as to any non-performance.

**Example:** Deepu Contracts with Jeetu to repair Jeetu's shop. Jeetu neglects or refuses to indicate to Deepu the Place in which the shop needs repair. Deepu is excused for the non performance, if it is caused by such neglect.

## 5.3 CHECK YOUR PROGRESS

Multiple Choice Question

1. Performance of a contract may be in the form of

   a. actual b. attempted

   c. either (a) or (b) d. both (a) and (b)

2. The performance of a promise is not required

   a. when the parties substitute the contract

   b. when performance is possible

   c. when the promisee rejects a tender of performance

   d. both (a) and (b)

3. The parties to a contract need not perform when the performance is

   a. dispensed with

   b. excused under the provisions of any law

   c. either (a) or (b)

   d. neither (a) nor (b)

4. A promises to deliver goods to B for Rs 20,000. A dies before performance of promises

a. The contract becomes void

b. The contract becomes impossible

c. The contract can be enforced against A's representatives and B is bound to pay Rs 20,000 to A's representatives

d. The contract is void

5. The Offer to perform must be made to

a. the Promisee

b. anyone of the Joint Promises

c. Authorized of Promisee

d. Either (a) or (b) or (c)

## 5.4 SUMMARY

Performance of the contract means that the parties have carried out or fulfilled their obligations arising out of the contract. Performance may be actual or attempted. Attempted performance in technical language is called as tender. The performance of a contract may be performed by promisor himself, agent, legal representative, third parties or joint promises in case there are more than one promise. Parties are free to fix the time and place of performance by agreements. Time is of the essence if the parties have expressly agreed or the circumstances are such that they go to prove that time is of essence of the contract. Promises which form consideration or part of the consideration for each other are called reciprocal promises. Where debtor owes several distinct debts and he makes a part payment, a question may arise as to which particular debt should the payment be applied? For this, there are rules regarding appropriation of payments.

## 5.5 KEYWORDS

**Actual Performance:** It means the execution of the contract.

**Legal Tender Money:** Legal tender money means current currency notes or coins.

**Reciprocal Promise:** a reciprocal promise implies a mutual promise.

**Mutual and Concurrent Reciprocal Promise:** When the promises are to be performed by both the parties simultaneously, it is the mutual and concurrent reciprocal promises.

**Appropriation:** It means application of payments.

## 5.6 SELF-ASSESSMENT TEST

1. What is the performance of a contract?
2. In how many ways can a contract be performed? What are the rules regarding appropriation of payments?
3. Discuss the meaning and types of performance of contracts?
4. What do you understand by reciprocal promises? Discuss the provisions of the Contract Act which deals with the performance of reciprocal promises.
5. What is an attempted performance, explain the essentials of a valid attempted performance.
6. "Impossibility of performance is a rule not an excuse for non-performance of contract." Discuss the statement.
7. Who can demand performance and by whom the contract should be performed?
8. Explain the law relating to time and place of performance of a contract. Whether time is of the essence of a contract.
9. Describe attempted performance. Under what circumstances attempted performance discharges a contract?
10. Define performance of a contract? Under what circumstances a contract need not be performed?
11. Discuss rules laid down in the Act as to the devolution of joint rights and liabilities.
12. Summarize the rules laid down in the Act as to the appropriation of payments.
13. When is time deemed to be the essence of the contract in the performance of contracts. Discuss.
14. State briefly the provisions of the Indian Contract Act relating to the time any place of the performance of a contract.

## 5.7 ANSWERS TO CHECK YOUR PROGRESS

Answer to Multiple Choice Question

1. C 2. D 3. C 4. C 5. D

## 5.8 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 6 | |

# DISCHARGE AND BREACH OF CONTRACT

## STRUCTURE



## 6.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to

a) Explain the circumstances under which a contract is said to be discharged.

b) Discuss the impossibility of performance as a mode of discharge of contract.

c) Explain the breach of contract as a mode of discharge of contract.

d) Discuss the remedies available to an aggrieved party on the breach of contract.

## 6.1 INTRODUCTION

A valid contract creates certain obligations on all the contracting parties, and the parties become liable to fulfil their respective obligations. When the parties fulfil their respective obligations, their liability under the contract, comes to an end and the contract is said to be discharged. Thus, the discharge of a contract means that the parties are no more liable under the contract. In other words, when the rights and obligations created by the contract come to an end, the contract is said to be discharged. The discharge of a contract may, therefore, be defined as the termination of contractual relationship between the parties.

## 6.2 MODES OF DISCHARGE OF A CONTRACT

Contracts may be discharged by any one of the following modes (for details see chart):

(a) By Performance

(b) By Consent or Agreement

(c) By Impossibility of Performance

(d) By Lapse of Time

(e) By Operation of Law

(f) By Breach of Contract

### 6.2.1 DISCHARGE BY PERFORMANCE

The obvious mode of discharge of a contract is by performance, for that is what the contract parties had contemplated at the time of entering into it. Every person who is bound by an obligation must be ready to perform it at the time when he had promised to perform it. According to Section 37 of the Contract Act, the parties to a contract must perform their respective promises, unless such performance is dispensed with or excused under the provision of this Act or of any other law. A person who is bound to perform a contract must be ready to perform it at the time when he has undertaken to do so. When a contract is performed, the parties are discharged and the contract is terminated. Performance may be of two types-actual and attempted.

a) *Actual Performance* - When the parties of the contract perform their promises, it is called actual performance. After such a performance the contract is discharged. It is the most common way of

discharge of a contract.

b) *Attempted Performance* - Attempted performance or tender takes place when a person who is bound to perform a promise is ready and willing to perform and has offered to perform his promise at proper time and place but the other party does not accept performance. In such a case, the contract is discharged of the wrongful refusal to accept the performance.

### 6.2.2 DISCHARGE BY MUTUAL AGREEMENT OF CONSENT

By agreement of all parties to the contract, or waiver or release by the party entitled to performance, a contract may be discharged. The discharge by consent may be expressed or implied; and an expressed consent may be given at the time of the formation of the contract or subsequently. For example, it may be agreed at the time of making the contract that on the happening of an event, one or both parties will be absolved from performance. A buyer may be given the option to return the goods sold within a specified period of time, if certain conditions are not fulfilled.

Express consent subsequently to the formation of the contract may be given by waiver, release, abandonment, novation, remission, alteration, rescission and in English law, by accord and satisfaction. Each one of these methods is dealt with here. Sections 62 and 63 expressly provide for these methods and are reproduced here:

"If the parties to a contract agree to substitute a new contract for it or to rescind of alter it, the original contract need not be performed." Section 62.

"Every promisee may dispense with or remit, wholly or in part, the performance of the promisee made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit." Section 63.

The analysis of these sections reveal that the original contract is discharged when the parties enter into a fresh contract in place of original contract. And the following are the important methods for the discharge of a contract by a fresh contract:

**a) Novation:** Novation occurs when a new contract is substituted for an existing contract, either between the same parties or between different parties, the consideration mutually being the discharged of the old contract.

A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor, instead of A. There is novation. The old debt of A to B is at an end, a new debt from C to

B has been contracted.

A common example of novation arises in the case of partnership contracts. For a valid novation it is not enough that a new promisor agrees to assume original promisor's obligation, the promisee too should consent to the change.

The following pre-requisites must be established by a party to make out a case of novation: (i) the old contract, (ii) The existence of liability under that contract, (iii) The assent of all parties to the extinguishment of liability under the old contract, (iv) The assent of the all the parties to the creation of the liability under the new contract and (v) the validity of the new contract.

A novation is ought to be before the time of performance expires, otherwise, there would be breach of contract, and the parties will by the new contract be only trying to adjust the remedial rights, which arises out of the breach of the old contract.

**(b) Alteration:** Alteration of a contract takes place when one or more of the terms of the contract are changed. Alteration is valid when it is made with the consent of all the parties to the contract. Where, however, an alteration of written contract is made by one party to the contract without the consent of the other party and of a material fact, so that the legal effect of the instrument is changed, the contract is discharged and the other party is also discharged from his duties.

**Example**: A agreed to supply to B 50 bags of rice at the rate of ₹100 per bag. The delivery was to be made in five equal installments, the first supply was to commence from 1st June. Subsequently, A and B entered into an agreement that the delivery would be made in two equal installments and the price would be ₹105 per bag. In this case, the old contract is discharged and the parties become bound by the contract with changed terms.

Following are various rules regarding the discharge of contract by alteration

(i) Alteration must be by a party to the contract, or a stranger while the document is in the possession of a party of the contract, and for his benefit. But exception is made if it is caused by mistake or accident

(ii) It must be in a material part-what alternation can be said to be material depends upon the character of the instrument and other circumstances of the case.

**(c) Rescission:** A contract may be rescinded by agreement between the parties at any time before it is discharged by performance or in some other way. For example, a contract for the sale of goods can be discharged by mutual agreement between the buyer and the seller at any time before delivery of the

goods or payment of the price.

Rescission may also take place in the following manner:

Where a party to contract fails to perform his obligation, the other party can rescind the contract without prejudice to his rights to receive compensation for breach of contract. In avoidable contract, one of the parties has the option of rescinding the contract.

**Examples**

(i) A promises to deliver certain goods to B on a certain date. Before the date of performance, A and B mutually agree that the contract will not be performed. The parties have rescind the contract.

(ii) A was induced to enter into an agreement by concern. He can rescind the contract.

**(d) Remission:** Remission is the acceptance of a lesser sum than what was contracted for. Sec. 63 specifically provides for remission of performance of promise. Thus, the law in India is different from that in England. In the later country, remission must be supported by a fresh consideration. In India, under Sec.63, a promisee may remit or give up a part of his claim and a promise to do so is binding even though there is no consideration for doing so.

**Examples**

(i) A owes B ₹5,000. A pays to B and B accepts in full satisfaction ₹2,000. The whole debt is discharged.

(ii) A owes B ₹5,000. C pays to B ₹1,000 and B accepts them in satisfaction of his claim on A. This payment is discharge of the whole claim.

**(e) Waiver:** Waiver means the intentional relinquishment of a right which a person is entitled to. A party may waive its rights under the contract, whereupon the other party is released from its obligations. In the case of an executory contract, (e.g., an agreement to sell and buy), each party may excuse the other from paying for or from buying the goods. In the case of unilateral promise, the party entitled to performance may waive performance of it.

**Example:** A promised to paint a picture for B. Afterwards, B forbade him to do so. In this case, B has waived his right to claim the performance. And thus, A is no longer liable to perform the promise. However, the party who has waived the compliance with a particular condition, may withdraw his

waiver by giving reasonable notice.

**(f) Acceptance of any other satisfaction:** Sometimes, the party entitled to claim performance accepts any other satisfaction instead of the performance of the contract. In such cases, the other party is discharged from the performance of his liability under the contract. Section 63 of the Indian Contract Act provides for this provision. According to this section, the party who has the right to demand performance, may accept any other satisfaction, which he thinks fit, instead of the performance of the promise made to him. And such acceptance, discharges the whole obligations under the contract.

**Example**: A owed B, under a contract, a sum of money, the amount of which had not been ascertained. Without ascertaining the amount, A gave ₹2000 to B. And B accepted this amount in satisfaction of the sum due under the contract. In this case, A is discharged of the whole debt due under the contract, whatever may be its amount.

### 6.2.3 DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE

The law relating to discharge by impossibility of performance of a contract is laid down in Sec.56 of the Contract Act. Section 56 states:

"An agreement to do an act impossible in itself is void. A contract to do an act which, after the contract is made becomes impossible, or by reason of some extent which the promisor could not present, unlawful becomes void when the act becomes impossible or unlawful".

Where one person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did now know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise.

**Examples:**

a) A agrees with B to discover treasure by magic. The agreement is void.

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

c) A contracts to marry B, being already married to C, and being forbidden by the law to which he is subject to practise polygamy. A must make compensation to B for the loss caused to her by the non-performance of his promise.

This section covers a wide range of causes and lays down certain clear rules. It is clear from the different parts of the section that impossibility is of various kinds. The impossibility may be absolute, i.e. inherent in the nature of the matter promised; or it may exist only relatively to the ability and circumstances of the promisor. The former is objective, (viz., inherent in the nature of the thing to be done) and discharges the contract. The latter is subjective impossibility, i.e. it is due to the inability of the individual promisor to perform his promise, and does not discharge a contractual duty.

The performance may be impossible as a matter of fact; or it may be impossible by the rules of law. The impossibility may exist at the time of contracting either with or without the knowledge of the parties or it may arise subsequently to the making of the contract, and in the latter case, it may be caused by events beyond the control of the parties or it may be caused by some act of the promisor or promisee.

**(i) Impossibility at the Time of Contract**

A contract to perform something that is obviously impossible, e.g. a promise to ride a horse to the moon, is void because there is no consideration for the contract. Here both parties were aware of the impossibility. It may be that at the time of the agreement both parties were ignorant of impossibility. In such a case also the contract is void on the ground of mistake.

**(ii) Subsequent or Supervening Impossibility**

Para 2 of Sec.56 provides that subsequent or supervening impossibility or illegality will make the contract void in certain circumstances and the contract will be discharged. Supervening impossibility may occur in many ways, some of which are explained below:

**(a) Destruction of Subject Matter:** When there is a contract in respect to a particular subject matter which is later destroyed without the fault of the parties, the contract is discharged.

In Taylor v. Caldwell (1863) 122 E.R. 299, the leading case on this point, a music hall was agreed to be let out for a series of events on certain days. The hall was burn down before the date of the first event. The contract was held to have become void and the owner of the hall was absolved from liability to let the hall as promised. Blackburn J. observed in this case as follows: “In contracts in which the performance depends on the continued existence of given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance".

**(b) Non-existence of a state of things necessary for performance:** When a contract is entered into

on the basis of the continued existence of a certain state of things, the contract is discharged if the state of things changes or cases to exist. In this case there is no destruction of any property affected by the contract, but the use of that property contemplated by the contract has became impossible

In Krell v. Henry (1903) 2 K.B. 740, H hired a room from K for two days. The room was taken for the purpose, as both parties well known, of using the room to view the coronation procession of Kind Edward VII, although the contract contained no reference to the coronation. Owing to the King's illness the procession was abandoned. Held, that H was excused from paying rent for the room, as the existence of the procession was the basis of the contract, and its cancellation discharged the contract.

**(c) Death or Personal Incapacity:** Where the personal qualification of a party is the basis of the contract, the contract is discharged by death or physical disablement of that party. In other words, the death or illness of a particular person whose action is necessary for the promised performance discharges the duty to render that performance.

In Robinson v. Davidson (1871) L.R. 6 Ex. 269 R contracted with D that D should play the piano at a concert given on a specific day. D was ill on the day in question and unable to perform. The contract was discharged and D's illness excused him from performance.

**(d) Discharge by supervening illegality:** A contract which is contrary to law at the time of its formation is void. But if after the making of the contract, owing to an alteration of the law or the act of some person armed with statutory authority the performance of the contract becomes impossible, the contract is discharged. This is so because the performance of the promise is prevented or prohibited by a subsequent change in the law.

In Baily v. De Crespignay (1869) L.R. 4 Q.B. 180, D leased some land to B and convenanted that he would not erect any but ornamental buildings upon the adjoining land. A railway company, under statutory powers, took this adjoining land and built a railway station on it. Held, D was excused from performance of his convenient, because the railway company's statutory power had rendered it impossible.

On the other hand, if at the time of the making of the contract, compulsory powers are in existence, the exercise of which may affect the contract, a party knowing of those powers cannot rely on the fact that they are subsequently exercised as a defence to his breach of contract. The exercise of the compulsory powers was event which might have been anticipated and guarded against in the contract. Also, a

continuing contract is not discharged by a prohibitive regulation which may be determined or varied and leaves a substantial part of the contract capable of execution. So, where a notification regulating retail prices was issued which did not make performance of the contact impossible or unlawful, the parties were not discharged. But if a contract to be performed in a foreign country becomes illegal owing to a change in the law of that country, the contract is discharged.

**(e) Declaration of War:** A contract entered into during war with an alien enemy is void ab initio. A contract entered into, before the war commence, between citizens of countries subsequently at war remains suspended during the pendency of the war, provided it does not involve intercourse with the alien enemy or is not helpful to him or his country. Such a contract will be revived and may be enforced at the end of the war. If a contract entered into before the outbreak of the war amounts to aiding the enemy in the pursuit of war, it would be abrogated or discharged and not merely suspended. It will also be discharged if it cannot remain suspended, e.g., the contract involves the continuous performance of mutual duties.

**Case which are not covered by the Doctrine of Supervening Impossibility (Impossibility not an Excuse)**

Apart from the cases mentioned above, impossibility does not discharge contracts. Therefore, impossibility of performance is as a rule not an excuse from performance. He who agrees to do an act should do it unless absolutely impossible which may happen in any one of the ways discussed above. It may be stated, as a general rule, that impossibility to perform arising subsequently to the agreement will not, as a rule discharge the promisor, because when there is positive contract to do a thing which is not unlawful, the promisor must perform it or pay damages for not doing it, although the performance becomes unexpectedly burdensome or even impossible on account of unforeseen events. The supervening event should destroy the contract itself. Merely making the contract difficult cannot attract Section 56. Some of the circumstances in which a contract is not discharged on the ground of supervening impossibility are stated here:

**(a) Difficulty of Performance:** The mere fact that performance is more difficult or expensive or less profitable that the parties anticipated, does not discharge the duty of performance. Increased or unexpected difficulty and expense do not, as a rule excuse from performance.

**Example:** A promised to send certain goods from Bombay to Antwerp in September. In August war

broke out, and the shipping space was not available except at very high rates. Held, the increased freight rates did not excuse performance.

**(b) Commencial Impossibility:** Commencial impossibility to perform a contract will not discharge the contract. A contract cannot be said to be impossible of performance because expectation of higher profits is not realised. A promisor's contractual duty is not discharged because the outbreak of war makes it expensive to procure the necessary materials.

**(c) Failure of third party:** The principle of supervening impossibility does not extend to the case of a third person on whose work the promisor relied.

**(d) Partial Impossibility:** Partial impossibility rarely discharges a promisor beyond the extent of the impossibility. This, if the state of things in question is not the sole basis of the contract, so that there will still remain a substantial portion, through not all, of what was contract for, the contract will not discharged. In other words, where there are several purposes for which a contact is made is made, failure of one of the objects does not terminate the contract.

In H.B. Steamboat Co. V.Hutton (1903) 2 K.B. 683, the company agreed to let a boat to H to view naval review at the coronation and to cruise round the fleet. Owing to the King's illness the navel review was cancelled, but the fleet was assembled and boat might have been used for the intended cruise. Held, the company were not discharged from performance as the naval was not naval was not the sole basis of the contract.

**(e) Strikes, lockouts and civil disturbances:** Strikes, lockouts and disturbances like riots do not terminate contracts unless there is a clause in the contract providing that in such cases the contract is not to be performed or that the time of performance is to be extended.

The lessee of certain salt pans failed to repair them according to the terms of his contract, on the ground of a strike of the workmen, Held, a strike of workmen is not sufficient reason to excuse performances of a term of the contract.

**The Doctrine of Frustration**

The Common law of England stated with the harsh doctrine that unless the parties expressly stipulated to the contrary, impossibility was no defence to an action for breach of a contract. In course of time, however, exceptions were introduced to modify the severity of the Doctrine. In English cases, it has been now held that when the common object of a contract cannot longer be carried out, the court may

declare the contract to be at an end. This is known as the Doctrine of Frustration. The doctrine developed in England under the guise of reading implied to stick to a contract the purpose of which has disappeared.

Thus, when the performance depends on the continued existence of a given person or thing, a condition is implied that impossibility of performance arising from the perishing of the person or thing shall excuse performance. If the act became impossible subsequently be reason of some event which the promisor could prevent, the contract is discharged. This is based on the *maixm les non cogit ad imposibilia* - the law does not compel the impossible. This discharge of a contract rendered impossible of performance by external causes beyond the contemplation of the parties is known as frustration.

Frustration, as said above, is device by which the rules as to absolute contracts are reconciled with a special exception which justice demands. It has become a gloss on the older theory of impossibility which has greatly developed under the guise of reading "implied terms" into contracts. Therefore, as observed by Lord Radcliffe, Frustration occurs whenever the law recognises that without default of either party, a contractual obligation has become incapable of being performed because circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni*- "It was not this that I promised to do".

Furthermore, under the doctrine of frustration, the fundamental assumption underlying the contract becomes impossible. The performance of the contract may do not be actually impossible, but if the contract cannot be performed as originally contemplated by the parties, there is frustration. In such a case, there is a frustration of the object of the contract. Where, for instance, goods were seized as prize and then released and transshipped so that they arrived two years late, the arrival was not such as was contemplated by the parties. The discharge of a contract by reason of frustration follows automatically when the relevant event happens and does not depend on the volition or election of either party. The doctrine applies if the disturbing cause goes to the extent of substantially preventing the performance of the whole contract. Thus, a contract may become frustrated or impossible of performance by an Act of Legislature, or by operation of law; it may be discharged by a subsequent declaration of war, or by emergency regulations.

**Indian Law Regrading Frustration**

In India, the law is codified and Sec. 56 which deals with the subject provides for discharges of contract

by impossibility of performance or frustration. Para 1 And 2 Sec. 56 read as follows.

"An agreement to do an act impossible in itself is void".

"A contract to do and act which after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful..."

It is clear from the language of the section that it departs from the English law to a large extent and lays down positive rules of law which according to English decisions are only matter of construction depending on the intention of parties. There is no question of reading implied terms of contract is equivalent to supervening impossibility or illegality. The point of frustration raises some difficulties but a pronouncement of the Supreme Court has clarified the position.

In Satyabrat Ghose V. Mugneeram Bangur & Co., who were the owners of a large track of land started a scheme for its development for residential purposes and accordingly divided in into a large number of plots for the sale of which they invited offers from intending buyers. The company's plan was to accept a small portion of the price by way of earnest money from the buyers at the time of agreement, construct the roads and drains itself and within one month after their completion call upon the buyers to complete the construction by paying one-third of the price at the time of the registration and the balance within 6 years bearing interest 6 percent per annum, time being deemed the essence of the contract.

B entered into a contact on those terms with M & Co., on 5-8-1919 and later on assigned the contract to S. Shortly prior to that assignment a portion of the land covered by the scheme was requisitioned for military purposes by the Government under the Defence of India Rules, and later the rest of the land was also requisitioned. M & Co., thereupon informed B that the land pertaining to the scheme was taken possession of by the Government and there was no knowing how long the Government would retain possession and that the company could not, therefore, take up the construction of roads and drains during the continuance of the war and possible for many years after its termination. The company also wrote to B to treat the contract as cancelled and take back the earnest money. This letter was handed over by B to his assignee S, who asserted that the company was bound by the contract and could not resile. S filed a suit for declaration that the contract dated 5-8-19 was subsisting and that S, as assignee of B, was entitled to get the conveyance executed and registered by the company on payment of consideration mentioned in the agreement and in the manner and under the conditions specified therein.

The company contended that the contract of sale became discharged by frustration as it became impossible of performance by reason of supervening events. On appeal, the Supreme Court held that it could not be said the requisition order vitally affected the contract or made its performance impossible and accordingly the appeal was allowed and the suit was decreed.

The law relating to frustration in India as laid down by the Supreme Court in Satyabrat Ghose's case may be summed up as follows:

" The Court in India should look primarily to the law as embodied in Sections 32 and 56 of the Indian Contract Act. Indeed, the above sections of the Contract Act embrace the whole of the Indian law on the subject. Sec. 32 applies in cases of contingent contract and Sec. 56 covers the rest. Under either, however, impossibility is the central or dominating idea and the determinating factor. "*The essential idea upon which the doctrine of frustration is based is that of immpossibility of performance of the contract.*" In fact, impossibility and frustration are after used as interchangeable expressions. The changed circumstances made performance of it as they did not promise to an impossibility. The doctrine of frustration is in reality an aspect or part of the law of discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done and hence comes within the purview of Sec. 55.

In deciding cases in India the only doctrine that we have to go by is that of supervening impossibility as laid down in Section 56, taking work impossible in its practical and not literal sense.

Section 56 days down a rule of positive law and does not leave the matter to be determined according to the intention of the parties. Therefore, in India, the doctrine of frustration is applied not on the ground that parties themselves agreed to an implied term which operated to release them from performance of the contract. The relief is given by the Court on the ground of subsequent impossibility when it finds that the whole purpose or the basis of a contract was frustration by the intrusion of occurrence of an unexpected event or change or circumstances which was beyond what was contemplated by the parties at time when they entered into the agreement. When such an event or change of circumstances occurs which is so fundamental as to be regarded by law as striking at the root of the contract as a whole, is the Court which can pronounce the contract to be frustration and at an end.

In applying this rule, the Court has to examine the nature and terms of the contract before it and the circumstances under which it was made and to determine whether or not the disturbing element which is alleged to have happened in the particular case has substantially prevented the performance of the

contract as a whole. If the answer be in the affirmative, the contract will stand dissolved or discharged by virtue of Sec.

**Effects of Subervening Impossibility or Frustration**

Sections 56 and 65 of the Indian Contract Act expressly provide for the consequences of the impossibility of performance as follows:

1. When the performance of a contract becomes subsequently impossible or illegal, the contract becomes void. (Section 56, para 2)
2. When a contract becomes void, any person who has received and advantage under it must restore it, or make compensation for it to the person from whom he received it.
3. Where one person has premised to do something which he knew or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise(Section 566, para 3).

### 6.2.4 DISCHARGE BY LAPSE OF TIME

The Limitation Act, in some circumstances, affords a good defence to suit for breach of contract, and in fact terminates the contracts by depriving the party of his remedy at law. For example, where a debtor has failed to repay the loan on the stipulated date, the creditor must file the suit against him within three years of the default. If the three years expire and he takes no action, he will be barred from his remedy, and the other party is discharged of his liability to perform. The period of limitation for simple contracts is three years in India and six years in England, and in the case of special contracts it is twelve years.

**Example: A** borrowed ₹5000 from B, a moneylender, and agreed to repay the loan on 31st March 2013. On 31st March, 2013, A failed to repay the loan. But B did not take any legal action against A till 31st March, 2016. In this case, B cannot recover the amount of loan from A as the limitation period for the recover of loan is three years from the date of default, which has expired. And thus, A is discharged from his liability to pay the loan.

### 6.2.5 DISCHARGE BY OPERATION OF LAW

Discharge under this head may take place as follows:

**(a) By Death**

Where contract requires personal skill or ability, the contract is terminated on the death of the promisor. In case of other contracts, the rights and liabilities of a deceased person are transferred to his legal representatives.

**Example:** A, an expert, agreed with B to translate some part of book from French to English. A died before the translation work started. In this case, the contract is of personal nature as it involves the personal qualification of the promisor (A). And thus, the contract is discharged on the death of A.

**(b) By Merger**

Where the parties embody the inferior contract in a superior contract, when between the same parties, new contract is entered into, and security of a higher degree, or a higher king is taken, the previous contract merges in the higher security. Where securities of the same kind of degree are taken there is no merger.

**Example**: A gave his land on lease to B. Subsequently, B bought the land which he was holding under the lease. In this cease, B becomes the owner of the property and his rights as a lessee merge into his rights as the owner. And thus, his rights as a lessee vanish, and are not to be enforced.

**(c) By the unauthorised alteration of terms of the contract**

Where a party to a contract in writing makes any material alternation without the knowledge and consent of the other, the contract can be avoided by the other party. An alternation even by a stranger will entitle the other party to avoid the contract, but where the alteration is due to mere accident or is not material, contract cannot be avoided.

**Example**: A contracted to sell his plot of 500 sq. yards to B for ₹100,000. The sale deed was executed which was in possession of A. Before the registration of the sale deed, A altered the deed and made it a deed for the sale of 300 sq. yards plot for ₹100,000. In this case, the contract is discharged and B is not bound to purchase the plot.

**(d) By insolvency**

The Insolvency Act provides for discharge of a contract under particular circumstances. So where the Insolvency Court passes an order discharging the insolvent, this order exonerates or discharges him from liabilities on all debts incurred previous to his adjudication.

**(e) Right and liability vesting in the same person**

Where rights and liabilities under a contract vest in same person, the contract is terminated and other parties to contract are discharged. For example, when a bill of exchange passes in the hands of the acceptor, the parties are discharged.

### 6.2.6 DISCHARGE BY BREACH OF CONTRACT

We have seen that contract must strictly perform according to its terms. But where the promisor has neither performed his contract nor tendered performance and where the performance is not excused by consent, express or implied, or where the performance is defective, there is a breach of the contract by him. Which entitles the other party to file a suit. If the contract is unilateral, the only remedy for the other party is to claim relief for beach and also in certain circumstances is exonerated from liability to perform his part of the contract.

The breach of contract may be (i) actual (ii) constructive or anticipatory. The actual breach may take place (a) at the time when performance is due, or (b) when actually performing the contract. The constructive or anticipatory breach of contract, i.e. a breach before the time for performance has arrived, may also take place in two ways, namely, (a) by the promisor doing an act which makes the performance of his promise impossible to perform his promise.

**(i) Actual breach of Contract**

**(a) Actual Breach of Contract at the time when Performance is due-** Where a person fails to perform a contract, when performance is due the other party can hold him liable for breach. But, if a party who has failed to perform the contract at the appointed time, subsequently expresses willingness to perform the question whether he can do so or not would depend upon whether time was of the essence of the contract or not. In all mercantile contracts time is the essence of the contract and breach of contracts results on failure to perform within the limited time. This is specially so in shipping contracts. In a sale of goods, subject to rapid fluctuations of market price, the time of delivery is of the essence. There are other transactions, e.g. contract relating to sale of land in which time is not deemed to be of the essence unless parties specially stipulate to the effect. But the terms of the contract, or the nature of the property sold, will determine whether time was of the essence or not. In the case of sale of a house to be immediately occupied or sale of a business as a going concern, time is not of the essence and the party express willingness to perform it after the appointed time, the law permits him to do so subject to payment of compensation for failure or due performance. The party accepts that he intends to

claim compensation otherwise he is deemed to have waived the right to compensation (Sec. 55)

**(b) Actual Breach during the Performance of the contract-** Where a party apparently performs the promise but the other party says that it is not a proper performance according to the contract, the question arises whether there is a breach of the contract exonerating the other party from performance of his part of the bargain. If breach is of a condition vital to the contract, the contract is discharged and the other party need not perform his part of the bargain. In the case of sale of goods by description, unless the goods answering to the description are offered, the buyer is not bound to take delivery or to pay for them. But if the breach is only of a collateral term (non-essential condition), this will not exonerate the party from performance of his part of the bargain, but only entitle him to claim damages. Where the buyer has obtained possession of goods and his right of enjoyment is disturbed in any way, he can claim damages caused by the breach of the implied warranty of quiet possession. Where the promisor had made more than one promise, or a divisible promise his repudiation must either be of the whole contract, or of a part of it which is a condition precedent to the promisee's liability, else the promisee will not be entitled to treat such repudiation as equivalent to the breach of the whole contract.

**(ii) Constructive or Anticipatory Breach of Contract**

It may sometimes happens that even before the time of performance arrives the promisor may do some act which makes the performance impossible or may definitely renounce the contract or show his intention not to perform it. Thus where A promised to assign to B within 7 years from the date of promise all his interests in 4 houses for ₹10,000 and before the end of the years assigned all his interests to another person, it was held that without waiting for the 7 years to elapse B could sue for breach of the promise.

In another case, a carrier was engaged in April to accompany his employer on a tour of three months to commence on June, 1. On May 11 the employer wrote to the courier that he had changed his mind and declined his services but refused to make him an compensation. On May 22 the courier brought his action for breach of contract, and the defence was that there could be no breach before June 1. It was held that the courier was entitled to treat the letter of May 11, equivalent to breach of contract.

It is to be note that a constructive or anticipating breach of contract does not give rise to a right of action, unless the promisee elects to treat it as equivalent to actual breach, Thus, instead of bringing an immediate action as in the examples given above, the promisee may treat the conduct, act or notice of

the promisor as inoperative, and wait for the time when the contract is to be performed, and then hold the promisor responsible for all the consequence of non-performance. But in that case the promisee keeps the contract alive for the benefit of the promisor not only to complete the contract in spite of previous repudiation, but also to avail himself any excuse for non-performance which may have come into existence before the time fixed for performance.

## 6.3 REMEDIES FOR BREACH OF CONTRACT

Where there is a breach of contract on the part of one party, the injured party becomes entitled to anyone or more of the following reliefs:

1. Rescission of the contract with the result that the injured party is freed from all obligations under the contract;
2. Suits for damages;
3. Suit upon a quantum meruit;
4. Suit for specific performance of the contract; and
5. Suit for an injunction.

### 1. Rescission

In one party has broken his contract, the other party may treat the breach as discharge, and refuse to perform his part of the contract. He may also successfully defend an action for non-performance, or an action brought for specific performance. Sec.75 further entitles him to compensation for any damage he may have sustained through the non-fulfillment of the contract.

For instance, A singer, contracts with B 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 ₹1000 for each nights's performance. On the sixth night, A willfully 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-fulfillment of the contract.

### 2. Damages

Where a contract has been broken, the party who suffers by such breach is entitled, under Sec.73 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 make the contract, to be likely to result from the breach of it.

But compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach. Compensation is also available against a party for breach of a quasi-contract. Sec73 is based on the leading case of Hadley V. Baxendale (1854) 9 Ex. 34 the facts the which are as follows:

The plaintiff, an owner of a mill, delivered a broken shaft to the defendant common carrier to take to a manufacturer to copy it and make a new one. The carrier delayed delivery of the shaft beyond a reasonable time, as a result of which the mill was idle for a longer period than should have been necessary. The plaintiff did not make known to the defendant carrier that delay would result in a loss of profits. Held, the carrier was not liable for loss of profits during the period of delay.

Alderson, B observed in this case, "When two parties have made a contract, which one of them has broken, the damage which the other party ought to receive in respect of such breach should be either such as may fairly be considered as arising naturally, i.e., according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both the parties at the time the contract was entered into as a probable result of the breach". This statement of law is known as the Rule in Hadley v. Baxendale.

The principle enunciated in Sec. 73 is that a party who suffers by the breach of contract is entitled to:

a) Such damages as naturally arose in the usual course of things, as a result of the breach;

b) And if he claims special damages for any loss sustained (which would not ordinarily flow from the breach) he must prove that the other party knew at the time of making the contract that the special loss was likely to result from the breach of the contract;

c) Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach; and

d) Compensation for quasi-contract as damage is the same as for a contract.

**Liquidated Damages and Un-liquidated Damages**

Where there is breach of contract by one party, the other party is entitled to sue for damages. Therefore, unless the court passes a decree for a specified amount, the claim for damages is merely a right to sue and not a debt or actionable claim. Consequently, this claim can be assigned or transferred, since it is not a debt under the law.

Liquidated damages are damages agreed upon by the parties in the contract itself to be paid by the party breaking the contract in case of breach. The plaintiff has only to prove the breach of contract, and no proof of loss is required. But liquidated damages must appear to be a genuine pre-estimate of the loss that will be caused to one party if the contract is broken by the other. Where no damages are fixed by the contract, but the amount of compensation claim for a breach of contract is left be assessed by the court, damages claimed are called unliquidated damages.

Unliquidated damages may be classified as follows:

**a) Ordinary Or Compensatory Damages**

In deciding a suit for damages, the court has to answer two questions: (I) Proximity and remoteness of damage (ii) Measure of damages. The Judge has to first decide whether or not the damage has resulted from proximate consequences of the breach, for remote consequences are not regarded. Once the court has decided that the damage is sufficiently proximate, it will the turn to the measure of damages, that is the amount of money that will compensate the plaintiff. The question of remoteness of damage is governed by the maxim recognised in Hadely v. Baxendale and Sec. 73 of Contract Act.

Thus, if the damage of loss suffered by reason of the breach of the contract is remote or indirect no compensation would be allowed. The aggrieved party, however, would in case of breach of contract, be entitled to recover compensation for damage or loss caused to him thereby, if such loss or damage arose naturally and directly in the usual course of things from such breach, of which the parties to the contract knew, at the time of making the contract, to be likely to result from breach of contract. The first part of this rule states the case for ordinary damages and the later concerns with special damages.

In Hadley v. Baxendale, the common negligence delayed delivery of the broken shaft to the manufacturer. The plaintiff did not make known to the defendant, the common carrier, that for want of the shaft the mill would remain idle which would result in a loss of profit. The plaintiff was held entitled to recover damages for delay in delivery but not for loss of profits occasioned by the closure of the mill since there was no way the common carrier could have been foreseen that the mere absence of a shaft would cause the closure for the mill. The mill-owner could have recovered damages for loss of profit if he had informed the carrier of the likely result of delayed delivery.

**Measure of damages**

The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of

events, from the breach of contract. The injured party is to be put in the same financial position as he would have been if the contract had been performed according to its terms.

In the case of sale and purchase, the damages, payable would be the difference between the contract price and the market price at the date of the breach. The damages are calculated as on the date of breach and any subsequent change of circumstances tending to an increase or reduction of damage cannot be taken note of.

**Example:** A cow was sold with condition that it was free from disease. The cow was suffering from foot and mouth disease at the time of sale. Not only the cow die but it also infected other cows of the buyer. Held damages could be recovered for the entire loss.

**b) Special Damages**

Special damages are those resulting from a breach of contract under some special circumstances. If at the time of entering into a contract, a person has notice of special circumstances which make special loss the likely result of the breach in the ordinary course of things, than upon his breaking the contract and the special loss following the breach, he will be required to make good the special loss. If therefore there be any special damage which is attributable to the wrongful act, then special damages, if proved, will be awarded. Hence if an unusual damage is likely to be sustained as the result of a breach of contract, its nature should be communicated to the other party before the contract is made so that he contracts subject to the prospective liability. Thus, if in Hadley v. Baxendale, the mill-owner had told the carrier that delay would result in a loss of profits through stoppage of the mill, he would have recovered damages for such a loss.

**(c) Exemplary or Punitive Damages**

These damages are sum awarded beyond the pecuniary loss sustained by the injured party. Ordinarily, damages for breach of contract are intended to compensate the plaintiff, not to punish the defendant. The object of exemplary damages is to punish the defendant and to deter him and others from similar conduct in the future. Award of exemplary damages is made in only two cases: (i) Breach of promise of marriage cases, (ii) where a bank wrongfully dishonors a customer's cheque.

In a breach of promise to marry, the amount of the damages will depend upon the extent of injury to the party's feelings. It is really and additionally sum known as a solatium awarded to the jilted women as a solace for her injured feelings.

In the case of wrongful dishonor of a cheque of a customer who is a trader the rule is the smaller the cheque dishonored the greater the damage.

**(d) Nominal Damages**

Nominal damages consist of a small of money, e.g., a rupee. They are a token award where there has been an infringement of contractual right, but no actual loss has been suffered. These damages are awarded to establish the right to decree for breach of contract.

**(e) Contemptuous Damages**

Damages are said to be contemptuous, when the court finds that a breach has been committed, but that the breach is so insignificant or petty that a reasonable man would not have filed a suit. A rupee or even less may be awarded to mark the court's disapproval of the plaintiffs conduct in bringing the action. The law does not take account of trifling things; and where it does, it awards also something of a contemptuous character. Such damages have been awarded to male plaintiffs in breach of marriage actions.

**Liquidated Damages and Penalty**

Where the parties have fixed at the time of contract the damages that would be payable in case of breach, a question may arise (in English law at least) whether the provision amounts to "liquidated damages" or a "penalty". Courts in English give effect to liquidated damages, but they relieve against penalty.

The test of the two is that where the amount fixed is a genuine per-estimate of the loss in case of breach; it is liquidated damages and will be allowed, and if the amount fixed is without any regard to probable loss, but in terrarium, is a penalty and will not be allowed.

In Indian law, there is no such difference between liquidated damage and penalty, as Sec. 74 specifically provides payment of only "reasonable" compensation.

The party suffering from breach is entitled to get the actual damages he has suffered. With regard to the amount named in the contract, the compensation payable is the reasonable amount up to the stipulated amount whether it is by way of liquidated damages or penalty.

a) A contracts with B to pay B ₹1,000 if he fails to pay B ₹500 on a given day. A fails to pay B ₹500 on that day. B is entitled to recover from A such compensation not exceeding ₹1000 as the

Court considers reasonable.

**Example:** A contracts with B that, if A practices as a surgeon within Calcutta he will pay B ₹5,000 A practices as a surgeon in Calcutta. B is entitled to such compensation, not exceeding ₹5000 as the court considers reasonable.

**Payment of Interest**

With regard to the payment of interest, the following rules have been laid down:

1. Payment of interest in case of default. Where a contract provides that the amount should be paid by a particular date and in default, it will be payable with interest, the court will give effect to the stipulation if the interest is reasonable. Where the interest is exorbitant, the Court will give relief.
2. Payment of interest as higher rate. Where the contract provides that in default of the payment of the principal by a stated date enhanced interest should be payable, if the enhanced interest is made payable from the date of default and is reasonable, it is regarded compensation and is allowed. But if the enhanced interest is exorbitant, e.g. increase from 12 percent to 75 percent, it will be penalty and relief will be granted against it.
3. Payment of compound interest. The Court do not lean towards compound interest, they do not award in the absence of stipulation but where there is a stipulation for its payment it is the absence of disentitling circumstances, allowed i.e. it will be allowed only if it is the absence of disentitling circumstances allowed, it will be allowed only if it is not an enhanced rate.

**3. Suit for Quantum Meruit**

Quantum meruit as much as he has earned. Suing on quantum meruit is the suing for the value of so much as is done. The injured party can use for quantum meruit, i.e. if the injured party has done can estimate at a money value of so much as he has already done.

A places an order with B for the supply of 100 chairs to be delivered by installments. B delivers 20 chairs when A informs him that he will require no more. In this case A's erudition discharges B from the obligation to supply the remaining chairs. He can sue A for the breach of contract for the value of 20 chairs already supplied. The later will be called suit for quantum meruit.

**4. Suit for Specific Performance**

Instead of or addition to awarding damages to the injured party, a decree for specific performance may be granted. Specific performance means the actual carrying out by the parties carrying out their agreement. This remedy, however, is discretionary and will not granted in the following cases:

(i) Where monetary compensation is an adequate remedy.

(ii) Where the Court can not supervise the execution of the contract, e.g. a building contract.

(iii) Where the contract is for personal services.

(iv) Where one of the parties is a minor.

Specific performance is usually granted in contracts connected with land, e.g. purchase of particular plot of house, or to take debentures in company. In the case of sale of goods, it will only be granted in the case of specific goods and is not ordered as a rule unless the goods are unique and cannot easily be purchased in the marked or are of special value to the party suing by reason of personal or family associations.

**5. Suit for Injunction**

An injunction is a mode of securing the specific performance of a negative terms of the contract. It is an order of the court whereby an individual is required to refrain from the further doing of the act complained of. It may be used to prevent many wrongful acts, e.g. torts, but in the context of contract, the remedy will be granted to enforce a negative stipulation in a contract in case where damages would not be an adequate remedy. Thus, where a party to a contract is doing something which he had promised not to do, the court may in its discretion, issue and order to the defendant restraining him from doing what he promised not to do. Its application may be extended to contracts where is no actual negative stipulation but where one may be inferred. In Metropolitan Electric Supply Company v. Ginder (1901) 2 Ch. 799, G agreed to make the whole electric required by his premises from the plaintiffs. Held, this was in substance an agreement not to take energy from any other person and it could be enforced by injunction.

## 6.4 CHECK YOUR PROGRESS

Answers the following Multiple Choice Question on the basis of your knowledge regarding this chapter:

1. Breach of a contract may be

a. Actual Breach b. Anticipatory Breach

c. Either (a) or (b) d. Neither (a) nor (b)

2. Which of the following is correct?

a. Supervening impossibility sometimes discharges a contract

b. Actual breach of contract takes place before the due date of performance

c. Both (a) and (b)

d. None of the above

3. If the subject matter of a contract is destroyed after formation of the contract, without fault of either party, the contract is

a. voidable b. discharged c. not discharged d. unlawful

4. ……. indicates that the parties are not further bound under the contract,

a. Waiver of a Contract b. Breach of a Contract

c. Rescission of a Contract d. Discharge of a Contract

5. A took a house on rent from B. during tenancy, A purchases that house. The earlier contract of tenancy is

a. Void b. Discharged c. Rescinded d. Voidable

## 6.5 SUMMARY

When the rights and obligations created by the contract come to an end, the contract is said to be discharged. The various modes in which a contract may be discharged are by performance, impossibility of performance, agreement, operation of law, lapse of time and breach. The contract is said to be discharged when parties to a contract perform their respective obligations which they have agreed to. Sometimes, the performance of a contract is impossible. In such cases, the contract is discharged because the parties cannot perform their respective obligations. A contract may be discharged by mutual agreement of the concerned parties. The important methods for discharge of a contract by a fresh contract are novation, rescission, alternation, remission, waiver and acceptance of any other satisfaction. In certain circumstances, the contract is discharged by the operation of law. If the contracts is not performed and the aggrieved party does not enforce his rights within the limitation period, then he is debarred from enforcing the contract. If any party fails to perform his obligation, there occurs a breach of contract. And the other party (the aggrieved or injured party) can enforce his rights in the Court of

law. Suit for rescission, damages, quantum meruit, specific performance and injuctions are the remedies available to the aggrieved party.

## 6.6 KEYWORDS

**Breach of Contract**: A breach of contract occurs if any party refuses or fails to perform his part of the contract or by his act makes it impossible to perform his obligation under the contract.

**Restitution**: It is return of the benefit received by one party to the contract from the other under a void contract.

**Injunction**: Injunction is generally granted to prevent the breach of an obligation arising out of a contract.

**Discharge of Contract**: It is the termination of contractual relationship between the parties.

**Novation**: Novation is the substitution of existing contract for a new contract.

**Rescission**: It is the cancellation of the contract.

**Remission**: Remission is the acceptance of lesser fulfillment of the terms of the promise.

## 6.7 SELF-ASSESSMENT TEST

1. State the circumstances under which a contract is said to be discharged.
2. What is meant by supervening impossibility. Discuss its effect in the performance of a contract.
3. Explain the law of frustration of contract. Give illustrations.
4. Write a note on discharge of contract by consent.
5. Does an impossibility which arises subsequent to the formation of a contract excuse the promisor from performing the contract in all cases?
6. Explain ‘breach of contract’ as a mode of discharge of contract.
7. What remedies are available to an aggrieved party on the breach of a contract.
8. What are consequences of breach of a contract?
9. What are the principles usually followed to access damages for breach of a contract.
10. “If a contract is broken, the law will endeavor so for as money can do it, to place the injured party in the same position as if the contract had been performed.” Comment.

11. Under what circumstances is a party entitled of specific performances?

## 6.8 ANSWERS TO CHECK YOUR PROGRESS

Answer to Multiple Choice Question

1. C 2.D 3.B 4. D 5.B

## 6.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 7 | |

# CONTIGENT CONTRACT AND QUASI CONTRACT

## STRUCTURE



## 7.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define contingent contract and state its essentials.
- List down the rules regarding contingent contract.
- Distinguish between a contingent contract and wagering agreement.

- Explain the meaning of quasi contracts and explain the cases which are treated as quasi contracts.
- Discuss about quantum meriut.

## 7.1 INTRODUCTION

A contract may be an unconditional contract, or conditional contract. In the case of unconditional contract parties are bound to discharge their duties without any condition. On the other hand in conditional contract parties are bound to discharge their duties only on the happening or non-happening of an event.

A contingent contract implies a conditional contract contingent on the happening or non-happening of an event. An absolute (unconditional) contract is not dependent upon the happening or non-happening of an event. It has' to be performed until and unless it becomes impossible. In this chapter, we will discuss the contingent contract. It is a specific contract which depends on the happening or non-happening of an event, contingent contract is also known as conditional contract.

## 7.2 MEANING OF CONTINGENT CONTRACT

'Contingent' contract is conditional contract and the condition implies in contract is uncertain nature. A contracts, B to pay ₹5,000 on the expiry of the year 2008 or on the death of C. It is not a contingent contract because these events are of a certain nature. But a contract to pay ₹5,000 on the destruction of a car in an accident is a contingent contract. Because that contingency may or may not happen. All contract of insurance contract of life insurance is not contingent contract, guarantee and indemnity are contingent contracts.

According to Section 31 of the Indian Contract Act, "A contingent contract" is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen."

**Examples:** i. A contract to pay B ₹50,000 if B's shop is burnt. This is a contingent contract.

ii. A agrees to purchase an old car subject to the approval of his mechanic. It is a contingent contract.

iii. If land is to be sold by X to Y, at a price to be fixed by Z, it is a contingent.

In a contingent contract the performance becomes due, only upon the happening of some event which may or may not happen. A contingent contract is different from reciprocal promises. In the contingent contract, the obligation is' all on one side, while in the reciprocal promises, it is mutual.

For the contingent contract it is essential that the particular event on the happening of which the contract is dependant must be an uncertain event. The event must be collateral to the contract. It can be said that the event must be unessential to the nature of the matter covered by the contract. It is also essential that the event must not form part of the consideration.

### 7.2.1 ESSENTIALS OF A CONTINGENT CONTRACT

The following are the essential elements of a contingent contract:

**1. Contract to do or not to do something:** A contingent contract is to do or not to do something.

**2. Depends upon contingency:** Performance of contingent contract is not complete. It depends upon the happening or non-happening in future of an uncertain event. Therefore, a contingent contract is different from absolute contract, for example. A contracts B to sell his cycle for ₹1,000. It is an absolute and unconditional contract. In this contract obligation of both parties arises when they entered into a contract. In the case of collateral contract obligation of party does not arise unless and until the happening or non- happening of collateral. The event must be uncertain i.e., it may or may not happen. If the event is sure, the contract is not contingent. It must depend upon the happening or non- happening in future of an uncertain event.

**3. The event must be collateral:** The event must be collateral, i.e., incidental to the contract. An event which is "neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise" is called as collateral event.

For example in marine insurance, insurance company promises to give certain money in case of accident of ship, but accident of ship is an uncertain event and it is collateral to contract.

**Example:** X gives a loan to Y and Z gives a guarantee. It is a contingent contract because Z will be liable only if Y fails.

**Example:** Following are the examples of uncertain events:

(i) Success in a litigation,

(ii) Success in a competition,

(iii) Occurring of an accident,

(iv) Recovery from a serious disease etc.

**4. Event may be within the control of one or both party or out of control of both:** The event may be within the control of one or both parties or out of control of both. For Example, Y will land money to X on the promise or guarantee of Z. Similarly, treasury will make payment to contractor on the approval of a particular officer.

**5. The event should not be mere will of the promisor:** The event should not be mere will of the promisor. For example, X promises Y that he (X) will give ₹5,000 to Y on his own will. It can not be a collateral contract.

A contingency does not depend on the mere will and pleasure of one of the parties to the contract. Thus, an agreement to work on such salary as the employer pleases to pay. It cannot be contingent contract.

### 7.2.2 RULES REGARDING CONTINGENT CONTRACTS

Rules regarding the enforcement or performance of contingent contract are given in Sections 32 to 36 of the Act. They are as under:

**1. Enforcement of contracts contingent on an event happening :** Section 32 of Indian Contract Act says that contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened.

Therefore, contingent contracts dependent on the happening of a certain event can be enforced only on the happening of such event. They can be never a complete contract until the uncertain future event happens and cannot be enforced until the event has happened.

**Example:** (i) 'A' makes a contract with 'B' to buy B's shop, till 'C' services. This contract cannot be enforced by law unless and until C dies in A's life time.

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

Section 32 also was that if the contingent event became impossible of performance, the contract became void.

**Example:** A contracts to pay B ₹1,000 when B marries C. C dies without being married to B. The contract becomes void.

**Contracts of Insurance, Indemnity and Guarantee are Contingent Contracts**

In a contract of insurance, the insurer and insured enter into an agreement by which the insured pays a premium and the insurer undertakes to compensate the specified losses suffered by insured. Thus, contract of insurance is a contingent contract because the payment or indemnity by insurer depends upon the happening of a future event.

In a contract of indemnity, one party promises to save the other party from a specific loss caused to him by the conduct of promisor himself or by the conduct of a third party. Thus a contract of indemnity is a contingent contract because the payment by promisor depends upon the loss suffered by promisee.

In a contract of guarantee, one person undertakes to perform the promise, or discharge the liability of a third person where he makes default. This contract of guarantee is contingent contract because the surety is liable to pay only when the principal debtor fails to do so.

**2. Enforcement of contracts contingent on an event not happening:** According to Section 33, "Contingent contracts to do or not to do anything if an uncertain future event does not happen, can be enforced when the happening of that event becomes impossible, and not before."

**Example:** A agrees to pay B ₹2,000, If a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks because the return of ship is not possible.

**3. If event on which contract is contingent to be deemed impossible, if it is the future conduct of a living person:** Section 34 says that when the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.

**Example:** A agrees to pay B ₹5,000 If B marries C. C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and that C may afterwards marry B.

**4. When contracts become void which are contingent on happening of specified event within fixed time:** According to Section 35 of the Indian Contract Act, "Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time, become void if, at the expiration of the time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible."

**Example:** A promises to pay B ₹10,000 if certain ship returns within six months. The contract may be enforced if the ship returns within six months and becomes void if the ship does not return or, is burnt within six months.

**5. When contracts may be enforced, which are contingent on specified event not happening within fixed time:** Section 35 also says, "Contingent contract to do or not to do anything, if a specified undertaken 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:** A promises to pay B ₹15,000 if a certain ship does not return within a period of six months. The contract may be enforced if the ship does not return within six months period, or is burnt within this period.

**6. Agreements contingent on impossible event void:** According to Section 36 of the Act, "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 agreement at the time when it is made."

**Examples:** (i) A agrees to pay B ₹5,000 if two straight lines should enclose at a space. The agreement is void because two straight lines cannot be enclosed.

(ii) A agrees to pay B ₹10,000 if B will marry A's daughter C. C was dead at the time of the agreement. The agreement is void because C has been dead.

Section 36 of the Indian Contract Act is based on the principle that persons cannot contract to do any impossible thing or make their contracts depend on the happening of any impossible event.

### 7.2.3 DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING AGREEMENT

The main points of difference between the two are given below:

| S. No. | Basic of Difference | Contingent Contract | Wagering Agreement |
|---|---|---|---|
| 1. | Section | There contracts are dealt with under sections 31 to 36 of the Indian contract Act. | Wagering agreements are dealt with under Section 30 of the Act. |

| | | | |
|---|---|---|---|
| 2. | Meaning | A contingent contract is a contract to do or not to do something. If some event, collateral to such contract does or does not happen. | A wagering agreement is an agreement to pay money or money's worth upon the happening or non happening of an uncertain event. |
| 3. | Scope | All contingent contracts are not wagering agreements. Its scope is wider. It includes a wager a Wagering agreement is a contingent agreement. | A contingent contract need not necessarily be a wager. All wagering agreements are contingent. |
| 4. | Interest of Parties | In the case of contingent contracts all parties have interest in the subject matter of contract. They are interested in the happening or non-happening of an uncertain event. | In the case of a wagering agreement, parties have no interest in the subject matter other than the money to win or lose. Party is not interested in the happening or non-happening of event. |
| 5. | Performance | In this case all parties intend to per form the contract. | In wagering agreement any party does not internal desire to perform the agreement. |
| 6. | Future uncertain Event | Future uncertain event is only collateral or incidental to contract. | Future uncertain event in the sole determining factor. |
| 7. | Mutuality of Promises | In it mutual promises are not essential.<br>Example: X promises Y to pay ₹5,000 if ship does not return. Here X is making a promise to pay but Y is not | In wagering agreements promises must be mutual.<br>Example: X agrees to pay Y ₹5,000 if it rains on Sunday and if it does not rain Y will pay ₹5,000 to. X Here there is |

| | | | |
|---|---|---|---|
| | | making a similar promise to Pay X thus there is no mutuality or promises. | mutuality of agreement. |
| 8. | Major Condition | Determination of an uncertain extent is not the sole condition. | In wagering agreements determination of uncertain event is the main condition. |
| 9. | Independent Interest | In the case of a contingent contract there is an independent interest. Example: X gets his shop insured. It is a contingent contract as X has independent interest. | There is no independent interest apart from the money to be lost or won. Example X promises to pay ₹15,000 to Y if it rains on Wednesday it is a wagering agreement. |
| 10. | Validity | It is validity unless they are declared by law to be bad. | It is invalid/void under Section 30 of the Indian contract Act. |

## 7.3 MEANING OF QUASI CONTRACTS

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

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

Salient features of quasi contracts are

(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.

### 7.3.1 CASES WHICH ARE TREATED AS QUASI CONTRACTS

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

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

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

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

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

**(2) Reimbursement to a person paying money due by another in payment of which he is interested.** A person who is interested in the pay1ent of money which another is bound by law to pay, and who, therefore, pays it, is entitled to be reimbursed by the other (Section 69).

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

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

**(3) Obligation of a person enjoying benefits of non-gratuitous act.** Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore the thing so done or delivered [Section70].

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

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

In order that Section 70 may apply, the following conditions must be satisfied: (a) the thing must be done lawfully; (b) the intention must be to do it non-gratuitously; and (c) the person for whom the act is done must enjoy the benefit of it.

**(4) Responsibility of finder of goods.** Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or other public place by accident or inadvertence, but if he takes them into his custody, an agreement is implied by law. Although, there is in fact no agreement between the owner and the finder of the goods, the finder is, for certain purposes, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of

his own. This obligation is imposed on the basis of a quasi contract. Section 71, which deals with this subject, says: "A person who finds good belonging to another and takes them into his custody, is subject to the same responsibility as a bailee". 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.

**Example:** '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.

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

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

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

The term mistake as used in Section 72 includes not only a mistake of fact but also a mistake of law. There is no conflict between the provisions of Section 72 on the one hand and Ss.21 and 22 on the other. If one party under mistake, whether of fact or law, pays to another party money which is not due by contract or otherwise, that money must be repaid

### 7.3.2 QUANTUM MERUIT

The phrase 'quantum meruit' means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other. But in certain cases, when a person has done some work under a contract, and other party repudiated the contract, or some event happens which makes the further performance of the contract impossible, then the party who has performed the work can claim remuneration for the work he has

already done. The right to claim quantum meruit does not arise out of the contract as the right to damages does; it is a claim on the quasi-contractual obligation which the law implies in the circumstances.

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

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

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

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

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

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

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

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

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

**Example:** A agreed to decorate B's flat for a lump sum of ₹750. A did the work but B complained for faulty workmanship. It cost B ₹204 to remedy the defect. Held, A could recover from B ₹750 less ₹204.

## 7.4 CHECK YOUR PROGRESS

Answer the following Multiple Choice Question:

1. A Quasi Contract

   a. is a contract b. is an agreement

   c. has only a legal obligation d. is none of these

2. Which of the following is correct?

   a. Quasi contracts are intentionally made by the parties

   b. Quasi contracts are imposed by law

   c. Quasi contracts are based on implied intentions of the parties

   d. Both (b) and (c)

3. Claim for necessaries supplied to a person incompetent to contract, from the property of such person. It is covered under concept of

   a. Quasi contract b. Caveat emptor

   c. Contigent contract d. Wagering agreement

4. A quasi contract is not a ……. Contract.

   a. real b. valid c. real and valid d. voidable

5. Which of the following statements is correct with reference to quasi-contractual obligations?

   a. There is no real contract in existence

   b. There is no offer and acceptance

   c. There is no intention to make a contract

   d. All of the above

## 7.5 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. Rules for enforcement of contingent contracts are (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.

## 7.6 KEYWORDS

**Contingent Contract:** A contract to do or not to do something, if some event, collateral to such contract, does or does not happen.

**Quasi Contracts:** Quasi contracts arise where obligations are created without a contract.

**Wagering Agreement:** A wagering agreement is an agreement to pay money or money's worth upon the happening or non-happening of an uncertain event.

**Quantum Meruit:** Quantum meriut means 'as much as merited' or 'as much as earned'.

## 7.7 SELF ASSESSMENT TEST

1. What is contingent contract? Explain its essentials.
2. Define contingent contract. Discuss the rules relating to contingent contracts.
3. What is a contingent contract? Discuss the rules regarding enforcement of contingent contracts.
4. The performance of a contingent contract depends on the happening or non-happening of a collateral event." Discuss what does collateral event mean?
5. What are quasi contracts? Discuss the quasi-contract dealt with under the Indian Contract Act.

6. Under the Indian Contract Act, there are certain relations resembling those created by a contract. Explain giving examples.

## 7.8 ANWERS TO CHECK YOUR PROGRESS

Answer: 1. D 2. B 3.A 4. A 5. D

## 7.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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# CONTRACT OF INDEMNITY AND GUARANTEE

## STRUCTURE



## 8.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define the meaning of a contract of indemnity and contract of guarantee.
- Explain the rights of indemnity holder.
- Make a distinction between a contract of indemnity and contract of guarantee.
- List out the rights of surety.

## 8.1 INTRODUCTION

Contracts of indemnity and guarantee are species of general contracts. Therefore, the general principles of contracts discussed so or far would also be applicable to them. These special contracts have been discussed in Sections 124 to 147 of the Indian Contract Act, 1872.

## 8.2 MEANING OF CONTRACT OF INDEMNITY

Indemnity literally means making good the loss or compensating a person

for any loss. "A contract of indemnity is a contract by which one party promises to save the other from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person." (Section 124). The person who promises to make good the loss is called the 'indemnifier' and the person to whom the promise is made, i.e., whose loss is to be made good is called the 'indemnified' or the 'indemnity-holder'

**Examples.** (a) A parked his scooter at the college scooter stand. He lost his token given by the scooter stand contractor. The scooter stand contractor refuses to return the scooter to A unless he (A) gives him an indemnity bond against any loss which he may suffer if any other person claims the scooter from the contractor.

(b) A and B two friends went to a shop. A says to the shopkeeper. "Let B, have the goods; I shall see you are paid." It is a contract of indemnity.

In the first example A is the 'indemnifier' and the scooter stand contractor the 'indemnified' or 'indemnity-holder'.

Definition given in Section 124 is very narrow. It includes only (i) express promises to indemnify, and (ii) the loss caused by the conduct of the promisor or any other person. However, it does not include (i) implied promises to indemnify, and (ii) loss caused by accidents and events not dependent upon the conduct of the promisor or any other person. However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused:

(i) By the conduct of the promisor himself, or

(ii) By the conduct of any other person.

Thus, loss occasioned by the conduct of the promise, or accident, or an act of God is not covered.

Therefore, strictly speaking, contracts of insurance cannot be included in the definition. However, it was not the intention of the legislature as it has been held by Justice M. C. Chagla that "Sections 124 and 125 of the Contract Act are not exhaustive of the law of indemnity and the Courts here would apply the same equitable principles that the Courts in England do." [Gajanan Moreshwar v. Moreshwar Madan (1942) Born. 302-4].

English Law has given a comprehensive definition which is as follows:

"A promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor."

From the above definition it would be seen that it covers the loss caused by accidents and events not depending upon the conduct of any person. Thus it• is much wider in its scope and as such Indian Courts apply the definition given by English Law to Indian cases.

A contract of indemnity may be (i) express, or (ii) implied. An implied indemnity may be inferred from the conduct of the parties or the circumstances of the case.

It has been held in number of cases that an indemnity may also arise by operation of law. Even Section 69 of the Act (already discussed earlier under quasi-contracts) implies a duty to indemnify in case a person, who is interested in the payment of money which another is bound by law to pay, has paid the amount.

**Example:** A broker forged the signature of the holder of a Promissory Note and endorsed it to the Bank of India. The Bank sent the note for renewal to the Government. The holder filed a suit against the Government and recovered damages. The Government in turn sued the Bank on the basis of an implied contract of indemnity.

### 8.2.1 COMMENCEMENT OF INDEMINIFIER'S LIABILITY

Sections 124 and 125 of the Indian Contract Act are not exhaustive, as such they have not specified the time from which the liability of the indemnifier starts. There is a conflict of opinion among the various High Courts. Some have held that the liability of the indemnifier commences only after the indemnified

had discharge his liability. However, others have held that the indemnity- holder is entitled to be indemnified even before he has actually discharged his liability. In *Osman Jamal* & *Sons v. Gopal* (1928) 1LR56 Cal. 262, the plaintiff was held. entitled to recover from the indemnifier before actually discharging his liability. The Court observed:

"Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay." Again, similar observations were made in the case of *Gajanan Moreshwar* V. *Moreshwar Madan* (1942) Born. 302. Therefore, if the indemnifier had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and pay it off.

From the above discussion it would be realised that the latter view viz. indemnified or indemnity holder can compel the indemnifier to indemnify before he has actually discharged his liability is more logical and correct. This is also the view of English Courts as observed by Kennedy L. J. in the case of *Liverpool Mortgage Insurance Co.* (1914) 2 Ch. 617.

"To indemnify does not merely mean to reimburse in respect of money paid, but to save from loss in respect of liability against which the indemnity has been given. If it be held that payment is a condition precedent to recovery, the contract may be of little value to the person to be indemnified, who may be unable to meet the claim in the first instance."

### 8.2.2 RIGHTS OF INDEMNITY HOLDER

Sec. 125 lays down that the promisee (indemnity-holder) in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the indemnifier:

1. All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies.
2. All costs which he may be compelled to pay in any suit if, in bringing or defending it, he did not act against the orders of the promisor and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.
3. All sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not against the order of the promisor, and was one which it would have been

prudent for the promise to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

It should be noted that a contract of indemnity is a species of the general contract and as such it must satisfy all the essentials of a 'valid contract like free consent, capacity of parties, lawful objects, etc. Thus if the object of a contract of indemnity is unlawful it will be void.

**Example:** A asks B to beat C, promising to indemnify B against its consequences. B beats C and in consequence is fined ₹100. B cannot recover the amount from A, as the object of this agreement is unlawful.

## 8.3 MEANING OF 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 in respect of whose default the guarantee is given is called the 'principal-debtor', and the person to whom the guarantee is given is called the 'creditor'. A guarantee may be either oral or written." (Sec. 126).

**Example:** A asks B to give a loan of ₹1,000 to C promising that if C does not return the amount, he (A) will pay the amount.

In the above example A is the surety, B is the creditor and C is the principal-debtor.

Guarantee is a promise to pay a debt owed by a third person in case the latter does not pay. Any guarantee given may be oral or written. From the above definition, it is clear that in a contract of guarantee there are, in effect three contracts:

(i) A principal contract between the principal debtor and the creditor.

(ii) A secondary contract between the creditor ad 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

### 8.3.1 FEATURES OF A CONTRACT OF GUARANTEE

A contract of guarantee is a species of general contract and as such all the essentials of a valid contract must be present. However, it has the following special features:

**1. Surety's obligation is dependent on principal-debtor's default -** There must be a conditional promise to pay on the default of the principal-debtor. If the promise is not conditional on default, it will not be a contract of guarantee but of indemnity.

**Example:** A asks B to sell certain goods on credit to C promising "I will pay the amount in case C fails to pay." It is a contract of guarantee as the promise is contingent on the default of C.

**2. Separate consideration for guarantee not necessary –** For a contract of guarantee, like any other contract, consideration is necessary. But Section 127 provides that anything done or any promise made, for the benefit of the principal-debtor, may be a sufficient consideration to the surety for giving the guarantee. Thus, there is no need for a separate consideration between the principal-debtor and the surety. Consideration received by the principal-debtor is sufficient for the surety. For example, in the example given above, goods to be received by the buyer is a sufficient consideration for the surety and no separate consideration is necessary.

**3. Principal-debtor need not be competent to contract –** Although the creditor and the surety must be capable of entering into contract, yet, the principal-debtor need not be competent to contract. In such a case the principal-debtor is not liable but the surety is liable as the principal-debtor.

**4. There must be existing debt or promise whose performance is guaranteed –** For a contract of guarantee there must be an existing debt or a promise whose performance is guaranteed. In case there is no such debt or promise, there cannot be a valid guarantee. Actually speaking, the debt or promise is the basis of guarantee, i.e., it is the consideration received by the debtor. Hence, if there is no consideration, there is no contract of guarantee. However, the debt may, even be void. In that case the surety himself will be liable to pay the debt.

Strictly speaking, a contract of guarantee is not a contract of *uberrimae fidei*, i.e., a contract of good faith requiring full disclosure of material facts likely to affect the willingness of the guarantor. However, there should not be any misrepresentation or active concealment of material facts by the creditor.

### 8.3.2 DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND GUARANTEE

| Basis | Indemnity | Guarantee |
|---|---|---|
| 1. Meaning | It is a contract to make good the loss of the other party. | It is a contract to perform the promise or discharge the liability of a third party in case of his default. |
| 2. Parties | There are only 2 parties i.e., the indemnifier and the indemnified. | There are 3 parties i.e., the surety, the creditor and the principal-debtor. |
| 3. Number of Contracts | It is a. simple contract consisting only of one agreement between the indemnifier and indemnity-holder. | In a contract of guarantee there are three agreements. One agreement between the creditor and the principal debtor, the second between the creditor and the surety and the third between the surety and principal-debtor. |
| 4. Contingency | In case of indemnity, liability of the indemnifier is dependent on the happening of a contingency. | In case of guarantee there is an existing debt or duty, the performance of which is guaranteed. However, the liability is contingent upon non-payment. |
| 5. Nature of surety's liability | The liability of the indemnifier is primary. | The liability of the surety, is secondary i.e.," the surety is liable only if the principal- debtor does not pay the amount. The liability of the principal- debtor is primary. |
| 6. Right to sue after performance | In ease of indemnity, except in rare cases, indemnifier cannot recover his loss from a third party. | In case of guarantee, if surety has paid the debt, he steps into the shoes of the creditor and can recover his loss from the principal-debtor. |
| 7. Indemnity | An indemnity-holder cannot sue | A surety can sue in his own name. No |

| | | |
|---|---|---|
| holder cannot sue in his own name | a third party in his own name. Assignment in favour of indemnity-holder is necessary. | such assignment is necessary. |
| 8. Request to act | Indemnifier does not act at the request of the indemnified. | A surety has to act at the request of the debtor. |
| 9. Capacity to contract | All the parties must be capable of contracting. | The principal-debtor may be a minor. In that case, the surety will be liable. |

### 8.3.3 NATURE OF SURETY'S LIABILITY

**Quantum of Surety's Liability**

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract (Section 128).

**Example:** 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.

The liability of the surety is equal to that of the principal- debtor. In the absence of a contract to the contrary it can neither be more nor less. However, by a special contract the liability of the surety can be made less than that of the principal-debtor, but *never greater*.

**Time when the liability of the surety arises**

In some cases, the surety's liability may begin simultaneously with the liability of the principal-debtor. In case the guarantee is contingent upon the happening of an event, the surety is liable when the contingency has actually happened. [*Subhan Khan v. Lal Khan* I.L.R. (1947) Nag. 643].

The liability of the surety arises only on default by the principal- debtor. Therefore, the surety will not be liable unless there is a default by the principal-debtor. However, when the default has been committed, then immediately the liability of the surety begins. A suit can be filed against the surety without suing the principal-debtor.

**Liability of surety when principal-debtor not liable**

The law regards surety and principal-debtor as two distinct persons. Therefore, liability of the surety is independent of the liability, of the principal-debtor. Thus, if the original contract between the principal-debtor and the creditor is void, e.g., when the debtor is a minor, incapable of entering into contract, then the surety is not discharged from the liability but is liable as a principal-debtor. Again if the creditor does not file a suit against the principal-debtor within the period of limitation although the principal-debtor is not liable in such a case, yet the surety is not discharged and he continues to be liable to the creditor under his contract of guarantee. [*Mahant Singh* v. *Bayi* (1939) 66 I. A. 198].

Even the operation of law will not discharge the surety from his liability. For example, where the principal-debtor dies or becomes insolvent before paying

the debt, the surety is liable for the debt.

Further any admission by the principal-debtor or judgment obtained against the principal-debtor will not be enforceable against the surety.

A creditor cannot ask the surety to pay any sum when he himself (creditor) has failed to carry out the terms of the contract, e.g., conveyance of the property to the purchaser. A surety is discharged from his liability when there is variation in the terms of the contract without his (surety's) consent.

### 8.3.4 KINDS OF GUARANTEE

A guarantee is given for the performance of a promise or discharge of a liability. Thus guarantee may be of the following types:

**1. Fidelity guarantee -** Guarantee given for good conduct and honesty of an-employee is called fidelity guarantee.

**2. Guarantee for repayment of a debt** – Guarantee given for repayment of a loan or a debt is called guarantee for repayment of debt.

**3. Specific guarantee –** A specific guarantee is given in respect of a single debt or transaction. For example, A asks B to give a loan of ₹500 to C promising to pay the amount on failure of C to pay the amount.

**4. Continuing guarantee –** Where the guarantee extends to a number of transactions, it is called continuing guarantee. Even a fidelity guarantee is also a continuing guarantee as it continues for a period of time.

**Example:** A asks a shop-keeper to sell goods on credit to B upto a limit of ₹1,000 during the next month, promising to pay the amount on B's default. This is a continuing guarantee and A is liable up to ₹1,000 on default of B.

**5. Retrospective guarantee –** Retrospective guarantee is given for an existing debt.

**6. Prospective guarantee –** Prospective guarantee is given for a future debt, i.e., a debt to be taken in future.

**7. Guarantee for the entire debt –** Where whole of the debt is guaranteed, it is called guarantee for the entire debt.

**8. Guarantee for a part of the debt –** A surety can limit his liability, where he feels that he cannot undertake responsibility for the whole of the debt. He may guarantee a part of the debt.

### 8.3.5 REVOCATION OF GUARANTEE

So far as a guarantee given for an existing debt is concerned, it cannot be revoked, as once an offer is accepted it becomes final. However, a guarantee for a future debt or continuing guarantee can be revoked for future transactions. In that case the surety shall be liable for those transactions which have already taken place.

**How Continuing Guarantee Revoked?**

A continuing guarantee can be revoked in any of the following ways:

**1. By Notice –** A continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditor (Sec. 130).

**Examples.** (1) A gives a loan of ₹1,000 to B on the guarantee of C. C cannot revoke his guarantee.

(2) A stands surety for any credit purchases upto ₹1,000 to be. made by B from a shop-keeper. After the shop-keeper has supplied goods worth ₹500, A gives a notice to the shop- keeper not to sell goods to B in future. A is liable for the purchases already made. However, he will not be liable for any purchases made after the notice of revocation.

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

However, it should be noted that the notice of death is not necessary.

### 8.3.6 RIGHTS OF SURETY

A contract of guarantee confers the following rights on the surety:

**(1) Rights Against the Creditor**

**(a) Rights before making payment –** In case of continuing guarantee or fidelity guarantee, a surety can ask the creditor not to sell goods on credit or to give credit in future. Similarly, in case of a fidelity guarantee the surety can ask the creditor (employer) to dismiss the employee, where the surety discovers that the employee had misconducted himself in that post or had been dishonest.

A surety can also file a suit for declaration that only the principal-debtor shall be liable to pay the amount.

**(b) Rights at the time of making payment –** At the time of making payment a surety can compel the creditor to release those securities first, which are in the creditor's possession.

**(c) Rights after making payment**

(i) Rights to 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. 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.** C advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sties A on his guarantee. A is discharged from his liability to the extent of the value of the furniture.

(ii) Right to claim set-off – A surety can ask the creditor to set-off or adjust any claim which the debtor has against the creditor.

**(2) Rights against principal-debtor**

**(i) Rights of subrogation (Sec. 140) –** Where a guaranteed debt has become, due, 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. In simple words a surety steps into the shoes of the creditor on making, the payment of the debt.

**(ii) Rights of indemnity (Sec. 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 all payment properly made, i.e., amount paid with interest and any damage or cost incurred.

**Example:** B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for the costs including the principal debt.

If, in the above example, A defends himself without reasonable ground, then he can recover the principal debt but not the costs.

**(3) Rights against Co-sureties**

When a debt is guaranteed by two or more sureties, each of them is called a co-surety.

**(1) Co-sureties liable to contribute equally (Sec. 146) –** Where 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 even 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.

**Examples:** 1. A, B and C jointly guarantee a sum of ₹3,000 lent by D to E. E makes a default in payment. A, B and C are liable to contribute 1,000 rupees each.

2. If A, B and C agree to share the guarantee in the ratio of 3: 2: 1 then their liability is 1,500, 1,000 and 500 rupees respectively.

**(2) Liability of co-sureties bound in different sums (Section 147) –** Co-sureties who are bound in different sums are liable to pay equally as far as limits of their respective obligations permit.

**Example**. In the above case, if E makes a default of ₹1,500, then each of them is liable to 500 rupees. Supposing E makes a default of ₹2,000, then C will be liable to pay 500 rupees, and A and B to the extent of 750 each.

### 8.3.7 DISCHARGE OF SURETY

When the liability of the surety is extinguished, he is said to be discharged; A surety may be discharged:

**I. Discharge of surety by revocation**

**(a) Revocation by notice** (Sec. 130) **–** A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor. But a specific guarantee cannot be revoked if the creditor has given the loan.

**(b) Revocation by death** (Sec. 131) - The death of the surety operates, in the absence of any contract to contrary, as a revocation of continuing guarantee for future transactions. The estate of the deceased surety will not be liable for any transactions entered between the creditor and the principal debtor even if the creditor has no notice of death. In case the parties have agreed to a notice of surety's death, then notice of death will be necessary. Under English Law also notice of surety's death is necessary.

**(c) Discharge of surety by novation** (Sec. 62) – A contract of guarantee is a species of the general contract. As such a contract of guarantee is discharged by novation, i.e., by substituting a new contract in place of the old one. The original contract is discharged.

**II. Discharge of surety by the act or conduct of the creditor**

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

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

It should be noted that variation discharges the surety in respect of transactions which take place after the variation. Therefore, he continues' to be liable for the transactions which were entered before the variation took place. **Example:** 1. A guarantees B's conduct as a clerk in a bank. B misappropriated a sum of money. Afterwards the bank without A's consent transferred him (B) to a lower post and B again misappropriated the funds. A is liable for the first misappropriation but not for the second.

Again, it should be noted that variation in one of the contracts will not discharge the other contracts. The scope of variation is limited to the concerned contract.

Further, it is immaterial whether the variation is for the good or bad of the surety. The only thing is that there must be variation in the terms of contract. In this respect observation made by Lord Westbury are interesting:

"……..you bind him (surety) to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. If that engagement be altered (without the surety's consent) in a single line, no matter whether it be altered for his benefit, no matter whether the alternation be innocently made, he has a right to say: The contract is no longer that for which 1 engaged to be surety, you have put an end to the contract that I guaranteed and my obligation therefore is at an end." [*Blest v. Brown* (1862) 45 E.R. 1225].

**(2) By release or discharge of principal-debtor** (Sec. 134) – A surety is discharged by any contract between the creditor and the principal-debtor by which the principal-debtor is released or by an act or omission of the creditor, the legal consequence of which is the discharge of the principal-debtor.

**Example**: A contracts with B for a fixed price to build a house for B within a month, B supplying the necessary timber. C guarantees A's performance of the contract. B fails to supply the timber. C is discharged from his suretyship.

**Exceptions**

In the following cases the surety is not discharged:

**(i) Death –** Death of the principal-debtor does not discharge the surety from his liability.

**(ii) Insolvency –** Similarly, insolvency of the principal-debtor does not discharge the surety.

**(iii) Omission to sue within the period of limitation –**The omission of the creditor to sue within the period of limitation does not discharge the surety. '

**Example:** B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for more than 3 years after the debt has become payable. Although the debt has become time-barred, yet the surety is not discharged from his liability as surety.

**(iv) Release of one of the co-sureties** (Sec. 138) – In case there are co-sureties, a release by the creditor of one of them does not discharge the other; neither does it free a surety so released from his responsibility to other co-sureties.

**(3) By compounding by the creditor with the principal debtor** (Sec. 138) – A contract between the creditor and the principal-debtor by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal-debtor, discharges the surety, unless such contract is made with the consent of the surety.

It should be noted that the surety is discharged only if he contracts to give time to the principal-debtors is made by the creditor with the principal-debtor. Therefore, if a contract is made with a third party the surety is not discharged (Section 136).

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

**4. By creditor's, act or omission impairing surety's eventual remedy** (Sec. 139) – In case 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.

**Example:** B contracts to build a ship for C for a sum of 2 lakh rupees, to be paid by instalment as the work reaches certain stages. A guarantees B's performance to C. C without the knowledge of A, prepays the last two instalments without the work being completed. A is discharged by the pre-payment.

It should be noted that the failure of the creditor to sue the principal- debtor within the period of limitation does not discharge the surety.

**5. By loss of security** (Sec. 141) – If the creditor loses or without the consent of the surety, parts with any security given at the time of contract, the surety is discharged to the extent of the value of the security.

It should be noted that the surety will be discharged only when he parts with any security given at the time of contract. He is not discharged when he parts with any security given after the contract of guarantee is made.

**Example:** A advances to B ₹2,000 on the guarantee of C. A also has an additional security for the ₹2,000 by a mortgage of B's furniture. A cancels the mortgage, and thereby returns the furniture to B. B becomes insolvent and is unable to pay anything. C is discharged from his liability to the extent of the value of the security (furniture).

**III. Discharge of surety by invalidation of the contract**

**(i) By obtaining guarantee by misrepresentation** (Sec. 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.

**(ii) By obtaining guarantee by concealment** (Sec. 143) – Any guarantee which the creditor has obtained by means of keeping silence as to material facts of circumstances, is invalid.

**Example:** A engaged B as a cashier. B misappropriates some cash. Thereupon A asks B to bring some surety who can guarantee his good conduct. C give his guarantee for B' s good conduct. A does not inform C about B's previous misconduct. B again misappropriates cash. C is not liable as a surety.

**(iii) By the failure of the co-surety to join** (Sec. 144) – Where a person gives guarantee upon a contract that the creditor shall not act upon it until the other co-surety has joined, the guarantee is not valid if the other person does not join.

**Whether failure of consideration between the creditor and principal debtor discharges the surety**

It has already been discussed that there is no need of separate consideration for a contract of guarantee between the creditor and surety. But there must be consideration between the creditor and the principal-debtor. Therefore, on the failure of such consideration, surety will be discharged from his liability.

## 8.4 CHECK YOUR PROGRESS

Answers the following Multiple Choice Questions:

1. A contract to perform the promise, or discharge the liability, of a third person in case of default is known as:

   A) Contract of indemnity B) Contract of guarantee

   C) Contingent contract D) Quasi contract

2. A guarantee which extends to a series of transaction is known as:

   A) Specific guarantee B) Continuing guarantee

   C) Both (A) and (B) D) None of the above

3. Section 142 of the Contract Act 1872 deals with

   A) Guarantee obtained by free

   B) Guarantee obtained by fraud

   C) Guarantee obtained by misrepresentation

D) None of these

4. "Guarantee" means_____
   A) Surety
   B) The word is also used as a name, to denote the contract of guarantee or the obligation of grantor
   C) All the above
   D) None of above
5. The contract of guarantee is a contract in which a person perform the promise or discharge the liability of
   A) The contractor
   B) Stranger
   C) Third person
   D) None of above

## 8.5 SUMMARY

A contract of indemnity is 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 is a contract to perform the promise or discharge the liability of a third person in case of his default. 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 though principal debtor is not liable-(i) principal debtor is incompetent to contract. (ii) Principal debtor is adjudged insolvent. (iii) The debts become time-barred.

## 8.6 KEYWORDS

**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.

**Contract of Guarantee:** A contract to perform the promise or discharge the liability of a third person in case of his default.

**Fidelity Guarantee:** Guarantee given for good conduct of an employee is fidelity guarantee.

## 8.7 ANSWERS TO CHECK YOUR PROGRESS

1. B 2. B 3. C 4. A 5. C

## 8.8 SELF ASSESSMENT TEST

1. What is a contract of indemnity? Whether a contract of insurance is covered by the definition.
2. What is a contract of guarantee? What are the various kinds of guarantees?
3. Distinguish between a contract of indemnity and guarantee;
4. Explain with examples the circumstances under which a surety is discharged from his liability.
5. Explain the rights of the surety against the (a) principal-debtor, and (b) creditor.
6. What is a continuing guarantee? How can it be revoked?
7. Whether failure of the creditor to sue the principal-debtor within the period of limitation discharges the surety.
8. What is the nature of surety's liability? What are his rights?
9. "The liability of a surety is co-extensive with that of the principal-debtor." "A surety's liability is independent of the liability of the principal-debtor." How will you reconcile these two statements?

## 8.9 REFERNCSES/SUGGESTED READINGS

1. M.C. Shukla, A Manual of Mercantile Laws; Sultan Chand & Company, New Delhi.
2. N.D. Kapoor, Mercantile Law; Sultan Chand & Co., New Delhi.
3. M.C. Kuchhal, Mercantile Law; Vikas Publishing House, New Delhi.
4. P. P. S. Gogna, A Textbook of Business Law; Sultan Chand & Company, New Delhi.

| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 9 | |

# BAILMENT AND PLEDGE

## STRUCTURE



## 9.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Understand the general principles underlying contracts of bailment and pledge.
- Describe duties and rights of the parties to the contracts.

## 9.1 INTRODUCTION

At one time or another, we enter into legal relationships, called bailment and pledge. Bailments are quite common in business also. Traders often store their surplus goods in warehouses; and utilise the services of cold storages for keeping their goods to be taken back as and when required; and factory owners often send machinery back to vendors for repairs. Also, goods are pledged for securing loans. The sections quoted in this chapter refer to the Indian Contract Act, 1872, unless otherwise state.

## 9.2 MEANING OF BAILMENT

Bailment and pledge are another class of special contracts. In our daily life we enter into transactions of bailment\very often. For example, when we give a piece of cloth for stitching to a tailor or when we give our watch for repair, etc.

The law relating to bailment has been discussed in Secs. 148 to 181. These provisions are not exhaustive in as much as all types of bailments have not been the discussed in the Act. Indian Contract Act deals only with the general 9rinciples of bailment. There are separate Acts to deal with special kinds of bailment, e.g., the carriage of goods has been dealt with in the Carriers Act, 1865, the Railway Act, 1989 and the Carriage of Goods by Sea Act, 1925.

According to See. 148, "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 over, be returned or otherwise disposed of according to the directions of the persons delivering them."

The person delivering the goods is called the tailor'. The person to whom the goods are delivered is called the 'bailee' and the transactions is called 'bailment'.

### 9.2.1 FEATURES OF BAILMENT

On analysing the above definition, we find the following characteristics of bailment:

**1. There should be a contract –** A bailment is based on a contract; i.e., it is created by a contract. The contract of bailment may be express or implied. In some cases e.g., in case of finder of goods a contract of bailment can be implied bylaw.

**2. Delivery of goods by one person to another –** In bailment there must be delivery of goods by one person to another. However, the word, 'delivery' is very wide. It may be actual or constructive.

It should be noted that in bailment only possession of the goods passes from one person to another. Possession means control of goods to the exclusion of others. Mere custody of goods as against possession is not sufficient: For example, a master while giving his goods to his servant retains the possession with him and parts only with the custody of the goods. Thus to create bailment there must be delivery of goods.

**Examples.** 1. A delivers his watch to a watch-maker for repair.

2. A lady handed over her old jewellery to a jeweller for melting and making it into a new one. Every evening she used to collect the half- made jewellery and put it into a box kept in the shop of the jeweller. She used to keep the key of the box with her. One day the box was stolen. Held, the jeweller was not liable as the jeweller had re-delivered the jewellery to the lady and as such the jeweller could not any more be regarded as a bailee. The lady must bear the loss herself.

It should be noted that in bailment only the possession of the goods is transferred not the ownership. Again1 only movable goods can be bailed as immovable goods cannot be delivered.

**3. The goods are delivered for certain purpose –** The purpose may vary from safe-keeping or safe custody to repairing or changing the form of the goods.

**Examples.** 1. A leaves his suit-case with a Railway Cloak Room for safe custody.

2. A gives his watch for repair to a watch-maker.

3. A gives a piece of cloth to a tailor for stitching it into a shirt. -

**4. The same goods must be returned –** For a transaction of bailment, it is necessary that the same goods must be returned. Where money is deposited in a savings bank account or any other account, it is not a transaction of bailment because the bank is not going to return the same currency notes but will return only an equivalent amount. However, where money or valuables are kept m safe custody, it will amount to a transaction of bailment as these will be returned in specie.

It should be noted that return of goods in specie does not mean that their

form cannot change. For example, old ornaments can be changed, into new one. A piece of cloth can be stitched into a shirt.

**Consideration is not necessary in case of contract of bailment**

In case of bailment for mutual benefit of the bailor and bailee consideration is there for both the parties e. g., A gives his watch for repair to B for ₹10. For A, consideration is repair of his watch and for B, consideration is ₹10. However, in case of bailment either for the benefit of the bailor or bailee alone consideration in the form of something in return is not there. In such cases the detriment suffered by the bailor in parting with the possession of goods is considered as a sufficient consideration to support the promise on the part of the bailee to return the goods.

### 9.2.2 KINDS OF BAILMENT

Following are the different kinds of bailment:

I. On the basis of the benefit derived by the parties

**(1) Bailment for the benefit of the bailor alone** – Where a person delivers his goods for safe custody with his relatives or friends without any reward. For example, A while going out of station, leaves his scooter with his friend, B for safe custody.

**(2) Bailment for the benefit of the bailee alone** – Where goods are lent for the use of friends and relatives. For example, A borrows B's books for a week.

**(3) Bailment for the mutual benefit of both the bailor and the bailee** – Where goods are bailed for reward or some consideration then the bailment is for the benefit of both the parties.

**Examples.** 1. A hires a taxi form B.

2. A gives his radio for repair to a radio dealer.

**II. On the basis of reward or consideration**

**1. Gratuitous Bailment –** A bailment without any reward or consideration is called gratuitous bailment. For example, A while going out of station, leaves his cycle with his friend B. B is not to get any reward in this case.

**2. Non-gratuitous Bailment** – A bailment for reward or hire is a non- gratuitous bailment. For example, A gives his watch for repair.

### 9.2.3 DUTIES AND RIGHTS OF BAILOR AND BAILEE

Before discussing duties and rights of bailor and bailee it may be pointed out that the duties of the bailor are more or less the rights of the bailee and vice-versa. The following are the duties and rights of the bailor.

**Duties of the Bailor**

**1. To disclose known faults** – It is the duty of the bailor to disclose known faults (defects) in the goods bailed so that bailee may not suffer any loss. Failure to disclose known defects will make the bailor liable to indemnify the bailee for any loss caused to the bailee directly due to such faults. In case of bailment for hire the liability of the bailor is very strict. The bailor is responsible for losses caused even by unknown defects (Sec. 150).

**Examples.** 1. A knows that his horse is vicious. A, while lending it to B, does not tell him that horse is vicious. B is thrown by the horse resulting in injuries to B. A is liable to make good B's loss.

2. A hires his horse to B.A does not know that his horse is vicious. B is thrown by the horse. A is still liable as in case of hire bailment the liability is strict one.

The reason for the rule that a bailor in case of hire bailment, is liable even for unknown defects is that the bailor will take extra care to find out the defects and get those defects removed to keep the goods to be hired in good repair or order.

**2. To bear extraordinary expenses of bailment** – When the bailment is gratuitous, i. e., without reward, the bailor must bear all the necessary expenses. If the bailment is non-gratuitous then the bailor will bear extraordinary expenses, while ordinary expenses will be borne by the bailee himself (Sec. 158).

**Examples.** 1. A leaves his cow in the custody of his neighbour B, while going to Hardwar, without any reward. Expenses of feeding the cow will be reimbursed by A.

2. In the above case if B is to be paid ₹5 per day for the safe custody of the cow, then B will bear the feeding expenses. But in case the cow suffers from some disease and is admitted to a veterinary hospital, hospitalisation expenses will be regarded as extraordinary expenses and as such will have to be borne by the bailor.

**3. To indemnify the bailee for any loss due to defect to title –** When the bailor has no right to bail the goods and bailee suffers any loss due to such bailment, the bailor is liable to indemnify the bailee for such loss (Sec. 164).

**4. To bear loss for wrongful refusal to take back the goods –** A bailor is liable to take back the goods when the purpose is over. In case he wrongfully refuses to take back the goods, he should compensate the bailee for any loss due to such refusal.

**Example.** A gave his coat for dry-cleaning. One of the conditions printed on the receipt was that the customer should take delivery within 15 days of due date. In case of default he will have to pay extra-charges at the rate of ₹1 per week or part thereof. If A does not take delivery within the stipulated time, he will have to pay extra-charges.

**5. To bear loss due to destruction or deterioration of .the goods bailed in natural course** – Where the goods bailed are destroyed without any fault of the bailee, the bailor shall bear the loss.

**Duties of the Bailee**

**1. To take reasonable care of the goods bailed** – It is the duty of the bailee to take reasonable care of the goods bailed as a man of ordinary prudence would, under similar circumstance, take of his own goods of the same bulk, quality and value as the goods bailed. It should be noted that the degree of care will be the same whether the bailment is gratuitous or non-gratuitous, i. e., for reward or not for reward. If he has taken reasonable care he is no more liable (Sees. 151 and 152).

**Examples.** 1. Some cattle belonging to A were left in the custody of B. One day the cattle were stolen without B's negligence. B did not inform either the owner or the police, under the impression that it will be of no use. Held, B was liable for the loss unless he could prove that in spite of the report the cattle could not have been recovered.

2. A customer entered a restaurant for dining. His coat was taken over by a waiter. He hanged it on a hook behind A. The coat was stolen. Held, the proprietor of the restaurant became bailee of the coat and as such was liable for the loss.

It should be noted that the amount of care required by Sec. 151 of the Contract Act is irreducible by any contract between the parties. [*Central Bank of India* v. *Grains and Gunny Agencies* AIR (1989) MP 28].

Clause 9 of the agreement read. "That during the continuance of this Agreement, the Bank shall not be responsible notwithstanding anything to the contrary in Sec. 152 of the Contract Act, for any loss or deterioration of or damage to the said goods whether caused by theft, fire, rain, flood, earthquake, lightning or any other cause whatsoever." The Court recorded its view that the clause does not exonerate the Bank on account of the negligence of its servants.

**2. Not to make any unauthorised use of good bailed** – A bailee is under a duty to use the goods according to the terms of the agreement. In case he makes unauthorised use of the goods. lie will be liable to make good the loss. (Sec. 154).

It should be noted that if the bailee makes unauthorised use of the goods his liability is absolute. He will be liable even if he is not guilty of negligence or even if the loss is the result of an accident or Act or God (Sec. 154).

**Example.** A lends his horse to B for his own riding. B allows his son C to ride the horse. C rides the horse with care but the horse accidentally falls and is injured. B is liable to A for the injury caused to the horse.

**3. Not to mix the goods with his own goods** – The bailee should not mix the goods bailed with his own goods. He should keep these goods separately. If he mixes the goods -

**(a) With the consent of the bailor** – In this case the bailor and bailee shall have proportionate interest in the mixture i. e., the goods mixed.

**(b) Without the consent of the bailor.**

**(i) When the goods can be separated** – The bailee is bound to bear the expenses of separation and any loss or damage arising from the mixture.

**(ii) When the goods cannot be separated** – The bailee will have to bear the loss (Sec. 157).

**Example.** A delivers 10 kg. pure ghee to B. B without A's consent mixes the ghee with his Dalda ghee (vegetable oil). It is not possible to separate pure ghee from Dalda ghee. Hence B must compensate A for the loss.

(c) In case the goods get mixed due to an accident or by an act of God, or by mistake of the bailee or any third party, the bailee shall bear the loss and expense incurred for separation of goods. In case the goods can not be separated, the bailee will have to bear the whole loss.

**4. Not to set up an adverse title** – The bailee holds the goods on behalf of the bailor. He is not entitled to deny the title of the bailor or set up an adverse title.

However, in case any third party proves a better title than that of the bailor, the bailee may deliver the goods to that third party.

**5. To return the goods bailed** – A bailee is under a duty to return or dispose of the goods bailed according to the directions of the bailor as soon as, after the purpose is over or the time for which they were deposited has expired (Sec. 160). Further, in case he fails to return the goods he will be responsible to the bailor for any loss, destruction or deterioration of the goods thereafter, even if he exercises reasonable care on his part (Sec. 161).

**Example.** A left his car at B's workshop for repair. B delays the car unreasonably. Thereafter, the car was destroyed in an accidental fire. B is liable to make good the loss, although B is not negligent.

The bailee, whether the bailment is gratuitous or for reward, is bound to take the same care of the property entrusted to him as a reasonably prudent and careful man may fairly be expected to take of his own property of the like description. If the property is not delivered to the true owner, the bailee cannot avoid his liability in conversion. Where the bank (bailee) delivers the goods to the wrong person the liability of the bank is absolute, though there is no element of negligence as the delivery was obtained by means of an artfully forged order [*UCO Bank* v *Hem Chandra Sarkar* (1991) 70 Comp. Cas. P. 119 (Supreme Court)].

Where the goods have been bailed by more than one joint owner, the bailee may return the goods to any of them. Consent of all the joint owners is not necessary. Again, in case of gratuitous bailment the bailor may at any time terminate the bailment even if the goods were bailed for a specified time or purpose. But in such a case if the bailee suffers a loss in excess of the benefit derived, the bailor will have to make good the loss (Sec. 159).

**6. To return any accretion to the goods** – In the absence of a contract to the contrary, a bailee is bound to return any increase or accretion to the goods bailed.

**Example.** A leaves his cow with B. The cow gives birth to a calf. A is entitled to both the cow and the calf,

**Rights of the Bailor**

It may be reminded that the duties of the bailee are the rights of the bailor and vice-versa. As such all the rights of the bailor and bailee are not being discussed separately. In addition the bailor has following rights:

**1. To take back the goods** – The bailor has a right to take back the goods after the purpose is over. In gratuitous bailment he has a right to recover back the goods even before the purpose or specified period

is over. However, in such a case, the loss to the bailee should not exceed the benefit derived by him (Sec. 159).

**2. To terminate bailment** – If the bailee does an act which is inconsistent with the terms of bailment, the bailor has a right to terminate the bailment (Sec 153)

**Example.** A hires his horse to B for his personal riding. B allows C to ride the horse. A can terminate the bailment.

**3. Right. against a wrong doer.** If a third party wrongfully deprives the bailee of the use or possession of the goods bailed, the bailor orbai1ee is entitled to file a suit for such deprivation or injury (Sec. 180). Whatever is received by way of relief or compensation in any such suit, is divisible between the bailor and the bailee in accordance with their respective interest (Sec. 181).

**Rights of Bailee**

As pointed out earlier, the duties of the bailor are the rights of the bailee. A bailee has the following additional rights:

**1. Rights to return goods to one of the joint owners without consent of all –** Where several joint owners of goods bail them, the bailee may deliver them back to, or dispose of them according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary (Sec. 165).

**2. Rights of immunity against delivery of goods to the bailor if he has no title to the goods** – 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 is not responsible to the owner in respect of such delivery (Sec. 166).

**3. Right to seek directions of the Court where a third person claims the goods bailed** – If a person other than the bailor, claims the goods bailed, the bailee may apply to the Court to stop the delivery of the goods to the bailor and to decide the title of the goods.

**4.. Right of lien** - Where the bailee expends labour and 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 the remuneration for the services rendered in respect of such goods (Sec. 170).

**5. Right of action against third parties** – If a third person wrongfully deprives the use or possession of the goods bailed, or injures them, the bailee is entitled to such remedies as the owner might have used in the like case if no bailment has been made (Sec. 180).

**6. Right to share compensation obtained by such suits** – Any compensation received from such suit shall be shared by the bailor and bailee in accordance with their interests.

### 9.2.4 RIGHTS OF A FINDER OF GOODS

A finder has the following rights:

**1. Right of Lien** – A finder of goods has a right of lien over the goods found for the expenses incurred or troubles undertaken in finding out the true owner. If the true owner refuses to pay the lawful charges, then the finder can exercise his right of lien, i. e., he can refuse to deliver the goods. However, it should be noted that a finder has no right to file a suit against the owner to recover such expenses (Sec. 168).

**2. Right to receive specific reward** – Where the owner has offered a specific reward for the return of the goods, the finder can file a suit to recover that reward (Sec. 168).

**3. Right of sale** – A finder also has a right to sell the goods found in the following circumstances:

(i) The true owner cannot he found with reasonable diligence; or

(ii) The true owner found but refuses to .pay the lawful charges of the finder; or

(iii) When the goods are in danger of perishing or of losing the greater part of their value; or

(iv) When the lawful charges of the finder, in respect of the thing found, amount to two-third or more of their value (Sec. 169).

**Obligations of finder of goods**

1. He must take reasonable care of the goods found. If he has taken reasonable care. he is not responsible for any loss.
2. He must not use the goods found until true owner is found within a reasonable time.
3. He must net mix them with his own goods until the true owner is found within a reasonable time.
4. He must take reasonable steps to trace the true owner otherwise, he will be guilty of wrongful conversion of goods.

### 9.2.5 TERMINATION OF BAILMENT

Law relating to termination of bailment is discussed in Secs. 153 and 162. However, these sections are not exhaustive. Hence ordinary rules regarding discharge or termination of contracts will also apply in the following cases:

**1. When the period or purpose is over** – In case the bailment is for a specific period or purpose, it is terminated on the expiry of that period or on the completion of the purpose;

**2. When the bailee makes unauthorised use of the goods** – In, case the bailee makes unauthorised use of the goods bailed, the bailment is voidable at the option of the bailor.

**3. When the subject-matter is destroyed or becomes illegal** – In case the subject-matter is destroyed or becomes illegal, the bailment is terminated.

**4. At will of the bailor.** Where the bailment is gratuitous it can be terminated merely at the sweet will of the bailor. 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).

**5. When the bailor or bailee dies** – A gratuitous bailment is terminated by the death of the bailor or bailee.

## 9.3 MEANING OF PLEDGE

A pledge is a special type of bailment for the mutual benefit of bailor and bailee. According to Sec. 172, the bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor is called the 'pawnor' or 'pledger'. The bailee is called the 'pawnee' or 'pledgee'.

**Example.** A borrows 200 rupees by depositing his watch with B as a security for repayment of the debt.

Pledge is a special type of bailment. As such all the essentials of a valid bailment are necessary for the creation of a pledge.

**Distinction between Bailment and Pledge**

| Basis | Bailment | Pledge |
|---|---|---|
| 1. Purpose | The purpose of bailment is very wide, e.g. safe custody, repair, etc. | The purpose of pledge is limited i.e., repayment of a debt or performance of a promise |

| | | |
|---|---|---|
| 2. Right to sell | A bailee cannot sell the goods, he can only retain the goods or sue for his charges. | A pawnee can sell the goods after giving notice. |
| 3. Lien | In case of bailment, lien can be exercised only for the labour and skill spent. | In case of pledge, lien can be exercised even for non-payment of interest. |
| 4. Right to use goods | A bailee can use the goods if the contract so provides. | A pawnee cannot use the goods pledged. |

**Distinction between Pledge and Lien**

| **Basis** | **Bailment** | **Pledge** |
|---|---|---|
| 1. Purpose | The purpose of pledge is to secure repayment of a debt. | The purpose of lien is to retain some one's property to recover the remuneration. |
| 2. Origin | Pledge arises out of an agreement. | Lien arises out of law. |
| 3. Right to sell goods | In pledge, the pawnee can sell the goods if the loan is not repaid. | There is no right to sell the goods, only the goods can be retained |
| 4. Termination | A pledge is terminated when the goods are returned to the owner. | The right of lien is lost when the possession of goods is lost. |

**Distinction between Pledge and Mortgage**

| **Basis** | **Bailment** | **Pledge** |
|---|---|---|
| 1. Subject-matter | Only movable goods can be pledged. | Only immovable property can be mortgaged. |

| | | |
|---|---|---|
| 2. Transfer | In pledge only the possession is transferred. | In mortgage transfer of ownership is made on certain conditions |
| 3. Form | A contract of pledge can be made orally. | A mortgage must be made in writing and registered if it exceeds ₹100. It should also be witnessed by two persons. |
| 4. Use of goods | In pledge, the pawnee cannot use the goods. | In mortgage, the mortgagee may use the property. |
| 5. Number of loans | In a pledge only one loan can be taken. | In mortgage subject to the value of the property, number of mortgages can be created. |
| 6. Right of pawnee/mortgagee | A pawnee has a right to sell the goods in case the loan is not paid. | First mortgagee has a prior right over subsequent mortgagees. |
| 7. Right of pawnor/mortgagor to impose restrictions | A pawnor cannot impose any conditions on the pawnee. | A mortgagor can impose restrictions on the mortgagee in certain cases. |
| 8. Re-pledge or re-mortgage. | A pawnee cannot re-pledge the goods pledge. | A mortgagee can re-mortgage the property. |

### 9.3.1 PLEDGE BY NON-OWNERS

The general rule is that it is the owner of the goods who can ordinarily create a valid pledge. However, in the following cases, even a pledge by non-owners shall be valid:

**1. Pledge by a mercantile agent.** Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same. Such a pledge shall, however, be valid only if the pawnee acts

in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge (Section 178).

A 'mercantile agent' as per Section (9) of the Sale of Goods Act 1930, means a mercantile agent having, in the customary course of business as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods. For a pledge by a mercantile agent to be valid the following conditions must be satisfied:

**(a) Good faith.** The pledgee must have acted in good faith and must not have at the time of the pledge notice that the pawnor had no authority to pledge the goods. The onus of proving both these facts rests upon the person disputing the validity of the pledge.

**(b) Acting in the ordinary course of business.** The mercantile agent must have acted in the ordinary course of his business. Therefore, if he does the business outside his business premises or out of business hours, such a transaction would fall outside this section.

**2. Pledge by seller or buyer in possession after sale.** Under Section 30 of the Sale of Goods Act, a seller left in possession of goods after sale, and a buyer, who obtains possession of goods with the consent of the seller, before sale, can create a valid pledge. Once again, for the pledge to be valid the pledgee should have acted in good faith and without notice of previous sale of goods to the buyer or of the lien of the seller over the goods.

**3. Pledge by a person in possession under a voidable contract (Section 178-A).** Where a person obtains possession of goods under a voidable contract the pledge created by him is valid provided: (a) the contract has not been rescinded before the contract of pledge and (b) the pawnee acts is good faith and without notice of the pawnor's defect of title.

**4. Pledge by co-owner in possession.** One of several joint owners of goods in sole possession thereof with the consent of the rest may make a valid pledge of the goods.

**5. Pledge by a person having limited interest (Section 179).** Were a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of the interest. Thus, a pledgee may further pledge goods to the extent of the amount advanced thereon.

### 9.3.2 RIGHTS AND DUTIES OF A PLEDGER AND PLEDGEE

According to Section176 in case the pledgor fails to pay his debt or complete the performance of obligation at the stipulated time, the pledgee can exercise any of the following right: (i) bring a suit

against the pledgor upon the default in redemption of the debt or performance of promise and retain possession of goods pledged as a collateral security; or (ii) sell the goods pledged on giving the pledgor a reasonable notice of sale.

In case the goods pledged when sold do not fully meet the amount of the debt, the pledgee can proceed for the balance. If, on the other hand, there is any surplus, that has to be accounted for to the pledgor. Before sale can be executed, a reasonable notice must be given to the pledgor so that: (a) the pledgor may meet his obligation as a last chance; (b) he can supervise the sale to see that it fetches the right price.

**Example.** A trader pledged certain goods in favour of a bank. On default to return the loan, the bank sold the goods without giving a notice of sale to the trader as the loan agreement specifically excluded it. Held, that such an exclusion clause is inconsistent with the provisions of the Act and as such void and unenforceable.

However, the sale made by the pledgee without giving a reasonable notice to the pledgor is not void, i.e., cannot be set aside. The pledgee will be liable to the pledgor for the damages. In addition to the rights mentioned in Section 176, a pledgee has the following rights:

1. It is the duty of the pledgor to disclose any defects or faults in the goods pledged which are within his knowledge. Similarly, if the goods are of an abnormal character say, explosives or fragile, the pledgee must be informed. In case the pledgor fails to inform such faults or abnormal character of the goods pledged, any damage as a result of non-disclosure shall have to be compensated by the pledgor.

2. The pledgee has a right to claim any damages suffered because of the defective title of the pledgor.

3. A pledgee's rights are not limited to his interests in the pledged goods. In case of injury to the goods or their deprivation by a third party, he would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd* v. *Union of India,* the Supreme Court held that the bank (pledgee) was entitled to recover not only ₹20,000 – the amount due to it, but the full value of the consignment, i.e., ₹35,000. However, the amount over and above his interest is to be held by him in trust for the pledgor.

4. Pawnee's right of retainer [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.

However, s.174 provides that the pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

5. A pledgee has a right to recover extraordinary expenditure incurred for the preservation of the goods pledged (Section 175).

**Duties of a Pledgee.**

1. The pledgee is required to take as much care of the goods pledged to him as a person of ordinary prudence would, under similar circumstances, take of his own goods, of a similar nature.

2. The pledgee must not put the goods to an unauthorised use.

3. The pledgee is bound to return the goods on payment of the debt.

4. Any accruals to the goods pledged belong to the pledgor and should be delivered accordingly. Thus, if the security consists of equity shares and the company issues bonus shares to the equity shareholders, the bonus shares are the property of the pledgor and not the pledgee.

**Duties of a Pledgor.**

1. He must disclose to the pledgee any material faults or extraordinary risks in the goods to which the pledgee may be exposed.

2. He is responsible to meet any extraordinary expenditure incurred by the pledgee for the preservation of the goods.

3. Where the pledgee has exercised his right of sale of goods, any shortfall has to be made good by the pledgor.

4. He is liable for any loss caused to the pledgee because of defects in his (pledgor's) title to the goods.

**Rights of a Pledgor.**

1. The pledgor has a right to claim back the security pledged on repayment of the debt with interest and other charges.

2. He has a right to receive a reasonable notice in case the pledgee intends to sell the goods, and in case he does not receive the notice he has a right to claim any damages that may result.

3. In case of sale, the pledgor is entitled to receive from the pledgee any surplus that may remain with him after the debt is completely paid off.

4. The pledgor has a right to claim any accruals to the goods pledged.

5. If arty loss is caused to the goods because of mishandling or negligence on the part of the pledgee, the pledgor has a right to claim the same.

## 9.4 CHECK YOUR PROGRESS

Answers the following Multiple Choice Question

1. The person who during the contract of bailment deliver goods is called
   A. Bailor
   B. Bailee
   C. Both (a) and (b)
   D. None of above
2. The person to whom goods are delivered according Bailment is called
   A. Bailor
   B. Bailee
   C. Both (a) and (b)
   D. None of above
3. The bailment of goods as security for payment of debt or performance of a promise is called
   A. Pledge
   B. Special bailment
   C. Both (a) and (b)
   D. None of above
4. The term "Pledge" means
   A. A thing which is given as security
   B. A thing which is saled out
   C. Both (a) and (b)
   D. None of above
5. Section 178, of the Contract Act 1872 deals with
   A. Pledge by Trust agent
   B. Pledge by mercantile agent
   C. Pledge by international agent
   D. None of above

## 9.5 SUMMARY

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 of according to the directions of the person delivering them is called bailment. Depositing currency notes in a bank 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 no same notes are returned to the depositor by the bank. Keeping of ornaments/valuables in a bank locker is not a bailment as there is no transfer of possession of ornaments or valuables. 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. Bailment of goods as security for payment of a debt/performance of a promise is called pledge. 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 is all the pledges are bailments but all the bailments are not pledges.

## 9.6 KEYWORDS

**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 of according to the directions of the person delivering them Bailor- Person who delivers goods for bailment.

**Bailee:** Person to whom goods are delivered under the contract of bailment.

**Pledge:** Bailment of goods as security for payment of a debt/performance of a promise.

**Pawnor:** Person who pledges goods as security.

## 9.7 ANSWERS TO CHECK YOUR PROGRESS

1. A 2. B 3. A 4. A 5. B

## 9.8 SELF- ASSESSMENT TEST

1. Define bailment. What are the requisites of a contract of bailment? Explain.
2. Comment:

i. Bailor is liable to the bailee for loss caused by faults in the goods bailed whether the bailor was aware of the same or not."

ii. "Bailee's right of lien is a particular lien and does not extend to other goods of the bailor in his possession."

iii. "The finder of lost goods has no right to file a suit for recovery of expenses incurred by him for finding out the true owner." Discuss.

3. What are the respective rights and duties of a pawnor and a pawnee?

4. When is a pledge created by non-owners valid?

5. When a pledgor fails to redeem his pledge, what rights does the pledge have in the pledge?

6. "Every pledge is a bailment, but every bailment is not a pledge". Discuss.

## 9.9 REFERNCSES/SUGGESTED READINGS

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2. M.C. Kuchhal, Mercantile Law; Vikas Publishing House, New Delhi.
3. P. P. S. Gogna, A Textbook of Business Law; Sultan Chand & Company, New Delhi.
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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 10 | |

# CONTRACT OF AGENCY

## STRUCTURE



## 10.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define agent and agency, and explain different kinds of agency.
- Enumerate the duties and rights of an agent.
- Explain the procedure for termination of an agency.

## 10.1 INTRODUCTION

Before the Industrial revolution, business was carried on largely by individual artisans in their homes and in small family operated shops. As population and trade expanded and division of labour and specialisation became the order of the day, there arose the problem of distribution of goods. To meet the rising demand, manufacturers and shopkeepers began to hire others to work for them. These helpers or "servants" as they were called performed whatever physical tasks were assigned to them, under the close personal supervision of the "master". Today, the legal terms master-servant and employer-employee are used interchangeably. Over time, employers delegated a broader range of responsibilities to their employees – for example, by giving them authority to contract for raw materials, to sell finished products and even to employ other employees. In these expanded roles, the employees became known as agents and their employers were called principals. The Indian Contract Act, 1872, makes provisions as regards agency. Sections 182 to 238 deal with the subject of agency. In this chapter, the sections quoted refer to that Act unless otherwise specified.

## 10.2 DEFINITION OF AGENT AND AGENCY

Agent is "a person, employed to do any act for another or to represent another in dealings with third person". Thus, agent is a person who acts in place of another. The person for whom or on whose behalf he acts is called the Principal. For instance, Anil appoints Bharat, a broker, to sell his Maruti Car on his behalf. Anil is the Principal and Bharat is his agent. The relationship between Anil and Bharat is called Agency. This relationship is based upon an agreement whereby one person acts for another in transaction with a third person. The function of agent is to bring about contractual relation between the principal and a third party. The agent is only a connecting link between the principal and the third party and is rightly called as 'conduit pipe'. The acts of the agent, within the scope of the instructions, bind the principal as if he has done them himself. The phrase '*qui facit per alium facit per se*' contains the principle of agency, which means, he who does through another does by himself. In simple words, the act of agent is the act of the principal.

Agent must be distinguished from a servant. A servant acts under the direct control and supervision of his master and is bound to carry out all his reasonable orders. Agent, on the other hand, though bound to exercise his authority in accordance with lawful instructions of the principal is not subject to his direct supervision and control. Agent, therefore, is not a servant; though a servant, may for some purposes, be

his master's agent. Further, agent may work for several principals at the same time, a servant usually serves only one master. No consideration is necessary to create agency (Section 185). The fact that the principal, has consented to be represented by the agent is a sufficient detriment and consideration to support the promise of the agent to act in that capacity. However, in case no consideration has passed to the agent, he is not bound to do the agreed work, but once he begins, he must complete it to the satisfaction of the principal.

**Who can Employ Agent?** Any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ agent Section 183). No qualifications as such are prescribed for a person to be agent except that he has attained majority and is of sound mind. Thus, a minor or a lunatic cannot contract through agent since they cannot contract themselves personally either. If agent acts for a minor or lunatic, he will be personally liable to the third party. Association or group of persons may also appoint agent; for instance, a partnership firm may, transact business through agent. Certain group of persons, because of the very nature of their organisation, must act through agent, e.g., a company, which is an artificial person and thus can transact business only through agent.

**Who may be Agent?** Since agent is a mere connecting link or a 'conduit pipe' between the principal and the third party, it is immaterial whether or not the agent is legally competent to contract. Thus, there is no bar to the appointment of a minor as agent. However, in considering the contract of agency itself (i.e., the relation between principal and agent), the contractual capacity of the agent becomes important. Thus, no person who is not of the age of majority and of sound mind can become agent, as to be responsible to his principal (s.184). Thus, if the agent happens to be a person incapable of contracting, then the principal cannot hold the agent liable, in case he misconducts or has been negligent in the performance of his duties.

Example. Rahim appoints Kiran, a minor, to sell his car for not less than ₹90,000. Kiran sells it for ₹80,000. Rahim will be held bound by the transaction and further shall have no right against Kiran for claiming the compensation for having not obeyed the instructions, since Kiran is a minor and a contract with a minor is void *abinitio*.

### 10.2.1 DIFFERENT KINDS OF AGENCY

A contract of agency may be created by an express agreement or by implication (implied agreement) or by ratification. Thus, there are different kinds of agencies.

**(i) Express Agency (Section 187).** A person may be appointed as agent' either by word of mouth or by writing. No particu1arrm-iequired for appointing agent. The usual form of a written contract of agency is the power of attorney on a stamped paper.

**(ii) Implied Agency (Section 187).** Implied agency arises from the conduct, situation or relationship of parties. Implied agency, therefore, includes agency by estoppel, agency by holding out and agency of necessity.

**(iii) Agency by Estoppel (Section 237).** When a person has, by his conduct or statements, induced others to believe that a certain person is his agent, he is estopped from subsequently denying it. The principal is precluded from denying the truth of agency which he himself has represented as a fact, although it is not a fact.

**Examples.** Prakash allows Anand to represent as his agent by telling Cooper that Anand is Prakash's agent. Later on, Cooper supplied certain goods to Anand thinking him to be Prakash's agent. Prakash shall be liable to pay the price to Cooper. By allowing Anand to represent himself as his agent, Prakash leads Cooper to believe that Anand is really his agent.

(ii) Anand owns a shop in Serampur, living himself in Calcutta and visiting the shop occasionally. The shop is managed by find he is in the habit of ordering goods from Cooper in the name of Anand for the purposes of the shop and of paying for them out of Anand's funds with Anand's knowledge. Bharat has an implied authority from Anand to order goods from Cooper in the name of Anand for the purposes of the shop.

**(iv) Agency by Holding Out.** Though part of the law of estoppel, some affirmative conduct by the principal is necessary in creation of agency by holding out.

**Example.** Puran allows his servant Amar to buy goods for him on credit from Komal and pay for them regularly. On one occasion, Puran pays his servant in cash to purchase the goods. The servant purchases good on credit pocketing the money. Komal can recover the price from Puran since through previous dealings Puran has held out his servant Amar as his agent.

**(v) Agency of Necessity (Section 189).** This arises where there is no express or implied appointment of a person as agent for another but he is forced to act on behalf of a particular person.

**Examples**. (i) The Master of a ship, which is in distress and requires heavy and urgent repairs, can pledge the ship or cargo (without express or implied authority) and raise money in order to execute the voyage. He will be considered as the agent of the owner by necessity.

(ii) A horse is sent by rail and at the destination is not taken delivery by the owner. The station master has to feed the horse. He has become the agent by necessity and hence the owner must compensate him.

The doctrine of agency by necessity also extends to cases where agent exceeds his authority provided

(a) it was not reasonably possible to get the principal's instructions,

(b) the agent had taken all reasonable and necessary steps to protect the interests of the principal and

(c) he acted *bona fide*.

**(vi) Agency by Ratification (Sections 196-200).** Where agent does an act for his principal but without knowledge of authority, or where he exceeds the given authority, the principal is not held bound by the transaction. However, Section 196 permits the principal, if he so desires, to ratify the act of the agent. If he so elects, it will have the same effect as if the act was originally done by his authority. Agency in such a case is said to be created by ratification. In other words, the agency is taken to have come into existence from the moment the agent first acted and not from the date of principal's ratification. The rule is that every ratification relates back and is equivalent to a previous command or authority.

**Example.** Lallan makes an offer to Badal, Managing Director of a company. Badal accepts the offer though he has no authority to do so. Lallan subsequently withdraws the offer, but the company ratifies Badal's acceptance. Lallan is bound by the offer. The ratification by the company relates back to the time Badal accepted the offer, thus rendering the revocation of the offer inoperative. An offer once accepted cannot be withdrawn.

However, for the rule of relation back to apply, the agent while accepting an offer should not show lack of authority, e.g., where he accepts, 'subject to ratification', the rule of relation back does not apply and revocation shall be valid, if communicated prior to such ratification.

**Express and implied ratification (Section 197).** The ratification may be express or implied.

**Examples.** (i) Amar without Puran's authority lends Puran's money to Kamal. Later Puran accepts interest on the money from Kamal. Puran's conduct implies ratification of the loan.

(ii) Amar without Puran's authority buys certain gods for him. Afterwards, Puran sells those goods to Kamal. Puran's conduct ratifies the purchase made by Amar.

**Requisites of a valid ratification.** To be valid, a ratification must fulfil certain conditions. These conditions are:

(i) The agent must contract as agent; he must not allow the third party to imagine that he is the principal. A person cannot enter into a contract at his own and later shift it to another.

(ii) The principal must have been in existence at the time the agent originally acted. This condition is significant in case of a company. The preliminary contracts entered into by promoters of a company on its behalf cannot be ratified by the company after incorporation because, if permitted, ratification will relate back to the point of time when promoters originally acted and at that time the company was not in existence. How can a person, not in existence, be a party to a contract?

(iii) The principal must not only be in existence but must also have contractual capacity at the time of the contract as well as at the time of ratification. Thus, a minor on whose behalf a contract is made cannot ratify it on attaining majority

(iv) Ratification must be made within a reasonable time. What is a reasonable time shall vary from case to case.

(v) The act to be ratified must be a lawful one. There can be no ratification of. An illegal act or an act which is void *ab initio*.

(vi) The principal should have full knowledge of the facts (l98).

(vii) Ratification must be of the contract as a whole. The principal cannot reject the burden and accept only the benefits.

(viii) Ratification of acts not within the principal's authority is ineffective. This again is basically relevant in case of companies. The acts of directors which are *ultra vires* the powers of a company cannot be ratified by the coman2.

(ix) Ratification cannot be made so as to subject a third party to damages or terminate any right or interest of a third person (Section 200).

**Examples:** Amar, not being authorised thereto by Bharat, demands on behalf of Bharat, the delivery of some property of Bharat, from Cooper, who is in possession of it. This demand cannot be ratified by Bharat, so as to make Cooper liable for damages for his refusal to deliver.

(ii) Amar holds a lease from Bharat terminable on three months notice. Cooper, an unauthorised persons of termination to Amar. The notice cannot be ratified by Bharat, so as to be binding on Amar.

**(viii) Agency Coupled with Interest.** Agency is said to be coupled with interest when authority is given for the purpose of securing some benefit to the agent. In other words, where the agent has himself an interest in the subject-matter of the agency, the agency is one coupled with interest.

**Examples.** (i) Agent is appointed to sell properties of the principal and to pay himself out of such sale proceeds the debt due to the agent. The authority of the agent is agency coupled with interest.

(ii) A consigns 100 bags of rice to B, who has made advances to him on such rice and desires B to sell the rice and to repay himself out of the price, the amount of his own advance. The authority of B is an authority coupled with interest.

(iii) A sells the goodwill and book debts of his business to B and appoints B as his agent to collect the debt.

It should be noted that, it is not the ordinary type of interest which every agent has such as the remuneration, but it is that special type of interest which agent possesses that makes it agency coupled with interest. In the case of agency coupled with interest, the a enc cannot, unless there is an express contract, be terminated to the prejudice of such interest (Section 202). It becomes irrevocable to the extent of such interest and does not terminate even by the insanity or death of the principal.

### 10.2.2 CLASSIFICATION OF AGENTS

Agents may be classified from different points of view. One broad classification of agents is: (i) mercantile or commercial agents and (ii) non-mercantile or non-commercial agents. Another classification of agents is: (1) general and (2) special.

**(i) Special and General Agents.** A special agent is a person appointed to do some particular act or enter into some particular contract. A special agent, therefore, has only a limited authority to do the specified act. If he does anything beyond the specified act, he runs the risk of being personally liable since the principal may not ratify the same. A general agent, on the other hand, is one who is appointed

to represent the principal in all matters concerning a particular business, e.g., manager of a firm or managing director of a company.

**(ii) Mercantile or Commercial Agents.** A mercantile or commercial agent may assume any of the following forms: broker, factor, commission agent, del credere agent, auctioneer, banker, *Pakka* and *Katcha Adatias* and indentor. A broker is a mercantile agent engaged to buy and/or sell property or to make bargains and contracts between the engager and third party for a commission (called brokerage). A broker has no possession of goods or property. He is merely a connecting link between the engager and a third party. The usual method of dealing by a broker is to make entries of the terms of contract in a book, called the memorandum book and to sign them. He then sends the particulars of the same to both parties. The document sent to the seller is called the sold note and the one sent buyer is called the bought note. A factor is a mercantile agent who is entrusted with the possession of goods with an authority to sell the same. He can even sell the goods on credit and in his own name. He is also authorised to raise money on their security. A factor has a general lien on the goods in his possession. A factor, however, cannot barter the goods, unless expressly authorised to do. Also, he cannot delegate his authority.

A commission agent is agent who is employed to buy or sell goods or transact business. The remuneration that he gets for the purpose is called the commission. A commission agent is not liable in case the third party fails to carry out the agreed obligation. A commission agent may have possession of the goods or not. His lien in case of goods in his possession is a particular lien. A del credere agent is one who, in consideration of an extra remuneration, called a del credere commission, guarantees the performance of the contract by the other party. A del credere agent thus occupies the position of a guarantor, as well as of agent. He is normally appointed in case of deals with foreign nationals, about whom the principal may know nothing.

An auctioneer is agent appointed to sell goods by auction. He can deliver the goods only on receipt of the price. An auctioneer can recover the price from the highest bidder (i.e., the buyer) by filing a suit in his own name. In any case, an auctioneer can sell only by public auction and not by a private contract. His position differs from a factor inasmuch as the auctioneer has a particular lien, whereas the factor has a general lien.

Though the relationship between banker and customer is ordinarily that of debtor and creditor, he acts as his agent when he buys or sells securities on his behalf. Similarly, when he collects cheques, bills,

interest, dividends, etc., or when he pays insurance premium out of customer's account, as per customer's mandate, he acts as his agent. A Pakka adatia is a person who guarantees the performance of the contract, not only to his principal but also to the broker (shroff) on the other side. A peculiarity of pakka adatia is that he can himself perform the contract instead of offering it to the third party. A Katcha Adatia, on the other hand, does not guarantee the performance of the contract. However, he guarantees the performance on the part of the principal. Thus, he will be responsible to the other broker or shroff who contracts on behalf of the other party, in case of non-performance by his principal.

An indentor is a commission agent, who for a commission, procures a sale or a purchase on behalf of his principal, with a merchant in a foreign country. Such agent gets commission at the rates mentioned in the indent.

**(iii) Non-mercantile or Non-commercial Agents.** Some of the agents in this category are: wife, estate agent, counsels (advocates), attorneys. The following principles provide guidelines as regards wife as agent of her husband: (i) if the wife and husband are living together and the wife is looking for necessaries, she is agent. But this presumption may be rebutted and the husband may escape liability if he can prove that (a) he had expressly forbidden his wife from purchasing anything on credit or from borrowing money, (b) goods, purchased were not necessaries, (c) he had given sufficient money to his wife for purchasing necessaries, or (d) the trader had been expressly told not to give credit to his wife. (ii) Where the wife lives apart from the husband, through no fault of hers, the husband is liable to provide for her maintenance. If he does not provide further maintenance, she has an implied authority to bind the husband for necessaries, i.e., he would be bound to pay her bills for necessaries. But where the wife lives apart under no justifiable circumstances, she is not her husband's agent and thus cannot bind him even for necessaries.

**(iv) Sub-agent and Substituted Agent (Sections 190-195).** The general rule is that agent cannot appoint agent. The governing rule is enshrined in a maxim 'a delegate cannot further delegate'. Agent being a delegate cannot transfer his duties to another. The principle underlying the rule is that the principal engages agent ordinarily on personal consideration and thus may not have the same confidence in the person appointed by the agent. Hence, sub-agency is not generally recognised. However, Section 190 deals with the circumstances as to when and how far agent can delegate his duties. Agent may appoint agent in the following circumstances: (i) where expressly permitted by the principal; (ii) where the ordinary custom of the trade permits delegation; (iii) the nature of agency is such that it cannot be

accomplished without the appointment of a sub-agent; (iv) where the nature of the job assigned to the agent is purely clerical and does not involve the exercise of discretion, e.g., if Anthony is appointed to type certain papers, because of lack of time, he assigns the job to another equally competent typist Bharat, the delegation is valid; (v) in an unforeseen emergency.

Under the above-mentioned circumstances stipulated by Section 190, if agent appoints another person in the matter of the agency, that other person may assume the position of either a sub-agent or a substituted agent. Section 191 states that a sub-agent is a person employed by and acting under the control of the original agent in the business of agency. Since the sub-agent is appointed by the act and under the control of the agent, there is no privity of contract between the sub-agent and the principal. The sub-agent, therefore, cannot sue the principal for remuneration and, similarly the principal cannot sue the sub-agent for any moneys due from him. Each of them can proceed against his immediate contracting party, viz, the agent except where the sub-agent is guilty of fraud. In that case the principal has a concurrent right to proceed against the agent and the sub-agent. A sub-agent properly appointed, however, can represent the principal and bind him for his acts as if he were agent originally appointed by the principal. But where agent, without having the authority to do so, has appointed a sub-agent, the principal is not represented by or responsible for the acts of such a sub-agent. The sub-agent can only bind the agent by contracts entered into with third parties.

Where agent appoints or names another person for being appointed as agent in his place, such person is called a substituted agent (Section 194).

**Example.** Amar directs Bharat, his solicitor, to sell his estate by auction and to employ an auctioneer for the purpose. Bharat names Cooper, an auctioneer, to conduct the sale. Cooper is not a sub-agent, but is Amar's agent for the conduct of the sale.

### 10.2.3 DUTIES AND RIGHTS OF AGENT

**Duties of Agent.** The duties of agent towards his principal are:

**1. To conduct the business of agency according to the principal's directions (Section 211).** The duty of the agent must be literally complied with, i.e., the agent is not supposed to deviate from the directions of the principal even for the principal's benefit. If he does so, any loss occasioned thereby shall have to be borne by the agent, whereas any surplus must be accounted for to the principal.

**Example.** Anil is directed by his principal to warehouse the goods at a particular warehouse. He warehouses a portion of the goods at another place, equally good but cheaper. The goods are destroyed by fire. Anil, the agent, is liable to make good the loss.

In the absence of instructions from the principal, however, the agent should follow the custom of the business at the place where it is conducted.

**Example.** Amar, agent, engaged in carrying on for Bharat a business in which it is the custom to invest from time to time, at interest, the money which may be in hand, omits to make such investment. Amar must make good to Bharat the interest usually obtained by such investment.

**2. The agent should conduct the business with the skill and diligence** that is generally possessed by persons engaged in similar business, except where the principal knows that the agent is wanting in skill (Section 212).

**Examples.** (i) Where a lawyer proceeds under a wrong section of law and thereby the case is lost, he shall be liable to his client for the loss.

(ii) Amar, agent for the sale of goods, having authority to sell on credit, sells to Bhagat on credit, without making the proper and usual enquiries as to the solvency of Bhagat. Bhagat, at the time of such sale, is insolvent. Amar has to compensate his principal in respect of any loss thereby sustained.

**3. To render proper accounts (Section 213).** The agent has to render proper accounts. If the agent fails to keep proper accounts of the principal's business, everything consistent with the proved facts will be presumed against him. Rendering of accounts does not mean showing the accounts, but maintaining proper accounts supported by vouchers.

**4. To communicate with the principal in case of difficulty (Section 214).** It is the duty of agent, in case of difficulty, to use all reasonable diligence, in communicating with his principal and in seeking to obtain his instructions. In case of emergency, however, the agent can do all that a reasonable man would, under similar circumstances, do with regard to his own business. He becomes agent by necessity.

**5. Not to make any secret profits.** Agent should deliver to the principal all moneys including secret commission received by him. He can, however, deduct his lawful expenses and remuneration.

**6. Not to deal on his own account.** Agent should not deal on his own account without first obtaining the consent of his principal. If he does so, the principal can claim from the agent any benefit which he might have obtained.

**Example**. Pawan directs Amar, his agent, to buy a particular house for him. Amar tells Pawan that it cannot be bought, but buys the house for himself. Pawan may, on discovering that Amar has bought the house, compel him to sell it to Pawan at the price he bought.

Further, in case agent deals on his own account, he shall cease to be entitled for his remuneration as agent.

**7. Not entitled to remuneration for misconduct (Section 220).** Agent who is guilty of misconduct in the business of agency is not entitled to any remuneration in respect of that part of the business which he has misconducted.

**Example.** Amar employs Bharat to recover ₹50,000 from Cooper and to lay it out on a good security. Bharat recovers the amount and lays out ₹30,000 on good security but lays out ₹20,000 on security which he ought to have known to be bad whereby Amar loses ₹5,000. Bharat is entitled to remuneration for recovering ₹50,000; and for investing ₹30,000. He is not entitled to any remuneration for investing ₹20,000 and he must make good the ₹5,000 to Amar.

**8. Not to disclose confidential information supplied** to him by the principal.

**9. To take all reasonable steps for the protection and preservation of the interests entrusted to him** when the principal dies or becomes of unsound mind (Section 209).

**Rights of Agent.** Agent has a number of rights. These are:

**1. Right to remuneration (Sections 219-220).** Agent is entitled to his agreed commission or remuneration and if there is no agreement, to a reasonable remuneration. But the remuneration does not become payable unless he has carried out the object of agency, except where there is a contract to the contrary. When the object of agency is deemed to have been carried out or the act assigned to the agent is completed would depend on the terms of the contract. Further, the transaction for which the agent claims remuneration should be the direct result of his services.

**Example.** Pawar appoints Amar, a broker. Amar is entitled to his commission when he has procured a party who is willing to negotiate on reasonable terms and to desirous of entering into a contract with Pawar.

Agent, however, is not 1ttitled to any remuneration in respect of that part of the business which he has misconducted. (Section 220)

**2. Right of retainer (Section 217).** Agent may retain out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business and also such remuneration as may be payable to him for acting as agent. This is known as agent's right of retainer. However, the right of retainer can only be claimed on moneys received by him in the business of agency. He cannot, therefore, retain sums received by him in one business for his commission or remuneration in an other business on behalf of the same principal.

**3. Right of lien (Section 221).** In the absence of any contract to the contrary, agent is entitled to retain goods, papers and other property whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him. This lien of the agent is a particular lien confined to all claims arising in respect of the particular goods and property by a special contract, however, agent may get a general lien extending to all claims arising out of the agency. Since, the word 'lien' means retaining possession, it can be enjoyed by the agent only where the goods or papers are in actual or constructive possession of the agent. The right of lien will, therefore, be lost where he parts with the possession of goods or papers. But if the possession is obtained from the agent by fraud or unlawful means, his lien is not affected by the loss of possession.

**4. Right of stoppage in transit.** The agent can stop the goods while in transit in two cases: (a) Where he has purchased goods on behalf of the principal either with his own funds, or by incurring a personal liability for the price, he stands towards the principal in the position of an unpaid seller. Like an unpaid seller, he enjoys the right of stopping the goods in transit if in the meantime the principal has become insolvent. (b) Where agent holds himself liable to his principal for the price of the goods sold, for example, *del credere agent*, he may exercise the unpaid seller's right of stopping the goods in transit in case of buyer's insolvency.

**5. Right of indemnification (Sections 222-224).** The principal is bound to indemnify agent against the consequences of all lawful acts done by the agent in exercise of authority conferred on him.

**Example.** John, at Singapore, under instructions from Amin at Calcutta, contracts with Cooper to deliver certain goods to him. Amin does not send the goods to John and Cooper sues John for breach of contract. John informs Amin of the suit and Amin authorises him to defend the suit. John defends the suit and is compelled to pay damages and costs and incurs expenses. Amin is liable to John for such damages, cost and expenses.

Section 223 further provides that agent shall have a right to be indemnified against consequences of acts done in good faith.

**Example.** B, at the request of A, sells goods in the possession of A, but which A had no right to dispose of. B does not know this and hands over the proceeds of the sale to A. Afterwards C, the true owner of goods, sues B and recovers the value of the goods and costs. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses, provided C has acted in good faith and he had no knowledge that the goods did not belong to A.

However, it must be remembered that agent cannot claim indemnification for criminal act, even though the principal had agreed to do so (Section 224).

**Example.** A employs B to beat C and agrees to indemnify him against all consequences of that act. B thereupon beats C and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

**6. Right to compensation for injury caused by principal's neglect (Section 225).** The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill,

**Example.** A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskilfully put up and B is in consequences hurt. A must make compensation to B.

### 10.2.4 PRINCIPAL'S DUTIES OF THE AGENT AND HIS LIABILITY TO THIRD PARTIES

**Duties of a Principal.** The rights of agent are in fact the duties of the principal. Thus a principal is:

(i) bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him (Section 222);

(ii) liable to indemnify agent against the consequences of an act done in good faith, though it causes an injury to the rights of third persons (Section 223);

(iii) bound to compensate his agent in respect of injury caused to such agent by the principal's neglect or want of skill (Section 225).

The principal is, however, not liable for acts which are criminal in nature though done by the agent at the instance of tie principal (Section 224).

**Liability of Principal to Third Parties**

1. Agent being a mere connecting link binds theprincipa1 for all his acts done within the scope of his authority (Section 226).

**Example.** A, being B's agent with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

2. The principal is liable for the acts of the agent falling not only within the actual authority but also within the scope of his apparent or ostensible authority

3. Where agent exceeds his authority and the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and the principal (Section 227).

**Example.** A, being the owner of a ship and cargo, authorises B to procure an insurance for ₹4,000 on the ship. B procures a policy of ₹4,000 on the ship and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

However, where agent does more than he is authorised to do and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound by the transaction (Section 228).

**Example.** Agent is authorised to draw a bill for ₹5,000 but he draws a bill for ₹10,000, the principal will not be liable even to the extent of ₹5,000.

4. The principal will be liable even for misrepresentations made or frauds committed by agent in the business of agency for his own benefit. But misrepresentations made or frauds committed by agents in matters beyond their authority do not affect their principals (Section 238).

**Example:** A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorised by B to make. The contract is voidable, as between B and C, at the option of C.

5. The principal remains liable to the third parties even where his name was not disclosed. The third parties, on discovering his name, can proceed against him on the contract.

6. The principal is bound by any notice or information given to the agent in the course of business transacted by him.

7. The liability of the principal continues even in cases where agent is held personally liable. Section 223 provides an option to the third parties to either sue the principal or agent or both.

**Undisclosed Principal.** Where agent, though discloses the fact that he is agent working for some principal, conceals the name of the principal, such a principal is called an undisclosed principal. The liability of an undisclosed principal is similar to that of a disclosed principal unless there is a trade custom making the agent liable. However, the undisclosed principal must exist and must also be the principal at the time the contract is made. He cannot be brought into existence as a principal after the contract has been concluded.

**Concealed Principal.** Where agent conceals not only the name of the principal but the very fact that there is a principal, the principal is called a concealed principal, In such a case, the third parties are not aware of the existence of the principal and regard the agent as the person contracting for himself. The third parties, thus, must look to the agent for payment or performance and the agent may sue or be sued on the contract. Legal position in this regard is as follows:

1. If the principal wishes to intervene, he may require the performance of the contract, but the other party has, as against him (principal), the same rights as he would have had as against the agent if the agent has been principal (Section 231)

2. Para II of Section 231 provides that in such a case, if the principal discloses himself before the contract is completed the other contracting party may refuse to fulfil the contract, if he can show that if he had known who was the principal in the contract, or if he had known that the agent was not the principal, he would not have entered into the contract.

3. If the principal requires performance of the contract, he can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

**Example.** A who owes ₹500 to B, sells 1,000 rupees worth of rice to B. A is acting as agent for C in the transaction but B has 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.

4. In contracts with a concealed principal, the agent is, in the absence of a contract to the contrary, personally liable to the third party. The party may hold either the agent or principal or both liable (Section 223).

**Example.** A enters into a contract with B to sell him 100 bales of cotton and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both for the price of the cotton.

### 10.2.5 PERSONAL LIABILITY OF AGENT

Agent is only a connecting link between the principal and third parties. Being only a medium, he can, in the absence of a contract to the contrary, neither personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them (Section 230).

From the above discussion, it may be inferred that agent can enforce contracts personally and be held bound for contracts entered into on behalf of his principal, if there is an agreement to the effect, express or implied. Section 230 enlists the following cases where a contract to this effect shall be presumed to exist: (1) where the contract is made by agent for the sale or purchase of goods for a merchant resident abroad; (2) where the agent does not disclose the name of his principal; (3) where the principal, though disclosed, cannot be sued, for instance, where principal is a minor. Besides, agent incurs a personal liability in the following cases:

**1. Breach of warranty.** Where agent acts either without any authority or exceeds his authority, he is deemed to have committed breach of warranty of authority in such a case. He will be held personally liable if his acts are not ratified by the alleged principal. Further, agent will be guilty of warranty of authority even where his authority is terminated without his knowledge, e.g., by death or lunacy of the principal.

**2. Where the agent expressly agrees to be personally bound.** This sort of stipulation may be provided particularly where principal does not enjoy much credit-worthiness and the third parties wish to ensure the payment or performance.

**3. Where agent signs a negotiable instrument in his own name.** In case agent signs a negotiable instrument without making it clear that he is signing it as agent only, he may be held personally liable

on the same. He would be personally liable as the maker of the note, even though he may be described in the body of the note as the agent (Section 28, Negotiable Instrument Act, 1881).

4. Agent with special interest or with a beneficial interest, e.g, a factor or auctioneer, can sue and be sued personally.

5. When agent is guilty of fraud or misrepresentation in matters which do not fall within his authority (Section 238).

6. Where trade usage or custom makes agent personally liable.

7. Where the agency is one coupled with interest.

### 10.2.6 TERMINATION OF AGENCY

**(i) Circumstances under which Agency Terminates or Comes to an End (Section 201).**

**1. On revocation by the principal.** The principal may, by notice, revoke the authority of the agent at any time. Where the agent is appointed to do a single act, agency may be revoked any time before the commencement of the act. In case of a continuous agency, notice of revocation is essential to the agent as well as to the third parties who have acted on the agency with the knowledge of the principals.

Where agency is for a fixed period of time and the contract of agency is revoked without sufficient cause, compensation must be paid to the agent (Section 205). However, the agency is irrevocable in two cases: (i) Where the authority of the agent is one coupled with interest; i.e., the agent has an interest in the subject-matter of the contract. The principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations already done in the agency (Section 204).

**Examples.** (i) A gives authority to B to sell A's land and to pay himself out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

(ii) A authorises B to buy 1,000 bales of cotton on account of A and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority to pay for the cotton.

**2. On the expiry of fixed period of time.** When the agency is for a fixed period of time, it comes to an end on the expiry of that time.

**3. On the performance of the specific purpose.** Where agent is appointed to do a particular act, agency terminates when that act is done or when the performance becomes impossible.

**4. Insanity or death of the principal or agent.** Death or insanity of the principal or the agent, terminates the agency. But, agent, in such a case, should take all reasonable steps for the preservation of property on behalf of the legal representatives of the principal (Section 209).

5. An agency shall also terminate in case the subject matter is either destroyed or rendered unlawful.

**6. Insolvency of the principal.** Insolvency of the principal, not of the agent, terminates the agency.

**7. By renunciation of agency by the agent.** If principal can cause termination of agency by revocation, agent may renounce his agency by giving a sufficient notice to that effect. Where, however, agency is for a fixed period and the agency is renounced without a sufficient cause, the principal must be compensated (Section 205).

**(ii) When Termination of Agency takes Effect?**

1. The termination of the authority of agent does not, so far as regard the agent, takes effect before it becomes known to him (Section 208).

2. As regards third parties, they can continue to deal with the agent till they come

to know of the termination of the authority (Section 208).

**Examples** (i) A directs B to sell goods for him and agrees to give B 5% commission on the price fetched by the goods. A afterwards, by a letter revokes B's authority B, after the letter is sent, but before he receives it, sells the goods for ₹100. The sale is binding on A and B is entitled to five rupees as his commission.

(ii) A, at Chennai, by a letter directs B to sell for him some cotton lying in a warehouse in Mumbai and afterwards, by another letter, revokes his authority to sell and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second. For the sale to him of the cotton C pays B the money, with which B absconds. C's payment is good as against A.

3. The termination of the authority of agent causes the termination of authority of

all sub-agents appointed by him.

## 10.3 POWER OF ATTORNEY

A power of attorney is defined by Section 2 (21) of the Stamp Act, as including "any instrument not chargeable with a fee under the law relating to court fees for the time being in force," which empowers "a specified person to act for and in the name of the person executing it". It is the Powers of Attorney Act, 1882, which deals with the subject, but does not define it. In common parlance, a power of attorney is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it. The person executing the deed is known as the Principal or donor and the one in whose favour it is executed is the agent, or the power agent or the power of attorney agent.

Section 2 of the Powers Attorney Act, 1882, provides that the donee may execute any instrument in and with his own name and signature and his own seal, where sealing is required, by the authority of the donor of the power. And such an instrument shall be as effectual in law as if it had been executed by the donor. As mentioned earlier, no consideration is necessary to create agency. Therefore, the deed of Power of Attorney may stipulate that the agent wifi not get any remuneration.

**A Power of Attorney may be Special or General.** If the deed conferring power by one to another relates to one single transaction, it is known as special power of attorney. If the deed conferring power relates to several transactions it is general power of attorney.

**Registration.** As a general rule, registration of power of attorney is not necessary but if it authorises the donee to recover the rents of an immovable property of the donor for the donee's benefit, it would require registration. And so also a power creating a charge in favour of the donee upon an immovable property referred to therein.

Further Section 32 (c) of the Registration Act, 1908, requires that where a document is presented for registration by the agent of a person entitled to present it for registration, such agent must be duly authorised by power of attorney executed and authenticated in manner as mentioned in s.33 of the Act.

Such a power of attorney is to be executed before and authenticated by a registrar or sub-registrar. Unregistered power executed in a foreign country before a notary public can be used by the agent for presentation of document for registration. The power of attorney, however, executed before a notary public in India wifi not enable the agent to present any document for registration under the Registration Act, 1908.

The power of attorney is required to be engrossed on non-judicial stamp paper. The amount of stamp duty varies with different types of powers as described in the Stamp Act and varies among different

States of India. Section 4 of the Power of Attorney Act, 1882 provides that the original deed of power can be deposited in the High Court in whose jurisdiction the principal resides and a certified copy of the deed can be obtained from the High Court. Such certified copies are equal to originals and are binding on all.

Further, Section 85 of the Indian Evidence Act provides that the Court shall presume that every document purporting to be a power of attorney and to have been executed before and authenticated by a Notary Public, or any Court, Judge, Magistrate, was so executed and authenticated.

## 10.4 CHECK YOUR PROGRESS

**1. The person for whom agents do any act or to represents whom is called**

A. Employer
B. Principal
C. Managing director
D. None of above

**2. The person acting employed by under the control of the original gent in the business of the agency is called**

A. Assistant agent
B. Associate agent
C. Sub-agent
D. None of above

**3. The person acting employed by under the control of the original gent in the business of the agency is called**

A. Assistant agent
B. Associate agent
C. Sub-agent
D. None of above

**4. An unsound person cannot become**

A. An agent
B. Principal
C. Both (a) and (b)
D. None of above

**5. As per section 185 of the Contract Act, 1872 consideration is**

A. Necessary to create agency

B. Not necessary to create agency

C. Depends upon type of agency

D. None of above

## 10.5 SUMMARY

Agency is the 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. Person appointed by the original agent in the business of agency under his direction and control and being responsible to the principal for acts is a sub-agent. Person is named by the agent expressly or impliedly to act for the principal in the business of agency is called substituted agent. 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 include (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 are (a) Right of retain out of sums received on principal's account (b) Right to remuneration (c) Agent's lien on principal's property (d) Right of indemnification for lawful acts (e) Right of indemnification against acts done in good faith.

## 10.6 KEYWORDS

**Agent:** A person employed to do any act for another or to another in dealings with third person.

**Special Agent:** He is a person appointed to do some particular act or enter into some particular contract.

**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.

**Special Power of Attorney:** The deed conferring power by one to another relating to one single transaction.

## 10.7 ANSWERS TO CHECK YOUR PROGRESS

**1. B 2. C 3. A 4. C 5.B**

## 10.8 SELF ASSESSMENT TEST

1. How is agency created?
2. (a) Can a minor appoint agent? (b) Can a minor be appointed as agent by an adult? (c) Who is a *del credere* agent?
3. Explain clearly the meaning of 'agency by ratification'. What conditions must be fulfilled for a valid ratification? Explain the effects of a valid ratification.
4. Discuss the extent to which agent can delegate his authority. State the consequences where the agent properly employs a sale agent and when he appoints him without authority.
5. Discuss the rights of agent against his principal.
6. In what ways may a contract of agency be terminated by the act of the parties?
7. How far is the principal bound when the agent exceeds his authority?

## 10.9 REFERNCSES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 11 | |

# SALE OF GOODS ACT: AN INTRODUCTION

## STRUCTURE



## 11.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to

a) Define a contract of sale of goods and state its essentials.

b) Make a distinction between sale and agreement to sell, and sale and hire purchase.

c) Define the goods and explain various types of goods.

d) State the rules governing the passing of title to the goods from the seller to the purchases.

e) Define bailment and explain its features.

## 11.1 INTRODUCTION

Most of economic activities involve buying and selling of movable goods. The sale of goods may on cash or credit basis. The goods may be sold on the spot or there may be a promise to sell the some in future. The law relating to the sale of goods or movable goods in India is contained in the Sale of Goods Act, 1930. Before the passing of the present Act, the law relating to the sale of goods was contained in Chapter VII of the Indian Contract act, 1872. The provisions of Chapter VII were found to be unsatisfactory and the present Act was passed with the main object of making the provisions more clear. The Act came into force on Ist July, 1930.

## 11.2 CONTRACT OF SALES OF GOODS

A contract of sales of goods is a contract whereby the sellers transfers or agrees to transfer the property in goods to the buyer for a price (Section 4).

The term 'Contract of Sale' is a generic term and includes:

i) Sales; and

ii) Agreement to sell

Where the seller transfer the property in the goods immediately to the buyer, it is a sale. But where the transfer of the property in the goods is to take place in a future time subject to some conditions thereafter to be fulfilled, the contract is called an agreement to sell. An agreement to sell becomes a sale when the time passed as the conditions are fulfilled subject to which the property in the goods is to be transferred.

### 11.2.1 ESSENTIALS OF A CONTRACT OF SALE

The general provisions of Indian Contract Act continue to be applicable to the contract of sales of goods in so far as they are not inconsistent with the express provisions of Sale of Goods Act (Section 3). Thus, for example, the provisions of Contract Act relating to capacity of the parties, free consent, agreements in restraint of trade, wagering agreements and measure of damages continue to be applicable to a contract of sale of goods. But the definition of consideration stands modified to the

extent that in a contract of sale of goods, consideration must be by way of 'price' i.e., only money consideration [Section 2(10) and 4]

The following are the essentials of the contract of sale:

**1. Contract**

The word contract means an agreement enforceable at law. It presumes free consent on the part of the parties who should be competent to contract. Thus, a compulsory transfer of goods is not a sale. The agreement must be made for a lawful consideration and with a lawful object. In other words, all the essential elements of a valid contract must also be present in a contract of sale.

**2. Two Parties**

To constitute a contract there must be two parties, viz., a buyer and a seller, as a person cannot buy his own goods. According to Section 4(1), there may be a contract of sale between one part-owner and another, e.g. if A and B jointly own a typewriter, A may sell his ownership in the typewriter to B, thereby making B sole owner of the goods. Similarly, a partner may buy the goods from the firm in which he is a partner and vice-versa. There is, however, one exceptional case when a person may buy his own goods. Where a person's goods are sold in execution of a decree, he may himself buy them, so as to save them from a transfer of ownership to someone else (Moore vs Singer Manufacturing Co.).

**Example:** A partnership firm was dissolved and the surplus assets, including the stock in trade, were divided among the partners, in spite. Held, it was not a sale as the partners themselves were the joint owners of the goods and they could not be both sellers and buyers [State of Gujarat v Raman Lal S & Co, AIR (1965) Guj Co].

There are certain other exceptions to the rule that the same person cannot be both a purchaser and a seller. These are:

a) A part owner can sell his share to the other part owner so as to make the other part owner the sole owner of the goods

b) A partner may also buy the goods from the firm in which he is a partner and vice-versa.

c) Where a pawnee sells the goods pledged with him on non-payment of bill money, the pawnor may himself buy such goods.

d) In case there is a sale by auction, the seller may reserve right of making a bid at the auction and may thus purchase his own goods.

**3. Transfer of Property**

Property means 'ownership'. Transfer of property in the goods is another essential of a contract of sale of goods. A mere transfer of possession of the goods cannot be termed as sale. To constitute a contract of sale, the seller must either transfer or agree to transfer the property in the goods to the buyer.

**4. Goods**

According to Section 2(7), "goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale". Thus, every kind of movable property except actionable claim and money is regarded as 'goods'. Goodwill, trade marks, patents right, copyrights, electricity, water, gas, decree of a court of law are all regarded as goods. Shares and stock are also included in goods. With regard to growing crops, grass and things attached to or forming part of the land, such things are regarded as goods as soon as they are agreed to be separated from the land. Thus where trees were sold so that they could be cut out and separated from the land and then taken away by the buyer, it was held that there was a contract for sale of movable property or goods (Kursell vs Timber Operators & Contractors Ltd). But contracts for sale of things 'forming part of the land itself' are not contracts for sale of goods. For example, a contract for the sale of coal mine or building stone quarry is not a contract of sale of goods.

Money is not regarded goods because it is the medium of exchange through which goods can be bought. Old and rare coins, however, may be treated as goods and sold as such.

**5. Price**

To constitute a valid contract of sale, consideration for transfer must be money paid or promised. Where there is no money consideration the transaction is not a contract of sale, as for instance goods given in exchange for goods or as remuneration for work or labour. Further, there is nothing to prevent the consideration from being partly in money and partly in goods or some other articles of value. For example, when an old car is returned to the dealer for a new one and the difference is paid

in cash, that would be a sale.

### 11.2.2 SALE AND AN AGREEMENT TO SELL

**SALE**

The term 'contract of sale' is a generic term and includes both a 'sale' and an 'agreement to sell' Sale: where under a contract of sale the property in the goods is immediately transferred at the time of making the contract from the seller to the buyer, the contract is called a 'sale' [Sec 4(3)]. It refers to an 'absolute sale', e.g., an outright sale on a counter in a shop. There is immediate conveyance of the ownership and mostly of the subject matter of the sale as well (delivery may also be given in future). It is an executed contract.

**AN AGREEMENT TO SELL**

Where under a contract of sale the transfer of property in the goods is to take place at a future time or subject to same condition thereafter to be fulfilled, the contract is called 'an agreement to sell' [Section 7(3)]. It is an executory contract and refers to a conditional sale.

**Examples**

(i) On 1 January, X agrees with Y that he will sell Y his scooter on 15 January for a sum of ₹4,000. It is an agreement to sell, since X agrees to transfer the ownership of the scooter to y at a future time.

(ii) X buys some furniture for ₹5,000 and agrees to pay for that in the monthly installments, the ownership to pass to him on the payment of second installment. There is an agreement to sell for the furniture dealer.

The Sales of Goods Act does not prescribe any particular form to constitute a valid contract of sale. A contract of sale of goods can be made by mere offer and acceptance . The offer may be made either by the seller or the buyer and the same must be accepted by the other . Neither payment nor delivery is necessary at the time of making the contract of sale. Further, such a contract may be amide either orally or in writing or partly orally and partly in writing or may be even implied from the contract of the parties.

### 11.2.3 DIFFERENCE BETWEEN SALE AND AGREEMENT TO SELL

A contract for sale of goods is a contract whereby the seller transfers or agrees to transfer the

property in the goods to the buyer for a price. Therefore, the effect of a contract of sale is the transfer of property in the goods from the seller to the buyer. In the sale of goods, the property in them is transferred from the seller to the buyer immediately, but where an agreement of sale is entered into, the property in the goods passes only after the seller has fulfilled certain conditions subsequently [Section 4(3)]. Thus, whether a contract of sale of goods is an absolute sale or an agreement to sell, depends on the fact whether it contemplates immediate transfer from the seller to the buyer or the transfer is to take place in future date. The following are the points of difference between them:

**(i) Transfer of Property**

In a sale, the property in the goods passes from the seller to the buyer immediately so that the seller is no more the owner of the goods sold. In an agreement to sell, the transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled. In this sense, a sale is an executed contract and an agreement to sell is an executory contract.

**(ii) Risk of Loss**

In a sale, the buyer immediately becomes the owner of the goods and the risk as a rule passes to the buyer; under an agreement to sell, the seller remains the owner and the risk is with him. Thus under a sale, if the goods are destroyed the loss falls on the buyer, even though the goods are in the possession of the seller. But, under an agreement to sell, the loss will fall on the seller in the case of destruction of goods even though they are in the possession of the buyer.

**(iii) Consequences of Breach**

In case of sale, if the buyer wrongfully neglects or refuses to pay the price of the goods, the seller can sue for the price, even though the goods are still in his possession. In case of an agreement to sell, if the buyer fails to accept and pay for the goods, the seller can only sue for damages and not for the price, even though the goods are in the possession of buyer.

**(iv) Insolvency of the Buyer**

In a sale, if the buyer is adjudged an insolvent, the seller in the absence of a lien over the goods is bound to deliver the goods to the Official Receiver or Assignee. The seller, will, however, be entitled to a rateable dividend for the price of the goods. On the other hand, in an agreement to sell, when the buyer becomes insolvent before he pays for the goods, the seller may not part with the goods.

**(v) Insolvency of the Seller**

In a sale, if the seller becomes insolvent, the buyer being the owner is entitled to recover the goods from the Official Receiver or Assignee. In an agreement to sell, if the buyer, who has paid the price, finds that the seller has become insolvent, he can only claim a rateable dividend and not the goods because property in them has not yet passed to him.

**(vi) Right to Resale**

In a sale, the property is with the buyer and as such the seller (in possession of goods after sale) cannot resell the goods. If he does so, the subsequent buyer having knowledge of the previous sale does not acquire a title to the gods. The original buyer can sue and recover the goods from the third person as owner, and can also sue the seller for the breach of contract as well as for the tort conversion.

On the other hand, in an agreement to sell, the property in the goods remains with the seller and as such he can dispose of the goods as he likes and the original buyer can sue him for the breach of contract only. In this case, the subsequent buyer gets a good title to the goods, irrespective of his knowledge of previous sale. Further, goods forming the subject matter of an agreement to sell can also be attached in execution of a decree of a court of law against the seller.

### 11.2.4 DISTINCTION BETWEEN SALE AND HIRE PURCHASE

The difference between a contract of sale and hire purchase agreement are given below:

**1. Nature of Contract**

A sale is an executed contract in which the ownership is transferred from the seller to the buyer as soon as the contract entered into.

In a hire purchase agreement it becomes the property of the buyer only after a certain agreed number of installments is paid till then the hire purchaser stands in the position of the bailee and not the owner of the goods.

**2. Termination of the Contract**

In a sale, the buyer cannot terminate the contract and as such is bound to pay the price of the goods. On the other hand, the hire-purchase has an option to terminate the contract at any stage, and cannot be forced to pay the further installments.

**3 Insolvency of the Buyer**

In a sale of seller takes the risk of any loss resulting from the insolvency of the buyer. But in a hire

purchase the owner is not at any risk because if the hirer does not pay any installments the seller has a right to take back the goods.

**4. Implied Conditions and Warranties**

A sale is subject to the implied condition and warranties provided under the Sale of Goods Act 1930. A hire purchase agreement is not subject to such implied warranties and conditions. It is however, subject to the implied conditions provided in the hire purchase agreement.

**5. Effect of Payments**

In a sale even if the payment is made by the buyer in installments the amount payable by the buyer to the seller is reduced, for the payment made by the buyer to the seller is towards price of the goods. The installments paid by the hire purchase are regarded as payment towards the price of the goods till the option to purchase the goods is exercised.

**6. Resale**

The buyer in a sale can resell the goods. But the hire purchase cannot resell unless he has paid all the installments of hire.

## 11.3 GOODS-SUBJECT MATTER OF CONTRACT OF SALE

Goods form the subject matter of a contract of sale. According to Section 2(7), "goods" means every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be severed before sale or under the contract of sale. Trade marks, copy rights, patent rights, goodwill, electricity, water, gas are all goods.

Actionable claim and money are not goods. An actionable claim is something which can only be enforced by action in a Court of law. A debt due from one person to another is an actionable claim and cannot be bought or sold as goods. It can only be assigned. Money here means current money and not old rare coins.

The definition of the term 'goods' also suggests that it includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be severed from land before sale. Growing crops and grass are included in the definition of the term 'goods' because they are to be severed from land. Trees which are agreed to be severed before sale or under the contract of sale

are goods [Badri Prasad v State of MP, AIR (1970) SC 706]

Goods may be classified into various types as shown below:

1. Existing goods
2. Future goods
3. Contingent goods

**1. Existing goods:** Goods earned and possessed by the seller at the time of the making of the contact of sale are called existing goods. Sometimes the seller may be in possession but may not be the owner of the goods e.g. sale of goods by a mercantile agent. Existing goods may again be either specific or ascertained or unascertained.

**a) Specific Goods:** These are the goods which are identified and agreed upon at the time a contract of sale is made. To be specific, the goods must be actually identified; it is not sufficient that they are capable of identification, e.g. if X who owns a number of horses, promises to sell one of them, the contract is for unspecified goods.

**b) Ascertained Goods:** These are the goods which are identified in accordance with the agreement after the contract of sale is made. Though commonly used as similar in meaning to specific goods, these are not always the same.

**c) Unascertained Goods:** It means generic goods. These goods can be defined by description or even by sample. The seller in the use of a contract for the sale of unascertained goods has the option, rather the right to supply any goods of the kind or the quality contracted for. He is not bound to deliver any particular goods and he may furnish any goods answering their description in the contract.

**2. Future Goods**

Goods to be manufactured, produced or acquired by the seller after the making of the contract of sale are called 'future goods' [Sec 2(6)]. These goods may be either not yet in existence or be in existence but not yet acquired by the seller. It is worth noting that there can be no present sale of future goods because property cannot pass in what is not owned by the seller at the time of the contract. So even if the parties purport to effect a present sale of future goods, in law it operates only as an 'agreement to sell [Sec 6(3)].

**Example:** X agrees to sell to Y all the mangoes which will be produced in this garden next year. It is

contract to sale of future goods, amounting to 'an agreement to sell'.

**3. Contingent Goods**

Goods, the acquisition of which by the seller depends upon an uncertain contingency are called 'contingent goods' [Sec. 6(2)]. Obviously, they are a type of future goods and therefore, a contract for the sale of contingent goods also operates as 'an agreement to sell' and not a 'sale' so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also the property does not pass to the buyer at the time of making the contract. It is important to not that a contract of sale of contingent goods is enforceable only if the event on the happening of which the performance of the contract is dependent happens, otherwise the contract becomes void.

### 11.3.1 ASCERTAINMENT OF PRICE

'Price' means the monetary consideration for sale of goods' [Section 2(10)]. By virtue of Section 9, the price may be (1) fixed by the contract, or (2) agreed to be fixed in a manner provided by the contract, e.g. by a valuer, or (3) determined by the course of dealings between the parties.

When it cannot be fixed in any of the above ways, the buyer is bound to pay to the seller a reasonable price. What is a reasonable price is a question of fact in each case?

Section 10 provides for the determination of price by a third party. Where there is an agreement to sell goods on the terms that price has to be fixed by the third party and he either does not or cannot make such valuation, the agreement will do void. In case the third party is prevented by the default of either party from fixing the price, the party at fault will be liable to the damages to the others to the other part, who is not at fault. However, a buyer who has received and appreciated the goods must pay a reasonable price for them in any eventuality.

### 11.3.2 STIPULATIONS AS TO TIME

Stipulations as to time in a contract of sale fall under the following two heads:

1. Stipulations related to time of payment
2. Stipulations not relating to time of payment, e.g. delivery of goods etc.

Stipulations relating to time of payment are not of the essence of a contract of sale, unless a different intention appears from the contract. As regards other stipulations, time may be of the

essence of the contract but this essentially depends on the terms of the contract. In a contract of sale, stipulations other than those relating to the time of payment are regarded as of the essence of the contract. Thus if a time is fixed for the delivery of goods, the delivery must be made at the fixed time, otherwise the other party is entitled to put an end to the contract.

### 11.3.3 CAPACITY TO BUY AND SELL

A sale of goods means transfer of ownership of the goods by the seller to the buyer. 'Buyer' means a person who buys or agrees to buy goods and 'seller' means a person who sells or agrees to sell goods. The two terms 'buyer' and 'seller' are complementary and represent the two parties to a contract of sale of goods.

In every contract of sale, there is an implied condition on the part of the seller that in the case of sale he has a right to sell the goods and in the case of an agreement to sell he will have a right to sell the goods at the time when the property in them is to pass.

Usually the owner of the goods or his agent may sell the goods. If a person has no title to the goods or otherwise does not have a right to dispose of certain goods, the buyer of such goods has a right to reject them and to claim back the price if the same has already been paid and refuse to pay if the price has not been paid till then. The leading case on this point is Rowland v Divall (1923). In this case, C purchased a motor car from D, and after using it for sometime he was compelled to return it to the true owner, it becoming clear that D had obtained the car by theft. It has held that D had not fulfilled the condition as to title and C was, therefore, entitled to recover the purchase money from D. Lack of title to the goods is not the only factor because of which the seller may not have a right to sell the goods. If a vendor is stopped by process of law from selling, he has not the right to sell the goods. Accordingly a sale which would be a breach of patent, copyright, or trade mark may be repudiated by the buyer. In Niblett v Confectioners' Materials Co Ltd (1921) the sellers sold to the buyers tins of condensed milk c.i.f. from New York to London. Some of the tins were bearing the labels marked "Nissly Brand" which was the trade mark of a third person, Nestle Co. At the instance of the Nestle Co. the Commissioners of customs detained the goods. The buyers had to remove those labels before taking delivery of those tins of condensed milk. The buyers suffered a loss because they had to sell the tins of milk without proper labels at a lower price. The buyers sued the sellers to claim compensation. The court held that the sellers had made a breach of condition that they had a right to sell the goods and as such they were bound to pay damages for the

loss suffered by the buyers. Further, Section 27 of the Act of the true owner states:

**Transfer of Title by Non-Owners**

The general rule contained in Sec 27 is subject to the provisions of this Act. Various exceptions to this rule have been mentioned in this Act and the Indian Contract Act and in those exceptional situations the seller of the goods may not be having a good title to the goods, yet the buyer of the goods gets a good title to them. The exceptions are:

**1. Sale by a mercantile agent (Sec. 27)**

A mercantile agent means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods [Sec 2(9)]. Thus as a rule of mercantile agent having an authority to sell goods conveys a good title to the buyer. But by virtue of this provision (provision to Sec. 27) a mercantile agent can convey a good title to the buyer even though he sells goods without having any authority from the principal. To do so, provided the following conditions are satisfied:

a) he should be in possession of the goods or documents of title to the goods in his capacity as mercantile agent and with the consent of the owner.

b) he should sell the goods while acting in the ordinary course of business.

c) The buyer should act in good faith without having any notice, at the time of the contract, that the agent has no authority to sell.

**Examples**

F entrusted his car to a mercantile agent for sale at a stated price and not below that. The agent sold it to S, a bonafide purchaser, below the reserve price and misappropriated the proceeds. S resold the car to K, the defendant. Held, S obtained a good title to the car from the mercantile agent and he conveyed a good title to K and therefore, F was not entitled to recover the car from K (Folkes v s King).

In Pearson v Rose & Young Ltd, the plaintiff gave possession of his motor car to Hunt, a mercantile agent, to know if the same could be sold. He did not actually authorise Hunt to sell the same. Hunt took the registration book relating to the car from the plaintiff by trick and then sold the car without the plaintiff's authority or knowledge. Hunt sold the car to X, X sold it to Y and Y sold the same to the

defendants. The plaintiff sued the defendants to claim damages for conversion on the ground that Hunt had no authority to sell and, therefore, no good title could be passed to any subsequent transferee.

It was observed that though Hunt got possession of the car as a mercantile agent but not the registration book. The sale of a second hand car without the registration book could not be considered to be in the ordinary course of business. It was held that for passing a good title, Hunt should have obtained the possession of the car as well as registration book with the consent of the owner, in the absence of which Hunt was not able to pass a good title to his transferee or the subsequent buyers.

It is also necessary that the mercantile agent must have obtained the possession of the goods or the documents of title in his capacity as a mercantile agent and not in any other capacity. If he is in possession in any other capacity he cannot convey a good title.

**2. Transfer of title by Estoppel**

Generally the owner of the goods can question the title of the transferee by contending that the seller did not have a right to sell the goods. Sometimes the law of estoppel may apply against the owner of the goods and he may not be allowed to deny seller's authority to sell. The closing words of the rule contained in Sec. 27 are as under:

Unless the owner of the goods is by his conduct precluded from denying the sellers authority to sell.

As noted above, sometimes the law of estoppel may apply against the owner of the goods and he may be estopped from denying seller's right to sell the goods. In other words, because of application of rule of estoppel against him he may not be able to assert that the seller of the goods did not have a right to sell and thus the buyer may have a good title even though the seller of the goods did not actually have a right to sell them. When the owner of the goods by his act or omission makes the buyer to believe that the seller of those goods has a right to sell them, subsequently he cannot deny the existence of such a right in the seller.

In reference to sale of goods, estoppel may arise in any of the following ways:

i) The owner standing by, when the sale is effected, or

ii) Still more, by his assisting the sale, or

iii) By permitting goods to go into the possession of another with all the insignia of possession thereof and apparent title, or

iv) If he has otherwise acted or made representations so as to induce the buyer to alter his position to his prejudice.

**Example:** M, the owner of a wagon allowed one of his employees K, to have his name painted on it. M did so for the purpose of inducing the public to believe that the wagon belonged to K. C purchased the wagon from K in good faith. C acquires a good title as M is estopped from denying K's authority to sell (O'Connor v Clark).

**3. Sale by One of Joint Owners**

Sale by one of the joint owners constitutes another exception to the rule of nemo dat quod non habet. According to Sec 28, if one of the several joint owners is in sole possession of the goods with the permission of the other co-owners a sale by him will convey a good title to the buyer who buys in good faith and at the time of buying has no notice of the fact that such a joint owner has no authority to sell.

**4. Sale by a Person in Possession of Goods under a Voidable Contract**

Section 29 deal with the case of a sale by a person who has obtained possession of goods under a voidable contract. It provides that a person in possession of goods under a voidable contract which has not been canceled can transfer a good title to the buyer who buys the goods in good faith. This exception is limited to contracts of sale voidable under Sections 19 and 19A of the Contract Act) voidable on the ground of coercion, fraud, misrepresentation and undue influence. It does not extend to all voidable contracts. Further, if the contract under which the seller obtains goods is void, then even an innocent buyer of the gods from such a seller does not acquire title to the goods.

**5. Sale by Seller in Possession after Sale**

Where a seller, after having sold the goods, continues to be in possession of the goods or of the documents of title to them and again sells or pledges them either himself or through a mercantile agent, he will convey a good title to the buyer or the pledgee provided the buyer or the pledgee acts in good faith and without notice of the previous sale. For the application of this exception, it is essential that the possession of the seller must be as seller and not as hirer or bailee.

**6. Sale by the Buyer in Possession**

Section 30(2) deals with a case where the buyer is in possession of the goods but the property in them has not passed to him. This section says that if a buyer has obtained the possession of the goods or the

documents of title to them with the consent of the seller any sale, pledge or other disposition thereof to any person will convey a good title to the transferee provided the person receiving the goods was acting in good faith and without any notice as regards any lien or other right of the original seller in respect of those goods.

In Cahn v Pockett's Bristol Steam Channel Co, A sold certain copper to B and forwarded to him the bill of exchange along with the bill of lading which was endorsed in blank with a view to have the acceptance or the payment of the bill of exchange. B, who was insolvent, did not accept the bill of exchange. Instead of returning the bill of lading and the dishonored bill of exchange to A, he transferred the bill of lading to C, who took the same in good faith and for consideration. It was held that since B had obtained the bill of lading with the consent of A, the transfer by B could convey a good title to C, and the right of A to stop the goods in transit was defeated.

**7. Resale by an Unpaid Seller**

Where an unpaid seller who has right of lien or stoppage in transit resells the goods, the buyer acquires a good title thereto as against the original buyer, even though the resale may not be justified in the circumstances, i.e. no notice of the resale has been given to the original buyer. Thus, a buyer at a resale acquires a good title.

**8. Sale by finder of Goods - Sec 169, Indian Contract Act**

According to Sec. 71, of Indian Contract Act, the finder of goods is subject to the same responsibility as the bailee. He is to take due care of the goods while they are in his possession and also to return them when their owner has been found. According to Sec. 169 of the Contract Act, however, if the owner cannot with a reasonable diligence be found or if he refuses upon demand, to pay the lawful changes of the finder, the finder may sell the goods -

(i) When the thing is in danger of perishing or of losing the greater part of its value, or

(ii) When the lawful changes of the finder, in respect of the thing found, amount to two-third of its value.

When the finder of goods sells them under the circumstances stated above,
the buyer of such good gets a good title to them.

**9. Sale by Pawnee - Sec. 176, Indian Contract Act**

Normally the pawnee of the goods is under a duty to return them if the debt secured by such goods is paid back to him. He may retain such goods until the debt and interest thereon and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged are paid to him. According to Sec. 176 of Indian Contract Act, if the pawnor makes a default in the payment of the debt, the pawnee may either sue him for the debt or may sell the goods pledged on giving the pawnor reasonable notice of the sale. Upon such a sale being made by the pawnee the buyer of such gods acquires a good title to them.

**10. Sale by Authorised Officer**

In some cases, a special power of sale is given to officers of court, liquidators of companies, receivers insolvent's estate, custom officers for duties remaining unpaid, etc. All these persons are not owners, yet they sell properties of others, and convey a better title to the buyers than they themselves possess.

## 11.4 CHECK YOUR PROGRESS

Answers the following Multiple Choice Questions:

**1.** The Sale of Goods Act, 1930 is based on
   A. US Sale of Goods Act
   B. English Sale of Goods Act
   C. Indian Sale of Goods Act
   D. None of above

**2.** The sale of Goods Act, 1930 contains
   A. 66 Sections
   B. 68 Sections
   C. 70 Sections
   D. None of above

**3.** As per-section 2(1), a person who buys or agrees to buy goods is called
   A. Buyer
   B. Seller
   C. Both (a) and (b)
   D. None of above

4. The voluntary transfer of possession from one person to another is called
   A. Transfer
   B. Change of possession
   C. Delivery
   D. None of above
5. As per section 2, sub section 7 every kind of moveable property other than actionable claim and money is called
   A. Goods
   B. Future goods
   C. Both (a) and (b)
   D. None of above

## 11.5 SUMMARY

Contract of sale is a contract by which the ownership of movable goods is transferred from the seller to the buyer. Where the property in the goods is immediately transferred to the buyer, the contract of sale is called a sale. Where the property in goods is to be transferred to the buyer at some future date or on the fulfillment of a certain condition, the contract of sale is called an agreement to sell. Only the goods can be the subject-matter of contract of sale. The goods may be classified into existing, future and contingent goods. There can be no valid sale of goods without the price. Stipulation relating to time of payment are not of the essence of a contract of sales unless a different intention appears from a contract. A seller cannot give a better title than that of his own. If the title of the seller is defective the buyer's title will also be subject to the same defect.

## 11.6 KEYWORDS

**Contract of Sale**: A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.

**Goods**: Goods means every kind of movable property other than actionable claims and money and includes stock and shares growing crops, grass and things attached to or forming part of the land which he agreed to be severed before the sale or under the contract of sale.

**Sale**: Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale.

**Agreement to Sell**: Where the transfer of the property in the goods is to take a place at a future time or subject to some condition thereafter to be fulfilled the contract is called an agreement to sell.

**Future Goods**: These are the goods which are not in existence at the time of contract of sale.

**Price**: The money paid for the purchase of goods is called the price.

**Hire Purchase Agreement**: A hire purchase agreement is an agreement under which the owner delivers his goods on hire basis to a person called 'hirer' for his use.

## 11.7 ANSWERS TO CHECK YOUR PROGRESS

1. B 2.A 3. A 4. C 5. A

## 11.8 SELF ASSESSMENT TEST

1. What is a contract of sale? State its essential characteristics
2. Define the term ‘goods’. Explain different types of goods.
3. Distinguish between:
   a) Sale and agreement to sell
   b) Sale and bailment
4. “A seller cannot convey a better title to the buyer than he himself has”. Discuss this rule of law and point out the exception.

## 11.9 REFERNCSES/SUGGESTED READINGS

1. N.D. KAPOOR, COMPANY LAW, SULTAN CHAND & SONS, NEW DELHI.
2. S.C. AGGARWAL, COMPANY LAW, DHANPAT RAI PUBLICATIONS, NEW DELHI.
3. S.K. AGGARWAL, BUSINESS LAW, GALGOTIA PUBLISHING COMPANY, NEW DELHI.
4. G.K. VARSHNEY, ELEMENTS OF BUSINESS LAW, S CHAND & CO., NEW DELHI.

| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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| Lesson No.: 12 | |

# CONDITIONS AND WARRANTIES

## STRUCTURE



## 12.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

a) Define the condition and warranty and differentiate between them.

b) State the circumstances in which a condition is reduced to the status of a warranty.

c) Discuss the implied conditions and warranties recognized by the Sales of Goods Act.

d) Explain the rule of Caveat Emptor.

## 12.1 INTRODUCTION

A contract of sale of goods is made by an offer by the seller and its acceptance by the buyer. When forming a contract, a party may make a statement with a view to inducing the other party to enter into the contract. Such statements when made before entering into the contract are known as representations. Such representations are generally about the nature, quality and fitness of goods. Such a representation may be a mere expression of an opinion of the seller and may not form a part of the contract of sale. For example, where a jewellery seller, while praising a particular diamond ring, states that the diamond is very lucky and anyone who shall purchase it must become wealthy, his statement, being commendatory in nature, does not form part of the contract and its breach does not give rise to any legal consequences. On the other hand, when a representation forms a part of the contract of sale and the other party relies upon it, such a representation is called a stipulation within the meaning of Section 12 of the Sale of Goods Act. However, all stipulations are not of equal importance. Some of these stipulations may go to the very root of the contract and their breach may frustrate the very purpose of the contract, while others are not so vital that their breach may seem to be a breach of the contract as such.

## 12.2 CONDITION AND WARRANTY

### CONDITION

The term 'condition' is defined under Section 12(2) of the Sale of Goods Act, which reads as under:

"A condition is a stipulation essential to the main purpose of the contract, the breach of which gives the aggrieved party a right to treat the contract as repudiated".

Thus, a condition is an important representation made by the seller the non-fulfillment of which defeats the very purpose of the buyer and he/she has the right to terminate the contract.

**Example:** A consulted B, a car dealer, and told him that he wanted to purchase a car 'suitable for touring purpose'. B, suggested that a 'Bugatti' car would be fit for the purpose. Relying upon this statement, A bought a 'Bugatti' car. Later on, the car turned out to be unfit for the touring purpose. A wanted to reject the car and demanded the refund of the price. It was held that A was entitled to reject the car and to have the refund of the price. In this case, the suitability of the car, for touring purpose, was a condition of the contract. It was so important that its non-fulfillment defeated the very purpose for which A bought the car.

### WARRANTY

According to Section 12(3) of the Act, a warranty is a stipulation collateral to the main purpose of the

contract, the breach of which gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated or broken. Thus, a warranty is not of that importance as a condition. It is not essential to the main purpose of the contract of sale. It is only collateral to the main purpose of the contract. Even if it turns out to be untrue, the buyer cannot put an end to the contract. The remedy available is to claim damages from the seller.

In brief, where the fulfillment of the main purpose of the contract depends on the fulfillment of the stipulation, the stipulation is condition and where it is not so, the stipulation is only a warranty. There is no specific rule as to which stipulation is a condition and which one is a warranty. Section 12(4) of the Act states "whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract as a whole. The court is not guided by the terminology used by the parties to the contract. A stipulation may be a condition though called a warranty in the contract". Thus the court has to look to the intention of the parties by referring to the terms of the contract, its construction and surrounding circumstances to judge whether a stipulation was a condition or a warranty.

**Examples**

(a): A person purchases a vehicle which is warranted quiet and smooth to drive. If the vehicle turns out to be noisy and inconvenient to drive, the buyer's only remedy is to claim damages. But if instead of buying a particular vehicle, a person asks a dealer to supply him with a quiet and smooth vehicle and the dealer supplies the person with a noisy one, the stipulation is a condition, and the buyer can return the vehicle. Besides, the buyer can also claim damages for breach of the contract.

(b): A made a contract for the sale of cashew-nuts. According to the terms of sale, the total bad nuts shall not exceed 20 per cent of the total. The purchaser entered into the contract relying upon the description. The above term being a basic element of the description of the goods agreed to be supplied, the purchaser was entitled to reject the goods if the bad nuts exceeded the stipulated percentage. He could also claim back the part of price paid to the seller. [Antony Thomas v Ayuppuni Mani; 1959 Kerala LT 1271]

From the above examples, it is clear that an exactly similar term may be a condition in one contract and a warranty in another, depending upon the construction of the contract as a whole.

### 12.2.1 DISTINCTION BETWEEN A CONDITION AND WARRANTY

The points of distinction between a Condition and a Warranty may be summed up as under:

1. A condition is a stipulation which is essential to the main purpose of the contract. A warranty is a stipulation which is collateral to the main purpose of the contract.
2. A breach of condition gives right to repudiate or rescind the contract and also a right to claim damages. Breach of warranty provides right to claim damages only. A breach of warranty does not entitle a buyer to reject the goods.
3. A breach of condition may be treated as a breach of warranty by the aggrieved party and accordingly the aggrieved party may not repudiate the contract. But a breach of warranty cannot be treated as a breach of condition.

### 12.2.2 CHANGE OF A CONDITION INTO A WARRANTY

Section 13 deals with cases where breach of condition would be treated as a breach of warranty only and as a consequence, a contract is not avoided. The buyer has to be contended with a claim for damages only. These cases are as follows:

I. Where the buyer elects to treat breach of condition as a breach of warranty. This is to say, he only claims damages and does not elect to repudiate the contract.

II. Where the buyer altogether waives the performance of the condition. Once the buyer has waived his right, he cannot afterwards insist on its fulfillment. Waiver may be express or implied.

III. Where the contract of sale is non-severable/indivisible and the buyer has accepted either the whole goods or any part thereof. In such a case, a breach of any condition by seller can only be treated as a breach of warranty, unless there is a term of the contract, express or implied, to the contrary. Indivisible contracts are those where price for a lot, comprising goods of different qualities, as such is fixed and not fixed per unit or per bag or per ton, etc.

Taking possession or delivery of the goods does not amount to their acceptance. According to Section 42, the buyer is deemed to have accepted the goods:

a) When the seller is intimated by him about the acceptance of goods; or

b) When he does any act in relation to goods which is inconsistent with the ownership of the seller, e.g. the buyer puts his mark on goods; or

c) When he continues to retain the goods even after the lapse of reasonable time without intimating

the seller that he has rejected them.

d) Where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

### 12.2.3 STIPULATION AS TO TIME

The stipulations as to time may be of two types :

i) As to time of payment;

ii) Other stipulations as to time e.g., with regard to the performance of the contract.

Regarding the importance of various stipulations as to time, Section 11 of the Act provides as under:

Unless a different intention appears from the terms of the contract, stipulation as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

It may be noted that the general rule stated in Section 11 is that the time of payment of the price is not deemed to be of the essence of the contract. Therefore, in case of delay in the payment of the price by the buyer, the seller cannot avoid the contract for that reason but he can only claim compensation for the same. The parties are, however, free to express a different intention in their contract. They may make the time of the payment of the price as of the essence of the contract.

Stipulations as to time, except as regards time of payment are usually of the essence of the contract. Where the parties to the contract stipulate that time as regards delivery of goods, payment or any other factor shall form the essential terms of the contract, time shall than be regarded as a condition in construction of a contract for sale of the goods, breach of which shall provide right to the aggrieved party to cancel the contract.

**Example:** A sold certain goods to B. The payment was to be made on delivery of goods. It was held that delivery was subject to the condition of payment and the condition being broken, A had the right to bring an action for the recovery of goods. [Bishop v Shillitoz Band A 329]

### 12.2.4 EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES (SECTION 14-17)

In a contract of sale of goods, conditions and warranties may be either (i) express or (ii) implied. Parties may expressly provide any conditions or warranties in their contract. Besides, certain conditions and

warranties, as provided in Section 14 to 17, are impliedly there in every contract of sale of goods unless the parties agree to the contrary. Implied conditions and warranties are enforced on the ground that the law presumes that the parties have incorporated them into their contract though they have not put them into it in express words. The implied conditions and warranties provided in the Act are binding in every contract of sale unless they are inconsistent with any express conditions are warranties agreed to by the parties. The implied conditions and warranties recognized by the Act are as follow:

**Implied Conditions**

**1. Condition as to Title (Section 14 (a))**

In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is an implied condition on the part of the seller that-

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

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

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

Want of title to the goods is not the only factor because of which the seller may not have a right to sell the goods. If a vendor can be stopped by process of law from selling, he has not the right to sell. If the goods sold bear labels infringing the trade mark of a third person, the seller has no right to sell them.

It may further be noted that where a seller having no title to the goods at the time of the sale, subsequently acquires the title (e.g. by paying off the true owner) before the buyer seeks to repudiate the contract, that title feeds the defective titles of both the original and subsequent buyers and it will then be too late for the buyer to repudiate the contract (Patten vs Thomas Motors).

**2 Condition as to Description (Section 15)**

Sometimes, the goods are sold by description. In such cases, the implied condition is that the goods shall correspond with the description. The term ‘correspondence with description’ means that the goods purchased by the buyer must be the same which were described by the seller. If subsequently, it is discovered that the goods do not correspond with the description, the buyer may reject the goods and

claim the refund of the price, if already paid.

**Example**: A purchased from B a car, which he had never seen. B described the car as a 'brand new'. However, on delivery, A found that the car was used and repainted. And thus A returned the car to B. It was held that the sale was by description and the car did not correspond with the description. In this case, A was entitled to reject the car.

It may, however, be noted that the buyer can reject the goods only if the sale is by description, and the goods do not correspond with the description. The buyer is given the right to reject the goods because a person cannot be compelled to buy a thing different from the thing he contracted to buy. In Bower v Shand (1877) 2 AC 455, Lord Blackburn emphasized this condition in the following words:

"If you contract to sell peas you cannot oblige a party to take beans. If the description of articles tendered is different in any respect it is not the article, bargained, and the other party is not bound to take it".

It will be interesting to know, that the term 'sale by description' has not been defined in the Sale of Goods Act. However, it generally means the sale when the goods are described in the contract as of particular kind or class, e.g., Basmati Rice, Long staple Cotton, Desi Wheat, etc. The sale will also be by description when the identity or quality of the thing is describe, e.g., Brand New Car, Maruti Swift Model etc. The term 'sale by description' includes the following situations:

(a) Sometimes, the buyer has never seen the goods but he buys on the basis of description given by the seller. In such cases the goods must correspond with the description given by the seller.

**Example**: A purchased a sewing machine which he had never seen. The seller (B) described the machine as "Brand New". But on delivery, A found that the machine was extremely old. In this case, the sale is by description, and A is entitled to reject the machine as it does not correspond with the description given by the seller.

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

**Example**: In an auction sale of a set of napkins and table cloths, these were described as "dating from the seventeenth century". The buyer bought the set after seeing it. Subsequently he found the set to be an eighteenth century set. Held he could reject the set (Nicholson & Venn v Smith Marriott, (1947) 177 L.T. 189).

Thus, once it is proved that the sale is by description, then the goods must correspond with the description. If they do not correspond, the buyer may reject them and the seller cannot take the defence by saying that they will serve the buyer's purpose.

But where the goods correspond with the description, the buyer is bound to take the delivery for whatever worth they may be otherwise.

**3. Sale by Sample (Sec 17)**

The sale is by sample where there is a term in the contract express or implied to that effect. There are three implied conditions when the goods are supplied according to the sample-

i) that the bulk shall correspond with the sample in quality;

ii) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(iii) that the goods shall be free from any defect, rendering them unmerchantable, which would have been apparent on reasonable examination of the sample.

**Example**: A agreed to sell to B two parcels of wheat. The sample of wheat was shown to B. The buyer (B) went to A's warehouse to examine the wheat. One parcel, which was lying in the seller's (A's) warehouse, was shown to B. But A refused to show the other parcel to B, which was not in the warehouse. It was held that the buyer could put an end to the contract. [Lorymere v Smith (1822) 1 B & C 1].

**4. Sale by Sample as well as Description (Section 15)**

When the goods are sold by sample as well as description it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description. Sometimes there may be a difference between the sample and the description of the goods. In such a case, the fact that the goods supplied conform to the sample but do not agree with the description entitle the buyer to reject the goods because the fundamental condition in every contract is that the goods should correspond to the description.

In Wallis v Pratt there was a contract of sale by sample of seed described as "English Sainfoin". but the "seller giving no warranty express or implied as to growth, description, or any other matters." The seed was sown and when the crop was ready it was discovered the seed supplied and the sample shown were not of "English Sainfoin" seed but of "giant sainfoin" seed. It was held that there was a breach of

condition and the buyer was entitled to recover damages.

**5. Condition as to quality or fitness (Section 16)**

Normally, in a contract of sale, there is no implied condition as to quality or fitness of the goods for a particular purpose. The buyer must examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for the purpose for which he is buying them.

The implied condition as to quality or fitness will operate if the following conditions are satisfied:

(i) The buyer requires the goods for a particular purpose.

(ii) The buyer makes known to the seller that particular purpose.

(iii) the seller's business is to sell such goods, whether he is the actual producer or not.

The particular purpose for which the goods, are required has to be made known to the seller. This may be done either expressly or impliedly. A particular purpose is the purpose expressly or impliedly communicated to the seller, for which the buyer buys the goods. Where an article is fit for one particular purpose alone, and turns out to be unsuitable for that purpose, when used, it is easy to see that the condition as to fitness has been broken. But where an article is capable of being applied to a variety of purposes,. the buyer must notify the specific purpose he has in mind, and if this is not shown, the buyer will have no remedy because it was unfit for that purpose.

**Example**: A who had no special knowledge of hot water bottles went to the shop of a chemist and asked for a hot water bottle. He was shown a bottle which the chemist said will not stand boiling water but was intended to hold hot water. A bought the bottle. After a few days, while using it, it burst and injured his wife. It was found that the bottle was not fir for use as a hot water bottle and therefore, the chemist was liable for damages. [Priest v Last (1903) 2 KB 148]

Where, however, the goods are sold under its patent or trade name, there is no implied condition as to its fitness for any particular purpose. Thus, when a patent smoke consuming furnace was ordered by the plaintiff by its patent name, for his brewery and the same being forwarded to him proved useless, it was held that the buyer had no cause of action against the seller. But the situation will be quite different where the buyer asks the seller to supply an article of a named make and indicates to the seller that he relies on his skill and judgement, for its being fit for a particular purpose. Implied condition as to quality or fitness will apply even though the article is described in the contract by its trade name.

**6. Implied Condition of Merchantable Quality**

Section 15 provides that when the goods are bought by description there is an implied condition that the goods supplied shall answer that description. According to this Section, there is a further implied condition in such a case that the goods supplied shall be of merchantable quality . Where;

(i) the goods are bought by description

(ii) from a seller who deals in the goods of that description

(whether he is the manufacturer/producer or not)

There is an implied condition that the goods shall be of merchantable quality. The term 'merchantable quality' has not been defined in the Act. It means that the article is of such quality and in such condition that a reasonable man acting reasonably would after a full examination accept it under the circumstances of the case in performance of his offer to buy that article, he buys for his own use or to sell again.

The goods should be immediately saleable under the description by which they are known in the market. Merchantability, however, does not mean that the goods should be of first quality.

Goods may be unmerchantable not only because of some defect in their physical condition, but also, because of some other circumstances as for example:

(i) where they infringe a trade mark, or

(ii) the use of them is dangerous or injurious in a way not to be expected from goods of the kind, or

(iii) they are unfit for use.

**Examples**: P asked for a bottle of Stone's Ginger Wine at D's restaurant. While P was drawing the cork, with a cork screw, the bottle broke at the neck and injured him. It was held that the sale was by description and since the bottle was not of merchantable quality. P was entitled to recover damages. [Morelli v Fitch and Gibbons (1928), 2 KB 636]

All such defects as make the goods unmerchantable are of two kinds, called patent defects and latent defects. Patent defects are those which can be found on examination by a person of ordinary intelligence with the exercise of due care. Latent defects are those which cannot be discovered on such examination. There is an implied condition on the seller's part that the goods are free from latent defects.

In case of patent defects where an opportunity is afforded to the buyer to examine the goods, but the

buyer makes only a casual examination of the goods, this will amount to an examination within the meaning of this section, and the seller would not be liable to for the defects which such an examination ought to have revealed.

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

The following table gives the comparison between the two:

| Sr No. | Condition as to Fitness of Goods for Buyer's Purpose | Condition as to Merchantability |
|---|---|---|
| 1. | The buyer must rely on the skill and judgement of the seller | The buyer is not required to rely on the skill and judgement of the seller. |
| 2. | When the goods are sold under patent or trade name then the condition as to fitness for buyer's purpose is not applicable i.e., it is excluded. | When the goods are sold under patent or trade name, then the condition as to merchantability is applicable, i.e. it is not excluded |
| 3. | There may be cases in which the goods are not fit for buyer's use but they may be merchantable. | There may not be such cases. |

**7. Condition as to Wholesomeness**

In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesomness.

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

**Condition implied by Custom**

An implied condition as to quality or fitness for a particular purpose may also be annexed by the usage of trade in the locality concerned [Sec. 16 (3)].

**Implied Warranties**

It is a warranty which the law implies into the contract of sale. In other words, it is the stipulation which has not been included in the contract of sale in express words. But the law presumes that the parties have incorporated it into their contract. It will be interesting to know that implied warranties are read into every contract of sale unless they are expressly excluded by the express agreement of the parties. These may also be excluded by the course of dealings between the parties or by usage of trade [Section 62]. It may be noted that sometimes there is conflict between the express and implied warranties. In such cases, the express terms shall prevail and the implied terms shall not be considered.

**1. Warranty of Quiet Possession**

In every contract of sale the first implied warranty on the part of the seller is that "the buyer shall have and enjoy quiet possession of the goods." If the quiet possession of the buyer is in any way disturbed by a person having a superior right than that of the seller, the buyer can claim damages from the seller. Since disturbance of quiet possession is likely to arise only where the seller's title to goods is defective, this warranty may be regarded as an extension of the implied condition of the provided for by Section 14 (a).

In the case of Mason v Bhumingham, the plaintiff purchased a second hand typewriter for pound 20 from the defendant. She thereafter spent a sum pound 11-10sh., for getting it overhauled and putting in order. Unknown to the parties the typewriter had been stolen and the plaintiff was compelled to return the same to its true owner. In an action by the plaintiff against the defendant it was held that the defendant had made a breach of warranty implied in a contract of sale of goods that the buyer shall have and enjoy quiet possession of the goods. The plaintiff was entitled to recover not only the sum of pound

11-10sh, the amount spent on overhauling, as the same was the loss arising naturally in the usual course of things.

**2. Implied Warranty of Freedom from Encumbrances**

There is an implied warranty on the part of the seller that the goods are free from any charge or encumbrance. A breach of this warranty will occur when the buyer discharges the amount of encumbrance. This warranty will not apply where such Encumberances are declared to the buyer when the contract is made or he has notice of them. Where there is a breach of this implied warranty, the remedy of the buyer is to sue for damages.

**Example**: A, the owner of the watch pledges it with B. After a week, A obtains possession of the watch from B for some limited purpose and sells it to C. B approaches C and tells him about the pledge affair. C has to make payment of the pledge amount to B. There is breach of this warranty and C is entitled to claim compensation A.

**3. Disclosure of Dangerous Nature of Goods**

There is another implied warranty on the part of the seller that in case the goods are inherently dangerous or they are likely to be dangerous to the buyer and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of this warranty, the seller will be liable in damages.

In Clarke v Army and Navy Co-operative Society Ltd. (1903) 1 K.B. 155, C purchased a tin of disinfectant powder from A. A knew that the tin was to be opened with special care otherwise it might prove dangerous. He also knew that C was ignorant about it but did not warn C. C opened the tin whereupon the disinfectant powder flew into her eyes causing injury. Held, A was liable in damages to C as he should have warned C of the probable danger.

## 12.3 CAVEAT EMPTOR

**DOCTRINE OF CAVEAT EMPTOR**

Caveat Emptor means "let the buyer beware", i.e. the buyer must take care. As a general rule, the buyer purchased goods after satisfying himself as to quality and fitness and, therefore, the buyer purchases the goods at his own risk, relying upon his own skill and judgement. In a contract for sale of goods there is no implied warranty or condition as to quality or fitness for any particular purpose of goods and therefore, the buyer purchased the goods at his risk relying on his own skill and judgement (Section 16)

**Example**: A purchase a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor being the rule. A can neither reject the horse nor can he claim any compensation from B.

This rule applies to the purchase of specific goods, for example, a horse or a picture where the buyer can exercise his own judgement it applies also whenever the buyer voluntarily chooses what he buys. But it has no application in any case, in which the seller has undertaken and the buyer has left it to the seller, to supply goods to be used for a purpose known to both parties at the time of the same.

**Example**: There was sale by sample by a woolen manufacturer of cloth to merchant who was also a tailor. The buyer required the cloth for making special uniforms but this fact was not made known to the seller. Owing to latent defect in the cloth which was also there in the sample, it was unfit for the purpose. But there was nothing to show that it was unfit for other purposes. It was held that the buyer was without remedy. [Jones v Padgelt, (1890). 24 Q.B.D. 650]

**Exception to the 'Doctrine of Caveat Emptor'**

In certain circumstances however, the doctrine has no application. They are as follows:

i) If the seller has made a false representation relating to the goods and the buyer has relied upon it to his detriment.

ii) When the seller has deliberately concealed a defect which is not apparent on the reasonable examination of the goods.

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

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

Where the trade usage attaches an implied condition or warranty as to quality or fitness and the seller deviates from that, the doctrine of caveat emptor does not apply and the seller is liable in damages [Sec. 16 (3)]

Where goods are bought by description from a seller who deals in such goods, there is an implied

condition that the goods shall be of 'merchantable quality'. Where, however, the buyer has examined the goods there is no such implied condition as regards defects which such examination could have revealed.

In Jackson v Rotex Motor and Cycle Co. (1910-2 K.B.), where a person ordered motor horns from a manufacturer of horns and the horns were damaged, it was held that the buyer was entitled to reject the horns.

It should be noted that goods are merchantable if they are fit for any one of the several purposes for which the goods may ordinarily be used.

## 12.4 CHECK YOUR PROGRESS

Answers the following multiple choice questions

1. **The condition on title is an example of…..**
   a) Express condition b) Express warranty
   c) Implied warranty d) Implied condition
2. **The warranty of quiet possession is?**
   a) Express warranty b) Express condition
   c) Implied condition d) Implied warranty
3. **The condition for quality or fitness is**
   a) Implied warranty b) Implied condition
   c) Express warranty d) Express condition
4. When a person sells the goods by infringing the copying or trademark of the others, there is breach of an implied.
   a) Condition as to tile
   b) Condition as to description
   c) Conditions as to merchantability
   d) None of these.
5. In case of breach of warranty, the buyer can
   a) Claim damages only
   b) Reject goods only
   c) Either (a) or (b)

d) Both (a) and (b)

## 12.5 SUMMARY

A condition is defined as a representation made by the seller which is so important that its non-fulfillment defeats the very purpose of the buyer. Warranty is a representation made by the seller which is not of that importance as a condition. Sometimes, a condition is changed to the status of a warranty and in such cases, the buyer loses the right to reject the goods on the ground of breach of condition. The importance of time in a contract of sale is contained in Section 11 of the Sale of Goods Act. In a contract of sale of goods, conditions and warranties may be either express or implied. Implied conditions and warranties are enforced on the ground that the law presumes that the parties have incorporated them into their contract though they have not put them into it in express words. In a contract of sales of goods, there is no implied condition or warranty as to quality or fitness for any particular purpose of goods and therefore, the buyer purchased the goods at his risk relying on his own skill and judgement.

## 12.6 KEYWORDS

**Condition**: It is defined as a representation made by the seller which is so important that its non-fulfillment defeats the very purpose of the buyer.

**Warranty**: Warranty may be defined as a representation made by the seller which is not of that importance as a condition.

**Cavet Emptor**: It means that a buyer purchases the goods at his own risk.

**Implied Condition**: It is a condition, which the law implies into the contract of sale.

**Express Warranty**: It is a warranty which has been expressly agreed upon by both the parties at the time of contract of sale.

## 12.7 ANSWERS TO CHECK YOUR PROGRESS

**1. D 2. D 3. B 4. A 5. A**

## 12.8 SELF- ASSESSMENT TEST

1. Define the terms 'Condition' and 'Warranty'. Explain the difference between the two.
2. Discuss the provision of the Sales of Goods Act relating to the implied conditions in a contract

of sale by sample.

3. "Let the buyer beware". Comment.

4. State the conditions in a contract for the sale of goods (i) by description (ii) required for a particular purpose.

## 12.9 REFERNCSES/SUGGESTED READINGS

1. P.P.S. GOGNA, MERCANTILE LAW, S.CHAND & COMPANY, NEW DELHI.
2. N.D. KAPOOR, COMPANY LAW, SULTAN CHAND & SONS, NEW DELHI.
3. S.C. AGGARWAL, COMPANY LAW, DHANPAT RAI PUBLICATIONS, NEW DELHI.
4. G.K. VARSHNEY, ELEMENTS OF BUSINESS LAW, S CHAND & CO., NEW DELHI.
5. K.R. BALCHANDARI, BUSINESS LAW FOR MANAGEMENT, HIMALAYA PUBLICATION HOUSE, NEW DELHI.

| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 13 | |

# TRANSFER OF PROPERTY IN GOODS

## STRUCTURE



## 13.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define transfer of property as per Sales of Goods Act and state its importance.
- Explain the rules regarding transfer of property.
- Describe the procedure regarding transfer of title by non-owners.

## 13.1 INTRODUCTION

While defining the contract of sale, we have seen that a sale is primarily the transfer of property in goods by seller to the buyer. Transfer of property in goods means transfer of ownership of the goods. Property of goods is different from possession of goods. Possession refers to the custody over the

goods. So the property in goods may pass from the seller to the buyer but the goods may be in the possession of the seller either as unpaid seller or as a bailee for the buyer. In other cases, the property in goods may still be with the seller although the goods may be in possession of the buyer or his agent or a carrier for transmission to the buyer. The precise moment of time at which property in goods passes from the seller to the buyer is of great importance from various points of view.

## 13.2 MEANING OF TRANSFER OF PROPERTY

A contract of sale of goods is a contract whereby the seller transfers property in the goods to the buyer for a price. 'Passing of property' in goods means 'transfer of ownership' of the goods. When the goods are sold, it is the property in the goods that is transferred to the buyer. It may be noted that there is a difference between 'property in goods' and the physical 'possession of the goods'. A person may be in possession of the goods but he may not be the owner of the goods. For example, an agent, a servant, a hire purchaser, or a bailee may be in possession of goods, but none of them is the owner of those goods because the property in the goods does not vest in them, and each one of them holds the goods for his principal master, hire seller, or bailor respectively. Similarly, a person maybe the owner of the goods; but he may not be in possession of these goods; however, the property in goods vests in him. Thus, the 'transfer of possession' is not the same thing as the 'transfer of ownership'. The ownership of goods may pass (transfer) with or without the transfer of possession. When the goods are sold to the buyer, he becomes the owner of the goods irrespective of the fact whether he has taken the possession (delivery) of the goods or not. Thus, the passing of property or transfer of ownership in fact means the legal ownership or absolute (unqualified) ownership, and not the physical possession of goods.

### 13.2.1 SIGNIFICANCE OF TRANSFER OF OWNERSHIP

In a contract of sale of goods, it is a very important question as to when the property in goods passes from seller to the buyer. The time of transfer of ownership of goods decides various rights and liabilities of the seller and the buyer. Thus, it is necessary to know the exact point of time when the property passes from the seller to the buyer. The following reasons indicate the importance of this question and they are also the rules to be applied in the absence of an agreement (or arrangement or understanding) concerning these points:

**1. Risk prima facie passes with ownership:** It is the rule of law that risk, at first sight or on the first impression, passes with property. Therefore, if property has passed to the buyer, he becomes the owner

of the goods and then the risk of destruction, deterioration, damages or loss of goods is that of buyer. He will have to bear the loss caused due to any reason.

**2. Exercise of proprietary rights or action against third party:** 'Proprietary right' means a right to own and control like a proprietor or owner of some property (estate). On transfer of ownership, buyer can exercise proprietary rights over the goods. For example, he can sue the seller if he refuses to deliver the goods and the buyer can also recover the goods from that another person to whom the seller has resold the goods. Moreover, if the goods are damaged or destroyed by an act of a third party, the buyer can take action against such party. Thus, the owner alone can exercise proprietary rights.

**3. Seller's right for price:** The seller becomes entitled to recover price of the goods from the buyer only when the property in the goods has passed to the buyer.

**4. Insolvency of the seller or buyer:** If the seller or buyer becomes insolvent, the question arises as to whether the Official Receiver or the Assignee can take over the goods from him or not. The answer depends upon the situation whether the property in the goods has passed to the buyer or not. If the ownership has passed to the buyer and the buyer is declared insolvent by the Court, then buyer's Official Receiver shall have a right to take possession of the goods even though the goods are still lying with the seller. On the other hand, if the goods are in the possession of the seller and he is adjudged insolvent, then the buyer has a right to take possession of the goods from seller's Official Receiver.

### 13.2.2 RULES REGARDING TRANSFER OF PROPERTY

The rules regarding transfer of property determine the point of time when the property passes or ownership is transferred from the seller to the buyer. In fact, the whole question of transfer of ownership is left to the intention of the parties and they are free to fix up any time for the transfer of ownership from the seller to the buyer. However, where the intention of the parties is not clear from the contract, the time of transfer of ownership depends mainly on the nature of the goods and is decided as follows:

**I. Where goods are specific or ascertained:** Specific goods mean those goods which are identified and agreed upon at the time of contract of sale. When the goods are identified after the contract of sale and then they become known to certain, such goods are called ascertained goods. Section 19 of Sale of Goods act provides that "Where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. "As far as the question of intention of the parties is concerned, such intention shall be

ascertained keeping in mind (i) the terms of the contract, (ii) the conduct of the parties, and (iii) the circumstances of the case. It is to be noted that sale is a matter of mutual opinion or consensus, the law leaves the parties free to settle any terms (of course not to be illegal) they please. Therefore, in formulating their intention the parties may fix any time when the ownership is to be transferred. It may be the time of delivery of goods or the time of payment of price, or the time of contract, or any other point of time.

**Rules for ascertaining the intention of the parties**

Where the goods are specific or ascertained, the following rules are to be applied for ascertaining the intention of the parties in regard to the time at which the property in the goods is to pass to the buyer:

**1. Specific goods in a deliverable State:** 'Deliverable state' means that state of goods in which the buyer shall be bound to take delivery of them. According to Section 20 of Sale of Goods Act, if (i) the goods are specific, (ii) the contract of sale is unconditional, i.e., there is no condition regarding the transfer of ownership of goods, and (iii) the goods are in a deliverable state, then in such a case the ownership passes to the buyer at the time when the contract is made. It is immaterial whether the time of payment of price or the time of delivery of goods, or both, is postponed.

**Examples:** (a) X sells his Fiat car in deliverable state to Y on the condition that the

ownership in car shall pass to Y only when Y accepts the bill of exchange. This is a conditional contract and the property in goods shall be transferred only when the condition of accepting the bill of exchange is fulfilled.

(b) P selects certain household articles from the General Stores of R. P and R agree that the articles shall be delivered at P's house on the following day and that the price shall be paid after one month. The ownership passes to P at the time when he has selected the articles, i.e., when the contract of credit sale is made, though neither the price has been paid nor the goods have been delivered.

**2. Specific goods not in a deliverable state:** 'Not in a deliverable state' means that the seller has something yet to do to the goods for the purpose of putting them into a deliverable state. For example, packing filling the goods in containers, collecting the goods, separating or loading the goods, etc. In such a case, according to Section 21 of Sale of Goods Act, "the property does not pass until such thing is done and the buyer has notice thereof." It means that in this type of cases, the ownership shall pass to the buyer at the moment when two conditions are fulfilled: (i) the seller has performed every act on his

part and has put the goods in a deliverable state, and (ii) the fact that the goods have been put in a deliverable state has come to the knowledge of the buyer. For example, if 5 'Voltas Opal' refrigerators are purchased but they are yet to be packed or sealed, the ownership in them shall pass to the buyer only when they have been packed or sealed. Similarly, if rice is sold and it is to be dispatched by railway, then it will be said to have been put into a deliverable state when the following acts have been completed by the seller: rice is packed in bags; bags have been weighed and marked with addresses, etc.; the bags have been put into the wagons of the railway; all forwarding formalities have been performed; and the ownership will pass to the buyer as soon as he gets the information of the dispatch of the rice by railway. If the weighed bags of rice are stacked in the go down of the seller, they cannot be said to have been put into a deliverable state. Similarly, B, an author, agrees to revise and correct a literary work and to sell it to C, a publisher. As soon as B makes the manuscript ready, the ownership is passed to C.

**3. Specific goods are in deliverable state but the seller has to do something to ascertain the price:** If the specific goods are in a deliverable state but the seller is yet to weight, measure, test or do some other act or thing in connection with the goods for the purpose of ascertaining the price, the ownership does not pass to the buyer until such act or thing is done and the buyer has notice thereof (Section 22 of Sale of Goods Act). It means that in such a case, the ownership is transferred to the buyer at the moment when two conditions are fulfilled: (i) the seller has done the act or thing which is necessary for ascertaining the price of the goods, for example, taking weight, measurement, counting, etc., and. (ii) the buyer has come to know that every act necessary to ascertain the price has been done by the seller. For example, X purchases 10 kg. of mustard oil from Y's shop. Here, the goods are specific and in. a deliverable state (being kept ready for sale) but Y has to weigh 10 kg. oil out of his container. The ownership of 10 kg. of oil shall pass to X as soon as Y weighs it and tells X about it.

**II. Where goods are unascertained, or future goods:** Unascertained goods are unidentified goods and they are defined by description or by sample only. Future goods are those which are yet to be acquired or manufactured. In case of such goods, the ownership is transferred to the buyer as soon as the two conditions are fulfilled: (1) the goods are identified or ascertained, and (2) the goods are appropriated or set apart for the purpose of delivery to the buyer.

These two points may be explained as follows:

**1. Ascertainment of goods:** Section 18 of Sale of Goods Act lays down the general rule that "No property in goods is transferred to the buyer unless and until the goods are ascertained." Ascertainment of the goods is the process by which the identity of the goods to be delivered is established and recognised. The goods are ascertained by an appropriation also. It may be noted that unless the goods are ascertained or appropriated, there is merely an 'agreement to sell'. It will become 'sale' only when the necessary process of ascertainment or appropriation is completed. For example, X agrees to purchase a TV from the shop of Y. The ownership in TV shall not pass to X until and unless a particular piece of TV is identified from the many TVs kept in the shop.

**2. Appropriation of goods:** Section 23(1) of Sale of Goods Act provides that where there is a contract for the sale of unascertained or future goods, the ownership in such goods passes to the buyer only when the goods have been unconditionally appropriated as per the requirements of the contract.

'Appropriation' means the process by which the goods are selected (or separated) with the common or mutual consent of the seller and the buyer so as to determine and identify the actual goods to be delivered. Thus, completion of this process leads to 'ascertainment' of goods. It may be noted that 'ascertainment of goods' is a unilateral act and is usually done by the seller alone, whereas in case of 'appropriation of goods' the mutual consent of the seller and the buyer is necessary and therefore it turns out to be a bilateral act of the parties. Certain important points concerning appropriation of goods may be discussed as follows:

(i) The appropriation of goods must answer the requirement or description of the contract of sale in terms of quantity as well as quality. For example, if 5 washing machines are to be sold, then selection of 25 such machines cannot be said appropriation as per requirement of the contract. Similarly, if 10 'Maruti-1000' cars have been sold under a contract, then selection of 10 'Maruti-800' cars cannot be said appropriation as per the requirement of the contract

(ii) The goods to be appropriated must be in a deliverable state.

(iii) The appropriation must be unconditional. The right of disposal of goods must not be reserved by the seller to himself.

(iv) It must be 'made', and should not be a result of mere mistake or mere accident. In other words, it should not have resulted by chance and without any intention to do so. Thus, there must be an 'intention to appropriate' the goods.

(v) The appropriation is done by mutual consent of the parties. However, it may be done by the seller with the assent (permission) of the buyer; or it may be done by the buyer with the assent of the seller. Thus, selection of other party. The assent of the other party may be express or implied. It may be given before or after the appropriation.

(vi) Appropriation of goods can be made in any of the following modes or ways:

(a) By separating contracted goods from the whole or other goods.

(b) By putting the contracted quantity in suitable container like boxes, bottles, casks, sacks, tins, or polythene bags, etc.

(c) By delivering the goods to a common carrier or other sort of bailee for the purpose of sending them to the buyer. However, in such a case, the seller must not reserve to himself the right of disposal of the goods. For example, if the common carrier is instructed by the seller that the carried goods should be delivered to the buyer only when he hands over the cheque, then the right of disposal is said to be reserved with the seller. It means the goods have not been 'appropriated'. And in such a case, the ownership does not pass to the buyer. On the other hand, if right of disposal is not reserved by the seller, then in case of the goods sent by V. P. P. (Value Payable Post), the ownership is transferred when the contracted goods are packed and the packet is delivered to the post office to be transmitted to the buyer. This is called 'unconditional appropriation' of goods (Section 23(2) of Sale of Goods Act).

**III. Where goods are sent on approval or 'on sale or return':** Section 24 of Sale of Goods Act provides that when goods are delivered to the buyer on approval or 'on sale or return' or other similar terms, the ownership in such goods passes to the buyer in any of the following situations:

1. When the buyer signifies (makes known) his approval or acceptance to the seller. In other words, when he sends the message of his acceptance to the buyer, or

2. When the buyer does some act which amounts to 'adoption of the transaction', i.e., the acceptance of the goods. For example, he sells the goods to another party or pledges it with a third party for taking loan; or

3. When the buyer fails to return the goods on the fixed time, namely, retains it beyond the fixed time without giving notice of rejection (ownership passes on the moment when the fixed time expires); or

4. When no time has been fixed for the return of goods, the buyer fails to return the goods within reasonable time, namely, he retains the goods beyond the reasonable time without giving notice of rejection (ownership passes on the moment when the reasonable time expires). Reasonable time is a question of fact and will depend on the circumstances and facts of each and thus it will differ in different cases.

It may be noted that sale on the basis of 'sale or return' differs from that made on the basis of 'sale for cash only or return'. In the latter case, there is involved a condition that the 'sale' will be treated to take effect only when the payment of price is made (i.e., credit sale is not to be treated as 'sale' in such cases). Therefore, in cases of 'sale for cash only or return', the ownership shall pass to the buyer only when the price is paid. For example, X delivered a horse to Y on the basis of 'sale or return' within 7 days. Y retains the horse even after the expiry of 7 days. On 8$^{th}$ day. Y shall be deemed to be the owner of the horse. But if the horse dies on the 4th day without any fault of Y, he shall not be liable to pay the price because the ownership has not passed to Y on the 4th day. For another example, P delivers certain books to R on the basis of 'sale for cash only or return' within 3 days. Here, the ownership of books shall pass to R only when he pays their price. If he does not pay the price and even does not return them within 3 days, then on the expiry of 3 days R shall not become the owner of the books

**Risk prima facie Passes with Property**

Section 26 of Sale of Goods Act lays down the general rule that "Risk prima facie (i.e., at first sight) passes with property (ownership)." In other words, 'risk always follows ownership'. Thus, the owner has to bear the whole burden of loss, the payment of price or the possession of goods is immaterial in deciding the question of risk. Whosoever is the owner, he carries the risk. Therefore, it may be said that as a rule, the goods remain at the seller's risk until the ownership therein is transferred to the buyer, and the goods are at buyer's risk when their ownership is transferred to him whether their delivery has been made to him or not. The loss due to destruction or damage of the goods, therefore, has to be borne only by the owner of the goods.

**Exception:** The general rule that 'the risk prima facie passes with ownership' has certain exceptions. It means that in the following circumstances the ownership may lie with one party while the risk may remain with the other party.

1. If the parties have by a special agreement stipulated that the risk will pass sometime after or before the ownership has passed. For example, even though the unascertained goods are always at seller's risk, however by a special agreement the parties may agree that such goods will remain in godown at buyer's risk.

2. Where the delivery of the goods has been delayed due to the fault of either the seller or the buyer, in such cases the goods are at the risk of that party who is responsible for such fault as resulted in loss of any kind. The defaulting party will bear the loss.

3. Sometimes trade customs may put the ownership and risk separately in two parties. For example, there may be a trade custom regarding a particular goods that the person who places an order for such goods bears the risk in the course of transit, i.e., when the goods are on their way, though the goods might have been purchased 'on approval' basis.

### 13.3.3 TRANSFER OF TITLE BY NON-OWNERS

'Property' means ownership, while 'title' means right to ownership. From another angle, 'property' is an absolute ownership and 'title' is a qualified ownership. The term 'title' is usually used to denote a claim or right to ownership which means an assertion of right to ownership. This term particularly refers to the right of ownership when goods are sold by a person who is not owner of those goods and who does not sell them under the authority or with the consent of the owner. However, in common parlance, both the terms are used to mean ownership.

There is a Latin maxim '*Nemo dat quod non habel*' which means that "No one can give what he himself has not." That is, no one can give to another person a title better than what he himself has. In this context, Section 27 of Sale of Goods Act lays down that where goods are sold by a person who is not owner thereof and who does not sell them under the authority or with the consent of the owner, then the buyer does not acquire better title to the goods than what the seller has. For example, in such a case if the seller is a thief than his buyer will also be treated as a thief in connection with the goods purchased. Thus, if a person deals with the goods of another without the owner's authority or without his consent, he does not convey absolute ownership to the buyer. The buyer in that case remains a qualified owner and he acquires similar title in the goods as the seller himself had. For example, X finds a necklace of Y on the road and sells it to Z who buys in good faith and for value. Here, the true owner Y can recover

the necklace from Z because X had 'no title' to the necklace and therefore he passes 'no title' to Z. Thus, if the title of the seller is defective, the title of buyer will also be suffering from the same defect.

However, there are certain exceptions to the above general rule and under the following situation of bona fide commercial transactions, the innocent buyers get better title than their sellers. It means that under the following circumstances the buyer gets a valid title, i.e., absolute ownership even if the seller is not the absolute or full owner:

**1. Title by estoppel:** When the owner of the goods, by his statement or conduct, lead the buyer to believe that the seller has the authority to sell, then subsequently he may be estopped from denying the seller's authority to sell.

**2. Sale by mercantile agent:** According to Section 27 of Sale of Goods Act, where a mercantile agent makes a sale of the goods or of a document of title to the goods, he shall pass a valid title to the buyer, or the buyer gets a better title if the following two conditions are fulfilled:

(i) The sale must be made by a mercantile agent with the consent of the owner and such agent must be in possession of the goods or the documents. Moreover, sale must be made by him when acting in the ordinary course of business of a mercantile agent, and

(ii) The buyer, who purchased goods from a mercantile agent, must have acted in good faith and he must not have notice or knowledge that such agent has no authority to sell.

**3. Sale by one of the joint owners:** Section 28 of Sale of Goods Act provides that if one of the several joint owners of certain goods has the sole possession of the goods by permission of the other co-owners, the property (ownership) is transferred to any person who buys such goods from such joint owner (co-owner) if that person (i) buys the goods in good faith, and (ii) has no notice or knowledge at the time of the sale that the seller has no authority to sell.

**4. Sale by a person who is in possession of goods under a voidable contract:** According to Section 29 of the Act, when the seller of the goods has obtained possession thereof under a voidable contract (i.e., on the ground of coercion, fraud, misrepresentation or undue influence) but the contract has not been rescinded (cancelled) at the time of the sale, the buyer acquires a good title to such goods if he (i) buys them in good faith, and (ii) without notice of the seller's defect of title. For example, X obtains a car from a vehicle dealer by playing a fraud upon him. The contract is voidable at the option of the

dealer. But before the dealer rescinds the contract, X sells the car to Z who buys it in good faith and without notice of the defective title of X. Here, Z gets a good title.

**5. Sale by seller in possession of goods after sale:** Section 30(1) of Sale of Goods Act lays down that where a person, who has sold the goods but continues to be in possession of them or of the documents of title to them, resells such goods or documents, then a third person (new buyer) will get a good title if he (i) buys them in good faith, and (ii) without any notice of the previous sale. A pledge or any other disposition of the goods or of the documents of title to them by such seller are also equally valid.

**6. Sale by a buyer who is in possession of goods under a contract of Sale:** According to Section 30(2) of the Act, where a person, who has either bought or agreed to buy goods, obtains the possession of the goods or of the documents of title to them with the consent of the seller, then any person will get a valid title to them if he (i) buys them in good faith, and (ii) without notice of any lien or other right of the original seller in respect of such goods or documents. A pledge or any other disposition of such goods or the documents by the said buyer are also equally valid.

**7. Resale by an unpaid seller:** Section 54(3) of Sale of Goods Act lays down that where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title thereto as against the original buyer whether the notice of resale has been given to the original buyer or not (See for further details, Chapter 21).

**8. Sale under provisions of other Acts**

(i) Under certain circumstances, a finder of goods may sell them and convey a good title to their purchase (See for details, Section 169 of Contract Act under Chapter 14).

(ii) If a pledger makes a default in payment of the debt or performance of his promise at the stipulated time, the pledge has the right to sell the pledged goods after giving a reasonable notice to the pledger. Ii such a case, the pledge (seller) conveys a good title to the buyer even though the pledgee is not the owner of the goods (see for details, Section 176 of the Contract Act under Chapter 14).

(iii) The Official Receiver or the Official Assignee or Liquidator of a company is appointed by the Court to sell the properties of the insolvent persons. Though they are not the owners of the properties, a person buying goods from them gets a good title thereto.

## 13.3 CHECK YOUR PROGRESS

Answers the following fill in the blanks:

1. Transfer of property in goods means transfer of _____of the goods.
2. _____refers to the custody over the goods.
3. The seller becomes entitled to recover _____of the goods from the buyer only when the property in the goods has passed to the buyer.
4. A contract of sale of goods is a contract whereby the seller _____ property in the goods to the buyer for a price.
5. 'Property' means ownership, while 'title' means _____ to ownership.

## 13.4 SUMMARY

The main object of the contract of sale is the transfer of property in goods and delivery of the possession of the property. Transfer of property in goods does not mean transfer of possession or delivery of goods. The determination of the exact moment as to when the property pass from the seller to the buyer is important because passing of property from seller to the buyer decides various rights and liabilities of the seller and buyer. For the purpose of understanding the rules regarding transfer of property from the seller to the buyer, the goods may be classified into specific or ascertained goods and unascertained and future goods. The property in goods, whether specific or unascertained, does not pass to the buyer if the seller reserves the right of disposal of goods. Where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had.

## 13.5 KEYWORDS

**Transfer of Property in Goods:** It means transfer of ownership of goods from the seller to the buyer.

**Transfer of Possession of Goods:** It refers to the physical custody or control over the goods.

**Deliverable State:** Goods are said to be in a deliverable state when they are in such state that buyer would under the contract be bound to take the delivery of them.

## 13.6 ANSWERS TO CHECK YOUR PROGRESS

Answer to Fill in the Blanks

1. Ownership
2. Possession
3. Price

4. Transfers
5. Right

## 13.7 SELF ASSESSMENT TEST

1. What are the rules for ascertaining the intention of the parties concerning time when the property in the specific goods is to pass to the buyer?
2. "Risk prima facie passes with property." Explain this statement. Write exceptions to this rule.
3. "No seller of goods can pass a better title than what he himself has." Explain, what are the exceptions to this rule?
4. State the circumstances when a non-owner can sell the goods and convey a valid title to the buyer.
5. State the circumstances when buyer gets a better title on goods than seller.
6. "No one can give what he himself has not." Explain this statement.

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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| Lesson No.: 14 | |

# PERFORMANCE OF CONTRACT OF SALE

## STRUCTURE



## 14.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Describe the duties of seller and buyer.
- Define the meaning of deliver and state its types.
- Enumerate the rules regarding delivery of goods.

## 14.1 INTRODUCTION

We have studied that the effect of formation of contract of sale is the transfer of property between seller and buyer. After the ownership of the goods is transferred to buyer, there arises the next stage of performance of the contract of sale. It means that the seller and the buyer are to perform their respective

duties as per the requirements of the contract. Sections 31 to 44 of the Sales of Goods Act lay down certain rules for the performance of a contract for the sale of goods. Most of them have already been discussed in general law of contract, while some require further explanation. These rules are elaborately discussed in the present lesson.

## 14.2 DUTIES OF SELLER AND BUYER

According to Section 31 of Sale of Goods Act, in the context of the performance of the contract it is the duty of the seller or deliver the goods in accordance with the terms of the contract of sale. On the other hand, it is the duty of the buyer to accept delivery of the goods, and to pay for them in accordance with the terms of the contract of sale.

**Payment and delivery are concurrent conditions:** Section 32 of the Act lays down that if there is no special agreement between the parties contrary to it, then the delivery of the goods and payment of their price are concurrent conditions (i.e., they run or happen together). In other words, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods. However, in certain special contracts the payment of price may be deferred to some future date or made in advance, for example, credit sale contracts, etc.

## 14.3 CONCEPT OF DELIVERY

Section 2(2) of Sale of Goods Act defines ‘delivery’ as a ‘voluntary transfer of possession from one person to another.’ Thus, if the transfer of goods is not voluntary and is taken by theft, by fraud, or by force, then there is no ‘delivery.’ Moreover, the ‘delivery’ should have the effect of putting the goods in possession of the buyer. The essence of the delivery is voluntary transfer of possession of goods from one person to another. There is no delivery of goods where they are obtained at pistol point or theft.

### 14.3.1 TYPES OF DELIVERY

Section 33 of Sale of Goods Act provides that delivery of goods sold may be made by doing anything which the parties agree that it will be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf. Delivery of goods may be made in any of the following ways:

1. **Actual delivery:** When the goods are physically handed over to the buyer or his authorised agent, it is called actual delivery of goods.

**Example:** A seller of a Honda City hands over it to the buyer. It is actual delivery.

**2. Symbolic delivery:** Where the goods are bulky and heavy and it is not possible to hand them physically over to the buyer, then some symbol which carries with it the real possession or control over the goods, i.e., some 'means of obtaining possession' is handed over to the buyer, it is called symbolic delivery. For example, delivery of the keys of godown where goods are lying, or transferring the bill of lading or railway receipt to the buyer to enable him to obtain the goods, all are in the nature of symbolic delivery, Symbolic delivery is as effective as actual delivery.

**Example:** A purchases 10 HP computers from B. B hands over to A the keys of the godown where the computers are lying. This is a symbolic delivery of computers.

**3. Constructive delivery:** Sometimes the delivery of goods may be made without any change in their actual and visible custody, and thus there is neither actual nor symbolic delivery. When a person who is in possession of the goods accepts or acknowledges to hold them on behalf of the buyer, it is called constructive delivery. For example, the seller who is in possession of the goods sold by assent to hold them solely on the buyer's account. It is constructive delivery Similarly, when at the time of sale, goods are in possession of a third person (e.g., a bailee like a warehouse keeper, a carrier, etc.) who acknowledges to hold them on behalf of the buyer, there is a constructive delivery. It is also called delivery by attornment (i.e., making legal acknowledgement of new owner). This may happen in any of the following three ways:

i. Where the seller in possession of goods after sale agrees to hold them on behalf of the buyer as his bailee.
ii. Where the buyer is in possession of goods and the seller agrees that buyer is holding the goods as owner.
iii. Where the third party (warehouseman) in possession of goods acknowledges to the buyer that he holds the goods on his behalf.

### 14.3.2 RULES REGARDING DELVERY OF GOODS

These rules are as follows:

**1. Delivery and payment are concurrent conditions:** Unless otherwise agreed, delivery of goods and payment of price are concurrent conditions. In other words, the seller shall be ready and willing to give the possession of the goods to the buyer in exchange for the price and the buyer shall be ready and

willing to pay the price in exchange for possession of the goods. For example, in a cash sale both the parties perform their respective obligations simultaneously.

**2. Modes of delivery:** Irrespective of the mode of delivery whether actual, symbolic or constructive, it must have the effect on putting the goods in the possession of the buyer or his authorized agent.

**3. Effect of part delivery:** Section 34 of Sale of Goods Act lays down two rules in this regard, which are as follows:

(i) Where the part delivery is made in progress (in continuation) of the whole delivery, then it is treated as a delivery of whole and the ownership of the whole quantity is supposed to pass to the buyer.

(ii) Where the part delivery is made with the intention of separating it from the whole lot, then such part delivery does not operate as delivery of the remainder part also. It means that delivery of a severed (separated) part is not treated as a delivery of the whole and therefore the ownership of the whole quantity is not transferred to the buyer such part of goods is delivered to him.

**Examples:** (a) X sells 10 quintals imported plastic granules to Y. The granules are lying at a wharf (raised platform at the sea-shore for loading and unloading of goods). X hands over a delivery order to the wharfinger to deliver the goods to Y who has paid the price for the granules. Y subsequently weighed 4 quintals of the granules and took them with him. This delivery of a part of goods amounts to delivery of whole goods.

(b) X sells to Y the entire crop of wheat growing in his field. Y asks X for a permission to cut and remove a part of the wheat. Here, the intention of the buyer and the seller is clearly to separate the part delivery from the remainder in the field. Thus, the delivery of the part of wheat does not amount to delivery of the whole.

**4. Buyer to apply for delivery:** Section 35 of Sale of Goods Act provides that if there is no express agreement between the parties to its contrary, the seller of goods is not bound to deliver them until the buyer applies for delivery. Thus, it is a statutory obligation on the buyer to call upon the seller to perform delivery. It may, however, be noted that if the seller so chooses he may deliver the goods without any application in that behalf by the buyer. But in case the goods are to be subsequently obtained or procured by the seller, then it is the duty of the seller to intimate the buyer that the goods have been obtained by him, even then the buyer is supposed to apply for delivery. The buyer can have no cause of action against the seller, if the buyer fails to apply for delivery.

**5. Place of delivery:** According to Section 36(1) of Sale of Goods Act, whether the buyer is to take possession of the goods or the seller is to send them, is a question which depends upon the terms of the contract and therefore it will differ from case to case. Apart from any such contract, the rules regarding place of delivery are as follows (rules to apply when nothing is agreed upon):

(i) The goods sold are to be delivered at the place at which they are lying at the time of sale.

(ii) In case of 'agreement to sell', the goods to be sold are to be delivered at the place at which they are lying at the time of agreement to sell.

(iii) If goods are 'future goods' and therefore they are not in existence at the time of the contract, then such goods are to be delivered at the place at which they are being manufactured or produced.

**6. Time of delivery:** Where the place of delivery is agreed upon, the goods are delivered at that place during business hours on a working day. Section 36 (2) of the Act provides that where the seller is bound to send the goods to the buyer under the terms of contract but no time for sending them is fixed, the seller is bound to send them within a reasonable time. Section 36(4) provides that the demand of delivery or tender of delivery may be treated as ineffectual unless it is made at a reasonable hour. What is 'reasonable time' or 'reasonable hour' is a question of fact it will depend upon the circumstances and facts of each individual case.

**Example:** A sold to B certain quantity of spirit made from molasses. A delivered 1/3$^{rd}$ of the quantity sold to B and B presses for the delivery of rest of the quantity also. But the seller delayed it. In the meantime, an act of Parliament was passes which prohibited the distillation of spirit from molasses and annulled all the contracts for the sale of such spirit. It was held that, A, the seller, was liable to pay damages to B, the buyer, as he had failed to deliver the goods within a reasonable time.

**7. Acknowledgement by a third person:** Section 36(3) of the Act lays down that where the goods at the time of the sale are in the possession of a third person, there is no delivery by seller to buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf.

**8. Expenses of delivery:** Section 36(5) of the Act provides that unless otherwise agreed, the expenses of putting the goods into a deliverable state and also the incidental expenses in this connection both shall be borne by the seller.

**9. Delivery of wrong quantity and quality:** Section 37(4) lays down that if there is no usage of trade, or no special agreement or no course of dealing between the parties, then the following rules shall apply when delivery of wrong quantity and quality is made:

**(i) When quantity is short:** Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject the delivery. However, if he accepts the less quantity of goods so delivered, he shall pay for them at the contract rate. [Section 37(1)]

**(ii) When quantity is in excess:** Where the seller delivers to the buyer a quantity of goods larger (more) than he contracted to sell, the buyer may accept the quantity included in the contract and reject the rest, or he may reject the whole. But if the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate. [Section 37(2)]

**(iii) When the quality is mixed:** Where the seller delivers to the buyer the goods he contracted to sell mixed with the goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest, or he may reject the whole.

**10. Instalment deliveries:** In the absence of an agreement to the contrary, the buyer is not bound to accept delivery by instalments. [Section 38(1)]

Sometimes, there may be a contract where goods sold are to be delivered by separate instalments each of which is to be separately paid for. There will be a breach of such contract in the following two cases:

(i) If the seller makes no delivery or makes defective delivery, in respect of one or more instalments; or

(ii) If the buyer neglects or refuses to take delivery of or pay for, one or more instalments.

In each of the above breach, it will depend upon the terms of the contract and the circumstances of each individual case whether (a) the whole contract is repudiated, or (b) it is a severable (separable) breach giving rise to a claim for compensation but not to a right to treat the whole contract as repudiated.

**[Section 38(2)]**

**Example:** A contracted to supply to B fixed quantity of coal. A shipped only a part of agreed coal and informed B about the same. However, B Did not object to this. It was held that the buyer merely consented to delivery of coal by instalments and was bound to accept delivery of the other instalments.

**11. Delivery to carrier or wharfinger:** In this connection there are following rules:

(i) Where the seller is authorised or required to send the goods to the buyer, the delivery of the goods to a carrier for the purpose of transmission to the buyer of the delivery of the goods to a wharfinger for safe custody, is *prima facie* deemed to be a delivery of the goods to the buyer. [Section 39(1)]

(ii) It is the duty of the seller to make with the carrier or the wharfinger such contract as would sufficiently protect the buyer's interest in the goods. If he fails in his duty and the goods are lost or damaged, then the buyer may hold the seller liable for damages or he may refuse to treat the delivery to the carrier or the wharfinger as delivery to himself. [Section 39(2)]

(iii) Unless otherwise agreed, in cases where goods are sent to the buyer by a route involving sea transit and it is usual to get them insured, then it is the duty of the seller to give such notice to the buyer so as to enable him to insure the goods. If the seller fails to do so, the goods shall be deemed to be at his risk during the sea transit. [Section 39(3)]

**12. Buyer's risk for deterioration of goods in transit:** According to Section 40 of Sale of Goods Act, where goods are delivered at a distant place, the liability of such deterioration in the goods as is necessarily incidental to the course of transit, will fall on the buyer even though the, seller agrees to deliver them at his own risk.

**13. Buyer's right of examining the goods:** Section 41 of the Act lays down that where those goods are delivered to the buyer which he has not previously examined, he is entitled to examine them for his satisfaction. He is not deemed to have accepted them unless and until he has had a reasonable. opportunity for such examination. And unless otherwise agreed, the seller is bound to afford the said opportunity at the time of delivery if the buyer requests for the same.

**14. Acceptance of delivery by buyer:** According to Section 42 of Sale of Goods Act, the buyer is deemed to have accepted' the goods (i) when he intimates to the seller that he has accepted them; or (ii) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, for example, he pledges them or resells them; or (iii) when after the lapse of a reasonable time, he retains the goods-without intimating to the seller that he has rejected them.

**15. Buyer not bound to return rejected goods:** Section 43 of Sale of Goods Act lays down that unless otherwise agreed, where the buyer refuses to take delivery of the goods and if he has a right to do so, he

is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.

**16. Liability of buyer for neglecting or refusing delivery of goods:** According to Section 44 of the Act, when the seller is ready and willing to deliver the goods and requests the buyer to take delivery and the buyer does not take delivery within a reasonable time after such request, the buyer is liable to the seller for loss occurred by his neglect or refusal to take delivery; and also for a reasonable charge for the care and custody of the goods.

## 14.4 CHECK YOUR PROGRESS

1. Sections _____ of the Sales of Goods Act lay down certain rules for the performance of a contract for the sale of goods.
2. When the goods are physically handed over to the buyer or his authorised agent, it is called - _____ delivery of goods.
3. When a person who is in possession of the goods accepts or acknowledges to hold them on behalf of the buyer, it is called _____ delivery.
4. _____ of Sale of Goods Act provides that if there is no express agreement between the parties to its contrary, the seller of goods is not bound to deliver them until the buyer applies for delivery.
5. In the absence of an agreement to the contrary, the buyer is not bound to accept delivery by _____.

## 14.5 SUMMARY

Performance of contract of sale means the delivery of goods by the seller and acceptance of the delivery of the goods and payment for the same by the buyer. It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them in accordance with the terms of the contract of sale. The parties are free to contain any terms in their contract as to time, place, place and manner of delivery of goods, acceptance of delivery and payment of price. In case the contracting parties are silent and do not contain anything regarding these matters in the contract of sale, the rules laid down in the Sales of Goods Act shall apply.

## 14.6 KEYWORDS

**Delivery:** Voluntary transfer of possession from one person to another.

**Actual Delivery:** Where the goods are physically handed over by the seller or his authorised agent to the buyer or his authorised agent, the delivery of the goods is said to be actual.

**Wrong Delivery:** It means either short or excess delivery of goods than the contracted quantity of goods.

**Constructive Delivery:** Where a person in possession of goods of the seller acknowledges to the buyer that he holds the goods on his behalf, constructive delivery takes place.

## 14.7 ANSWERS TO CHECK YOUR PROGRESS

1. 31 to 44
2. Actual
3. Constructive
4. Section 35
5. Instalments

## 14.8 SELF ASSESSMENT TEST

1. What is meant by delivery of goods under Sale of Goods Act? Explain the provision of law with regard to delivery.
2. "Payment and delivery are concurrent conditions." Explain.
3. Define delivery. What are various modes?
4. Enumerate important rules regarding delivery
5. "Delivery to the carrier prima facie amounts to delivery to the buyer." Do you agree?

## 14.9 REFERENCSES/SUGGESTED READINGS

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2. M.C. Shukla, A Manual of Mercantile Laws; Sultan Chand & Company, New Delhi.
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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 15 | |

# RIGHTS OF UNPAID SELLER AND BUYER'S RIGHT

## STRUCTURE



## 15.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define unpaid seller.
- Describe the rights of unpaid seller.
- Enumerate the buyer's remedies for breach by seller.

## 15.1 INTRODUCTION

Every contract is comprised of reciprocal promises. In a contract of sale of goods, seller is under an obligation to deliver the goods to buyer and buyer has to pay for it. In case buyer fails to pay, the seller,

shall have certain rights In the present lesson, we shall discuss who is an unpaid seller, his rights as well as remedies available to the buyer.

## 15.2 UNPAID SELLER

According to Section 45 of Sale of Goods Act, 'unpaid seller' means:

1. A seller of the goods who has not been paid or tendered the whole of the price, or
2. A seller who has received the price through a bill of exchange or any other negotiable instrument like cheque etc., but which is subsequently dishonoured.

Thus, an unpaid seller has an immediate right of action for the unpaid price. It may be noted that if the price has been tendered by the buyer but the seller has wrongfully refused to accept it, then the seller cannot be called 'unpaid seller'. Similarly, if price is fully paid but some other expenses remain to be paid, then the seller is not an unpaid seller. Moreover, where the seller has sold the goods on credit, he cannot be termed as an unpaid seller. If the seller does not receive the price in full after the expiry of the credit period, he will be called an 'unpaid seller'.

The term 'seller' here includes any person in the position of a seller, For example, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid the price, or a consignor or agent who is directly responsible for the price. The term 'unpaid seller', however, does not include a buyer, who after having paid the price, rejects the goods. He will therefore not be entitled to the right of lien or rejected goods as available to an unpaid seller.

**Features of an unpaid seller**

Following are the features of an unpaid seller:

1. He must sell the goods on cash terms and must be unpaid.
2. Where he sells the goods on credit basis, he becomes unpaid if the buyer does not pay him the price after the expiry of credit period or becomes insolvent before the expiry of credit period.
3. He must be unpaid wholly or partially. Even if substantial portion of the price has been paid, the seller becomes unpaid seller within the meaning of Sec. 45.
4. Where the price is paid through a negotiable instrument (bill of exchange, cheque or PN) and the same has been dishonoured, he is an unpaid seller.
5. Where the seller has obtained a decree for the price of the goods and the same has not been satisfied, he is an unpaid seller.

6. Seller is not an unpaid seller where buyer tenders the payment and the seller refuses to accept it.

**Examples**

1. A sells his Wagon R car for Rs. 4 lac to B on cash terms and B has not paid the price. Suppose, B pays Rs. 3,50,000 to A. A is an unpaid seller in both the cases (i) where the whole of the price has not been paid and (ii) where part of the price (Rs. 50,000) has not been paid.
2. A sells LG 'CTV' to B for Rs. 20,000 on 3 months' credit period and B does not make the payment after the expiry of 3 months' credit period or B becomes insolvent after 30 days, in both these cases A is an unpaid seller.

### 15.2.1 RIGHTS OF AN UNPAID SELLER

Section 46(1) of Sale of Goods Act lays down that the unpaid seller has the following two types of rights:

I. Rights of an unpaid seller against the goods:

(A) When the property in goods has been transferred:

1. Right of lien,

2. Right of stoppage of goods in transit, and

3. Right of resale.

(B) When the property in goods has not been transferred:

Right of withholding delivery

II. Right of an unpaid seller against the buyer personally:

1. Right to sue for price,

2. Right to sue for damages,

3. Right to sue for repudiation of contract, and 4.

Right to sue for interest or special damages.

#### 15.2.1.1 Rights of an Unpaid Seller against Goods

(A) When property in goods has passed to the buyer:

**1. Right of Lien**

A lien is a right to retain possession of goods until certain charges due in respect of them are paid or tendered. The general rule is that the property passes when the parties intend it to pass. The right of lien is a possessory right and can be exercised by the unpaid seller only when the goods are in his possession and the property in the goods has passed to the buyer. A person cannot have a lien on his own goods. An unpaid seller has the right of lien over the goods until the full price is paid or tendered.

**When can lien be exercised:** Section 47 of Sale of Goods Act lays down that the unpaid seller of goods who is in possession of them is entitled to retain their possession until the price is paid or tendered in the following cases:

(i) Where the goods have not been sold on credit;

(ii) Where the goods have been sold on credit, but the time of the credit period has expired;

(iii) Where the buyer becomes insolvent, i.e., he has ceased to pay his debts in ordinary course of business or cannot pay his debts as they become due.

The seller may exercise his right of lien in spite of the fact that he is in possession of the goods as agent or bailee for the buyer.

Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show he has waived the lien (Section 48 of the Act).

In case the documents of title have been delivered but the goods are in the actual possession of the seller, the right of lien can be exercised. The right of lien can be exercised only for price, and not for any other expenses, for example, interest, godown charges, etc. The right of lien is indivisible in nature. It means that the seller may refuse to deliver a part of the goods even on payment of the price for that part by the buyer.

The right of lien can be exercised even though the seller has obtained a decree for the price of the goods [Section 49(2) of the Act].

**Termination of lien (When the lien is lost):** According to Section 49(1) of Sale of Goods Act, the unpaid seller loses his lien on the goods in the following cases:

(i) When the goods have been delivered to a carrier or other bailee for the purpose of their transmission to the buyer, without the right of disposal of goods. Because the delivery to the

carrier amounts to be the delivery to the buyer himself. For example, X sells plastic toys to Y for 50,000 and delivers the same to the railways for the purpose of their transmission to Y. The railway receipt (RJR) is taken by X in the name of Y and that is also sent to Y by post. Here, X cannot exercise his right of lien.

(ii) When the buyer or his agent has lawfully obtained possession of the goods. It may be noted that if the buyer or his agent has obtained possession by deceiving the seller or by using any other illegal methods, then it will not amount to be a 'lawful' possession by them.

**Example:** A agreed to sell some goods to B at a certain price. As per the terms of the agreement B was to pay the price and then take the delivery of goods. B without payment of price obtained the possession of goods tactfully from A without his consent. In this case as B has not obtained possession of goods lawfully, A does not lose his right of lien.

(iii) When the seller has waived his right of lien. The waiver may be express or implied. For example, when the seller extends the period of credit, or when he agrees to a sub-sale by the buyer, there is an implied waiver by the seller.

(iv) When the buyer tenders the price but the seller refuses to accept it, then the right of lien is lost.

(v) Where the buyer disposes of the goods by sale or in any other manner and the seller assents thereto [Section 53(1) of the Sale of Goods Act].

(vi) Where a document of title of goods has been lawfully issued to the buyer and the buyer transfers the documents to an innocent purchaser, who takes them for consideration and in good faith and the seller has assented thereto [Section 53(1) of the Act].

(vii) When the right of lien is once lost, it will not revive if the buyer redelivers the goods to the seller for any particular purpose.

**2. Right of Stoppage in Transit**

The right of stoppage in transit simply means the right of stopping the goods while they are on the way to the buyer's place. This right arises only when the seller's lien on the goods is lost. In this sense, the right of stoppage in transit i.s an extension of the right of lien. By exercising this right, the unpaid seller resumes or regains possession over the goods.

If the seller is unpaid and the property in goods has passed to the buyer, then according to Section O of Sale of Goods Act, the right of stoppage in transit can be exercised in the following cases:

(i) Where the unpaid seller has parted with the possession o1 the goods and they are in the transit, i.e., neither in the possession of the seller nor in the possession of the buyer, and

(ii) The buyer of goods has become insolvent, i.e., is unable to pay his debts in the ordinary course of business or as they become due.

Such stopped goods in transit may be retained by the seller until the price for them is paid or tendered.

**Duration of transit:** The goods can be stopped by the seller only when they are in the course of the transit. In this connection, an important question arises as to how long and upto what time the goods can be said to be in transit? Section 5(1) of Sale of Goods Act explains the duration of transit. It provides that 'Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent takes delivery of them from such carrier or other bailee." Thus, the goods are said to be in transit when they are in possession of the carrier who is acting as an independent person. However, the transit does not mean that the goods should be actually moving.

Section 51(4) of the Act provides that if the goods are rejected by the buyer and they continue to be in possession of the carrier or other bailee, then the transit continues even if the seller has refused to receive them back. Similarly, if the buyer asks the seller to deliver the goods at a different place other than the agreed one, the goods are deemed to be in transit until they are received by the buyer or his agent.

**Termination of transit or seller's right of stoppage in transit:** In the following circumstances or cases, the transit comes to an end, and the seller loses his right of stoppage in transit:

(i) When the buyer or his agent obtains delivery of the goods before their arrival at the appointed destination, the transit comes to an end.

**Example:** The seller sends the goods to the railway company for transmission to the buyer. When the goods arrived at the destination the railway company delivered the goods to the buyer. The buyer loaded them in the cart. Before the cart has left the railway compound, the railway company received a telegram to stop the goods. No action was taken by the railway company on the telegram and it was

sued by the seller. **Held** the transit has terminated on handling over the goods to the buyer. The railway company, therefore, could not exercise right of stoppage of goods.

(ii) If the goods have arrived at the appointed or fixed destination and then the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on buyer's behalf and continues in possession of them as bailee for the buyer, the transit comes to an end. Then, it is immaterial that a further destination for the goods may have been indicated to the carrier by the buyer.

(iii) When the goods are delivered to a carrier who has been hired by the buyer and thus who acts as an agent of the buyer, the transit ends at the time of delivery of goods to such carrier.

(iv) Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent, the transit ends at the time of such wrongful refusal to delivery.

(v) Where the part delivery of the goods has been made to the buyer or his agent, the remainder of goods may be stopped in transit. But if such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of goods, the transit comes to an end at the time of such part delivery.

**How stoppage in transit can be effected or exercised practically:** According to Section 52 of Sale of Goods Act, there are two modes or methods of exercising the right of stoppage in transit by the seller as follows:

(i) By taking actual possession of the goods from the carrier or the other bailee, or

(ii) By giving notice of his claim to the carrier or other bailee in whose possession the goods are lying.

Such notice may be given either to the person in actual possession of the goods or to his principal. In case the notice is given to the principal, the same to be effective must be given at such time and in such circumstances that the principal may, by the exercise of reasonable diligence, communicate it to his servant or agent (i.e., the person carrying the goods), in time to prevent the delivery to the buyer. In other words, the notice to the principal shall be effective only when there is sufficiently reasonable time for him to further pass on the information to his servant or agent. The notice need not be in writing and no particular form for it is laid down.

When notice of stoppage in transit is given by the seller to the carrier or the other bailee, he shall redeliver the goods to the seller or according to seller's directions. [Section 52(2) of the Act].

**Distinction between Lien and Stoppage in Transit**

| S. No. | Basis | Lien | Stoppage in transit |
|---|---|---|---|
| 1. | Insolvency of buyer | Unpaid seller can exercise right of lien when buyer becomes insolvent or he is solvent but does not pay the price. | Unpaid seller can exercise right to stop the goods in transit only when the buyer becomes insolvent. |
| 2. | Possession of goods | In order to exercise right of lien of goods must be in the possession of the unpaid seller. | In order to exercise right to stoppage in transit the goods must be in the custody of carrier or other bailee. |
| 3. | Object | The object of exercising right of lien is to retain the possession of goods. | The object of exercising right to stop the goods is to regain the possession of goods. |
| 4. | Termination of right | It is a possessory lien. When the possession is lost, this right is also lost. | Right to stop the goods in transit terminates when the carrier or other bailee parts with the possession of goods. |
| 5. | Exercise of right | Lien is exercised by the unpaid seller himself. | The right to stop the goods in transit is exercised by the seller through the carrier or bailee in possession of goods. |
| 6. | Loss of possession | Right of lien comes to an end when the possession of goods is lost by the unpaid seller. | Right of stoppage of goods in transit commences when the seller parts with the |

possession of goods.

**Effect of sub-sale or pledge by buyer on the seller's rights of lien and stoppage in transit:** According to Section 53(1) of Sale of Goods Act, the unpaid seller's right of lien or stoppage in transit is not affected by any sub-sale, pledge, or other disposition of the goods by the buyer unless the seller has agreed to such a sub-sale, etc. For example, X sells certain goods to Y of Mumbai. The goods are handed over to the railways for transmission to Y. In the meantime, Y sells these goods to Z for consideration. Y becomes insolvent. X can still exercise his right of stoppage in transit.

But there are two exceptions to the above rule when the right of lien and stoppage in transit are affected by a sub-sale, pledge or other disposition of the goods. These exceptions are as follows:

(i) In case the sub-sale or other disposition by the buyer has been done with the consent of the seller, the unpaid seller cannot exercise lien or stoppage in transit.

**Example:** A sells B 100 bags of wheat out of large stock lying in his godown. Out of this purchase B sells 60 bags to C, before the ascertainment of goods. C obtains delivery order and presents it to A who endorses thereon that wheat will be forwarded to him in due course. Thereafter B becomes insolvent. A will not be able to exercise lien on the wheat since he has assented to the sub-sale of 60 bags of wheat by B to C.

(ii) Where a document of title to goods (e.g., bill of lading, railway receipt etc.) has been issued or lawfully transferred to any person as a buyer, and that person (buyer) transfers the document to a purchaser who purchases them in good faith and for consideration, then the unpaid seller's right of lien or stoppage in transit is defeated, i.e., would come to an end, if the transfer by the buyer to the purchaser is by way of sale. For example, X sells certain goods to Y and sends the railway receipt to Y. Then, Y before making the payment of the goods transfers the railway receipt to Z for consideration. Z buys the goods in good faith. Y becomes insolvent. The right of X to stop the goods in transit is defeated and Z shall get a good title [Section 53(1) of Sale of Goods Act].

Section 53(2) of the Act further provides that if such transfer of documents of title is not by way of sale, but by way of pledge or other disposition for value, then the unpaid seller's right of lien or stoppage in transit are not completely defeated, and he can exercise these rights subject to the rights of the pledgee or transferee, i.e., he can exercise only those rights which are not in conflict with the rights of the

pledgee, etc. For example, X sells certain goods to Y and sends the railway receipt to Y. Without paying for the goods, Y pledges the railway receipt with Z as a security for a loan of 25,000. Then, Y becomes insolvent. Here, X can get back the railway receipt after paying 25,000 to Z.

**3. Right of Resale**

The unpaid seller has two important rights, namely, right of lien and right of stoppage in transit. In case, he exercises any of these rights he again gets the possession of the goods which had been sold earlier by him. Now, a question arises as to how long the unpaid seller should wait for the buyer to pay the price and take delivery of the goods. This question assumes more importance in case where the goods are of perishable nature. Therefore, the unpaid seller has another right and that is the right of resale. It may be noted that a contract of sale is not rescinded by the mere exercise by the seller of his rights of lien or stoppage in transit. In other words, in spite of the exercise of these two rights by the seller, the buyer still remains entitled to perform the contract if he so chooses and he can pay the price and take delivery of the goods. In that case, the seller is not entitled to rescind the contract of sale. However, according to Section 54(2) of the Act, in the following circumstances, the unpaid seller can resell the goods whose possession he has got after the exercise of his right of lien or stoppage in transit:

**(i) Where the goods are of a perishable nature:** 'Perishable goods' means the goods which quickly deteriorate in market value with the passage of time. If there is much delay, they are destroyed physically and lose their market value to a considerable extent or sometimes completely. In case of perishable goods, the unpaid seller can resell them after the expiry of reasonable time depending upon the quickness of deterioration of such goods in each individual case. Then, he is not required to give notice of resale to the buyer.

**(ii) When the unpaid seller gives notice of his intention to resell:** An unpaid seller after having exercised his right of lien or stoppage in transit regains possession of the goods, he may give notice to the defaulting buyer asking him to pay the price within a reasonable time failing which he would be reselling the retained goods. If the buyer does not pay or tender the price within a reasonable time, the unpaid seller may resell the goods. Moreover, the seller would be entitled to recover from the original buyer damages for any loss occurred to him by the breach of contract, but the original buyer shall not be entitled to any profit which may occur on the resale If the unpaid seller does not give such notice of his intention to resell, he shall not be entitled to recover such damages and the original buyer shall be entitled to the profit, if any, on the resale.

It may be noted that the new buyer acquires a good title as against the original buyer in spite of the fact no notice of resale has been given to the original buyer.

**(iii) Where the seller expressly reserves a right of resale:** Where in a contract of sale, the seller expressly reserves a right of resale if the buyer should make default, in such a case the seller may resell the goods in the event of default by the buyer. No notice of resale is necessary in such cases. When the buyer defaults and the seller resells the goods, the original contract of sale is thereby rescinded. However he would be entitled to claim damages from the original buyer for the loss suffered by him.

It may be noted that if the buyer had paid some money to the seller by way of advance or deposit, then this amount can be claimed back by him but subject to the seller's claim for damages, if any.

**(B) Where the property in goods has not passed to the buyer:**

**Right of withholding delivery:** According to Section 46(2) of Sale of Goods Act, if the property in goods has not passed to the buyer, the unpaid seller in addition to his other remedies has a right to withhold delivery of the goods. This right is similar to and co-extensive with the rights of lien and stoppage in transit where the property has passed to the buyer. It may be noted that if the property has not passed to the buyer, the unpaid seller cannot exercise the rights of lien and stoppage in transit. Other remedies may include the seller's right to claim damages for the loss suffered, special damages, etc.

### 15.2.1.2 Rights of an Unpaid Seller Against the Buyer Personally

In addition to the above mentioned rights of an unpaid seller against the goods, he has certain remedies against the buyer personally, which are as follows:

**1. Suit for price:** Section 55(1) of Sale of Goods Act lays down that where under a contract of sale the property in the goods has passed to the buyer and then the buyer wrongfully neglects or refuses to pay for the goods as per the terms of the contract, the seller may sue him for the price of the goods.

Where the property in goods has not passed to the buyer, the seller as a rule cannot file a suit for the puce, and his only remedy is to claim damages. But Section 55(2) of the Act lays down that where under a contract of sale, the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price even though the

property in the goods has not passed and the goods have not been appropriated (set aside) as per the contract.

**2. Suit for damages for non-acceptance of delivery:** According to Section 56 of the Act, where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance of delivery.

**3. Suit for damages for repudiation of the contract:** Section 60 of Sale of Goods Act lays down that where the buyer repudiates, i.e., to accept the contract before the date of delivery, the seller may either treat the contract as subsisting (existing) and wait till the date of delivery, or he may treat the contract as rescinded (cancelled) and sue for damages for the breach.

**4. Suit for interest or special damages:** According to Section 61 of the Act, the seller has a right to recover interest or special damages from the defaulting buyer. In the absence of any other contract in this regard, the Court may award interest at such rate as it thinks fit on the amount of the price from the date of the tender of the goods or from the date on which the price was payable.

## 15.3 BUYER'S REMEDIES FOR BREACH BY SELLER

There are certain rights of the buyer in case if there is breach of contract by seller, which are as follows:

**1. Suit for damages for non-delivery:** Section 57 of Sale of Goods Act lays down that where the buyer is ready and willing to take delivery of the goods but the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

The damages will be assessed as per the provisions contained under Sec. 73 of the Indian Contract Act. These are:

a) *Where there is a ready market for the goods* the buyer is entitled to claim damages equal to the difference between the contract price and market price on the date of breach.
b) *Where the goods do not have a ready market*. In such a case the quantum of damages will depend upon the facts of each particular case. The buyer is under obligation to mitigate loss by taking appropriate steps.

According to Section 61 of the Act, the buyer is also entitled to sue the seller for special damages, which were in the contemplation of the parties at the time of formation of the contract.

**2. Suit for specific performance:** According to Section 58 of the Act, in a contract of sale of specific or ascertained goods, the buyer may file a suit for specific performance. The Court may direct the seller that the contract shall be performed specifically only when damages would not be an adequate relief, for example, where the goods under the contract is a rare thing or of a unique nature, such as rare coins or antiques (material of a past period, i.e., of old times, for example, a piece of furniture, a work of art, etc., belonging to a 200 years' old period).

**3. Suit for breach of warranty:** According to Section 59 of the Act, where there is a breach of warranty by the seller or where the buyer elects or is compelled to treat any breach of a condition as a breach of warranty, the buyer is not entitled to reject the goods but he may have either of the following two remedies:

(i) If the price has not been paid by the buyer, he may deduct from the price the loss suffered by him and pay the balance, or

(ii) if the loss suffered is more than the price, the buyer may file a suit for damages.

**4. Suit for repudiation of contract before due date:** Section 60 of the Act lays down that where the seller repudiates (refuses to accept) the contract before the date of delivery; the buyer may either treat the contract as subsisting (existing) and wait till the date of delivery; or he may treat the contract as rescinded (cancelled) and sue for damages for the breach.

**5. Suit for interest:** If the buyer has already paid the price but the seller fails to deliver the goods, then as per Section 61 of Sale of Goods Act, he may file a suit for the refund of the price. In such a suit, he may also claim interest or special damages from the defaulting seller. In the absence of any other contract to the contrary, the Court may award interest at such rate as it thinks fit on the amount of price from the date on which the payment was made. It may be noted that the buyer can claim interest only when he is entitled to the refund of price.

## 15.4 CHECK YOUR PROGRESS

Answers the following multiple choice questions

1. Section_____ of the Sale of Goods Act deals with rights of unpaid seller.

   A. 46 C. 48

   B. 47 D. None of above

2. Where an unpaid seller has made part delivery of the goods he may exercise his right_____ .

A. Return on the remainder
B. Of lien on the remainder
C. Sale to any other person
D. None of above

3. Apart from an action for the price, what other remedy does the unpaid seller have against the buyer for breach of contract?
   a) Damages for non-acceptance of the goods
   b) Damages for late payment
   c) A claim in equity
   d) None
4. Section 58, of The Sale of Goods Act provide right of suit for Specific Performance of Contract on the part of
   A. Seller
   B. Buyer
   C. Both (a) and (b)
   D. None of above
5. Section 31 of the Sale of Goods Act deals with duties of seller
   A. To show goods
   B. To deliver goods
   C. To change goods
   D. None of above

## 15.5 SUMMARY

The seller of goods is deemed to be an 'unpaid seller' when the whole of the price has not been paid or tendered; or where a bill of exchange or other negotiable instrument has been received as a conditional payment, i.e., subject to the realization thereof, and the same has been dishonored. The unpaid seller's lien is a possessory lien, i.e., the lien can be exercised as long as the seller remains in possession of the goods. He may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer. According to Section 51, goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent takes delivery of them. It is the duty of the carrier, after receiving due notice, not to deliver the goods to the buyer but to redeliver them to, or according to the directions of the seller. If by mistake he delivers the goods to the buyer, he can be made liable for conversion. The expenses of redelivery are to be borne by the seller. If on a resale there is a loss to the seller, he can recover it from the defaulting buyer. But if there is a surplus on the resale, the seller can keep it with him because the buyer cannot be allowed to take advantage of his own wrong.

## 15.6 KEYWORDS

**Delivery:** It is defined as a voluntary transfer of possession from one person to another.

**Unpaid Seller:** A seller of goods is an unpaid seller when the whole of the price has not been paid or tendered, or a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonor of the instrument or otherwise.

**Transit:** It means that the goods are in the custody of carrier who holds them in an independent capacity.

**Right of Stoppage:** This means the right to stop further transit of the goods while they are with a carrier for the purpose of transmission to the buyer.

**Express Waiver:** Waiver is express where under the terms of the contract, the seller cannot retain the possession of the goods even if the price has not been paid.

## 15.7 SELF ASSESSMENT TEST

1. Define an unpaid seller. What are his rights against a buyer?
2. Explain the rights of an unpaid seller (i) against the goods, and (ii) against the buyer personally.
3. "Right of stoppage in transit is an extension of the right of lien." Comment.
4. When lien can be exercised? Explain also the circumstances when the lien is lost.
5. What is the law regarding duration of transit in a contract of sale? When the transit is deemed to be terminated?
6. How stoppage in transit can be effected?
7. What are the remedies available to a seller and a buyer in case of breach of a contract of sale?

## 15.8 ANSWER TO CHECK YOUR PROGRESS

1. A 2. B 3. A 4. A 5.B

## 15.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 16 | |

# NEGOTIABLE INSTRUMENT ACT: MEANING, FEATURES, TYPES AND PARTIES OF NEGOTIABLE INSTRUMENTS

## Structure



## 16.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Understand the meaning of negotiable instrument and explain the essential characteristics of negotiable instrument.
- Enumerate the presumptions as to a negotiable instrument.
- Describe the various types of negotiable instruments.

## 16.1 Introduction

The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce making provision of giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry on with it the bulk of the currency in force. The introduction of negotiable instruments owes its origin to the bartering system prevalent in the primitive society. The negotiable instruments are, in fact, the instruments of credit being convertible on account of the legality of being negotiated and thus easily passable from one hand to another. The source of Indian law relating to such instruments is admittedly the English Common Law. The main objective of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods. The purpose of the Act was to present an orderly and authoritative statement of the leading rules of law relating to the negotiable instruments.

## 16.2 MEANING, FEATURES AND PRESUMPTIONS OF NEGOTIABLE INSTRUMENT

Section 13 (1) states that a 'negotiable instrument' means a promissory note, bill of exchange or cheque payable either to order or bearer. 'Payable to order' means which is expressed to be payable to 'order' or to a 'Particular person' and does not contain words prohibiting transfer of indicating an intention that it shall not be transferable. 'Payable to bearer' means which is expressed to be payable to 'bearer' or on which the only or the last endorsement is an 'endorsement in blank'. Where the instrument is expressed to be payable to the order of 'specified person', and not to 'him or his order', even then it is payable to 'him or his order' at his option.

**Examples:** (i) An instrument to be negotiable must be payable in any of the following 5 forms : (a) 'to X', (b) 'to X or order', (c) 'to the order of X', (d) 'to bearer', (e) 'to X or bearer'.

(ii) A bill or cheque is drawn in this form 'Pay Ajay five hundred rupees.' In legal effect, it is a bill or cheque payable to Ajay or order, and is a negotiable instrument.

(iii) A note is drawn in this form: 'I promise to pay Rs. 1,000 to Vishal only.' This note is not negotiable.

(iv) A bill payable 'to Ganesh or bearer' is payable to bearer.

(v) A bill is made payable thus: 'Sudhakar Rao or order.' Sudhakar Rao endorses it in blank and negotiates it. Then, the bill becomes payable to bearer.

(vi) A bill 'payable to the order of Shankar' is in legal effect payable to Shankar or order. Shankar can demand payment of such a bill without giving any endorsement on it. But if Shankar orders it to be paid to any other person, he must endorse it.

Section 13 (2) provides that a 'negotiable instrument' may be made payable to two or more payees jointly, or it may be made payable in alternative to one of two, or some of several payees. For example, a bill may be made payable 'to Mohan and Sohan' or 'to Rajesh or Ratan',

Thomas says that a negotiable instrument is one which is, by a legally recognised custom of trade or by law, (a) transferable by delivery or by endorsement and delivery (b) without notice to the party liable, in such a way that the holder of it for the time being may sue upon it in his own name, and (c) the property in it passes to a bona fide transferee for a value free from equities and free from any defect in the title of the person from whom he obtained it,

Simply stated, 'negotiable' means possessing the quality of being transferable free from equities; and 'instrument means a written document executed formally as a means of offering evidence of an act or an agreement or an right or duties. Hence, a negotiable instrument is the written document the title to which passes by delivery, the holder of which may for the time being sue in his own name, notice of assignment need not be given to person liable thereon, whose bona fide holder for value takes free from any defect in title of predecessors, and which is of a type recognised by law as negotiable.

**Features of Negotiable Instruments**

A close observation of various definitions of negotiable instrument brings out its following essential features or characteristics:

**1. Negotiability:** Negotiable instruments are easily transferable from one person to another without complying with any special formalities like writing a transfer dead, stamping, etc. A negotiable instrument does not merely give possession of the instrument after its transfer but the right to property or title also, The '*bona fide*' holder for value of the instrument is treated as its owner and he acquires property in it by his own conduct and nobody can deprive him or it. In the case of a 'bearer' instrument, the ownership of the instrument passes from one person to another by mere delivery; whereas in case of

an 'order instrument' the ownership passes by endorsement and delivery. Thus, it is the most important characteristic of a negotiable instrument that the property in it is easily transferable.

**2. Transferee not affected by any defect in the title of transferor:** The transferee who obtains a negotiable instrument 'in good faith', 'for value' and 'before maturity' is called 'holder in due course'. The title of the 'holder in due course' is not affected in any way even if the title of the transferor or any prior party to instrument, was defective, In other words, he acquires a better title that of the transferor or the predecessors.

**3. Right, of the holder to sue upon the instrument:** The 'holder in due course' of a negotiable instrument is entitled to sue the instrument in his own name for the recovery of the amount. He need not give any notice to the transferor or any other person liable for payment on the instrument that he has become the holder of it.

**4. Transfer:** A negotiable instrument can be transferred infinitum, i.e., any number of times, till its maturity. However, a cheque can be transferred any number of times till it becomes stale.

**5. Unconditional promise:** It is an important feature of a negotiable instrument that it is always 'unconditional'. The maker or drawer of the instrument promises 'unconditionally' without imposing any condition for the fulfillment of his promise.

**6. Sum certain:** The promise under a negotiable instrument is always for a sum certain.

**7. Principle of 'privity of contract' not applicable:** The principle of 'privity of contract' states that only a person who is a party to a contract may sue on it, i.e., has rights upon it and is bound by it. This principle does not apply to negotiable instrument. In other words, an indirect or remote owner of the instrument has rights upon it and is bound by it.

**Presumptions of Negotiable Instrument**

According to Section 118, certain legal presumptions are applicable to all negotiable instruments. These presumptions are also called 'special rules of evidence' which are as follows:

**(a) Consideration:** It shall be presumed that every negotiable was made or drawn for consideration, and that every such instrument when it has been accepted, endorsed, negotiated or transferred for consideration. The presumption in case of negotiable instrument exists whether any consideration is mentioned in the instrument or not.

**(b) Date:** It shall be presumed that every negotiable instrument bearing a date was made or drawn on such date.

**(c) Time of acceptance:** It shall be presumed that every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity.

**(d) Time of transfer:** It shall be presumed that every transfer of a negotiable instrument was made before its maturity, unless the contrary appears from the date of endorsement of the instrument.

**(e) Order of endorsement:** It shall be presumed that the two or more endorsements appearing upon negotiable instruments were made in order in which they appear thereon.

**(f) Stamp:** A lost promissory note, a bill of exchange or a cheque is presumed to have been duly stamped (under the Indian Stamp Act, 1899).

**(g) Holder is a holder in due course:** The presumption of law is that the holder of a negotiable instrument is a holder in due course. Every holder of such an instrument is presumed to have paid consideration for it and to have taken it in good faith before its maturity. It may be noted that it is not for the holder to prove how he became a holder in due course.

**(h) Proof of protest:** Section 119 states that in a suit upon an instrument which has been dishonoured the Court shall, on the production of proof of protest, presume the fact of dishonour. Thus Protest operates as a prima facie evidence of dishonour. Thus, protest operates as a prima facie evidence of dishonour.

**Other Rules of Evidence**

In addition to the above presumptions, the following are the other rules of evidence in case of negotiable instruments:

**1. Estoppel against denying original validity of instrument:** Section 120 provides that the maker of a promissory note, the drawer of a bill or cheque shall not deny the validity of the instrument as originally made or drawn. Naturally, it is clear that the maker and the drawer are directly responsible for bringing these documents into existence and therefore, they should not be allowed to plead invalidity of such instrument.

**2. Estoppel against denying capacity of payee to endorse:** According to Section 121, the maker of a note and the acceptor of a bill of exchange payable to order, shall not be permitted to deny the payee's

capacity at the date of the note or bill to endorse the same. Thus, the maker will not be permitted to say that the payee was a minor, or that he was insane at the time of making the note.

**3. Estoppel against denying signature or capacity of prior party:** Section 122 provides that any endorser in a negotiable instrument shall not be permitted to deny the signature or the capacity to contract, of any prior party to the instrument.

## 16.3 TYPES OF NEGOTIABLE INSTRUMENTS

Section 13 (1) of the Act as discussed above, mentions three kinds of negotiable instruments only, namely, bills of exchange, promissory notes and cheques, which may be described as follows:

### 16.3.1 PROMISSORY NOTE

Section 4 defines a 'promissory note' as an instrument in writing (note being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument.

**Examples:**

(A) The following are the illustrations of promissory notes:

(i) 'I promise to pay Mohan of order Rs. 1,000.'

(ii) 'I acknowledge myself to be indebted to Ranjan in Rs. 2,000 to be paid on demand, for value received.'

(B) The following are not promissory notes:

(i) 'Mr. Suresh, IOU Rs. 500.'

(ii) 'l promise to pay Shiva Rs. 600 and all other sums which shall be due to him.'

(iii) I promise to pay Harish Rs. 1,000, first deducting there out any money which he may owe me.'

(iv) 'I promise to pay Vinod Rs. 700, and ten days after my marriage with Vimla.'

(v) 'I Promise to pay Tarun Rs. 600 on B's death, provided B leaves me enough to pay that sum.'

(vi) 'I promise to pay Naveen Rs. 800 and to deliver to him my Priya scooter on 1st December next.'

**Requisites or Essential Elements of Promissory Notes**

If we carefully examine the definition of the promissory note, we find the following special features are the essentials of a promissory note, i.e., the requirements of a valid promissory note:

**1. In writing:** A promissory note must be in writing. Any oral promise, through telephone or otherwise, is excluded from the definition of promissory note. No particular form of words is necessary but the words used must contain an unconditional undertaking to pay.

**2. A promise or undertaking to pay:** A promissory note must contain an express promise or undertaking to pay. The undertaking to pay may be inferred either from express words or by necessary implication. A mere acknowledgement of a debt is not enough to constitute a promissory note without promise to pay the debt. Thus the following are promissory notes as these contain an express promise to pay:

(a) 'I promise to pay Sikandar the sum of Rs. 2,000.'

(b) 'I acknowledge myself to be indebted to Raj in Rs. 7,000 to be paid on demand, for value received.

However, the following instruments are not promissory notes as there is no undertaking or promise to pay therein:

(a) 'Mr. Sameer, I owe you (I.O.U.) Rs. 500.'

(b) 'The amount which I have received today from you in cash is Rs. 500. The sum I am bound to pay you.'

**3. Definite and unconditional promise:** For the validity of a promissory note it is essential that the promise to pay contained in the note must be definite and unconditional. The promise to pay should not depend upon the happening of some uncertain event, i.e., a contingency or the fulfilment of a condition.

**Examples:** The following instruments are not promissory notes:

(i) 'I promise to pay Manjeet Rs. 1,000 by instalments with a promise that no payment shall be made after may death.'

(ii) 'I promise to pay Jitendra Rs. 1,000 on Ram's death provided he leaves me sufficient to pay the said sum.'

**4. Signed by the maker:** A promissory note must be signed by the maker, otherwise it would be incomplete and of no legal effect. The intention to sign must accompany the signature in all cases. It is essential that the maker should intend to subscribe to the terms of the document. It should be noted that a pro-note may be signed by an authorised agent of the maker.

**5. The parties to the promissory note must be certain:** The maker and the payee of a promissory note must be certain, definite and different persons. A note cannot be made payable to the maker himself.

Similarly, the instrument must point out with certainty the party who is to receive the money without stating the name of the payee, the promissory note will be invalid.

**6. The sum payable must be certain:** The sum expressed to be payable by a promissory note must be certain and definite. Thus, the following instrument would be invalid as promissory notes as not being for a sum certain:

(a) 'I promise to pay Shyam Rs. 500 and all other sums which may be due to him.'

(b) 'I promise to pay Harish Rs. 500 and all fines according to rules.'

(c) 'I promise to pay Bhima Rao Rs. 500 first deducting thereout any interest or money which he may own to me.'

It has to be noted that it is not necessary that the amount payable should be stated both in words and figures.

**7. Promise to pay money and money only:** The promissory note must contain a promise to pay money and money only. Money means legal tender money of India. A promise to pay something other than money or something in addition to money, would not constitute a valid promissory note. The following instruments are not valid promissory notes:

(i) 'I promise to pay Rakesh Rs. 500 and to deliver 500 kg. of Sugar.'

(ii) 'I promise to pay Han Rs. 2,000 worth of shares.'

**8. Intention and delivery:** The maker of a promissory note, while signing it, must affix his signature so as to show the intention to make a promissory note, and not a receipt, etc. Sections 46 and 48 bring out that a promissory note is of no legal effect, till it has been delivered. Even endorsement on it, is not sufficient until the note has been delivered either actually or constructively.

**9. Other formalities:** There are certain other formalities, such as number, date, place, consideration, attestation. etc., which are usually found in a promissory note, but they are not essential in law. The omission to mention date and place where it is made or where it is payable, does not invalidate the instrument. Similarly, the omission of these words: 'for value received, 'does not invalidate the promissory note, because as per Section 118, consideration is presumed to exist. It is also not necessary

to include the words 'on demand' in the language of the promissory note. However, it must be properly stamped under the Indian Stamp Act, 1899.

Specimen of a Promissory Note

Rs. 3,000

Delhi

October 8, 2018

Three months after date, I promise to pay Madhukar or order the sum of Rs. 3,000 (rupees three thousand only) with interest @ 13% per annum thereon, for value received.

To,

Madhukar

56, Dilshad Garden, (Stamp)

Delhi-110 095 Sunil Jindal

### 16.3.2 BILL OF EXCHANGE

Section 5 of the Negotiable Instrument Act defines a 'bill of exchange' as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

Generally, a bill of exchange is drawn by a creditor (who supplied some goods on credit), who directs his debtor (who purchased goods on credit) to pay the money to the person specified in the instrument.

**Parties to a bill of exchange:** Usually, there are three parties to a bill of exchange as follows:

**1. Drawer:** He is the maker of a bill of exchange (Section 7). He gives the order to pay.

**2. Drawee:** The person who is directed by the drawer to pay, is called drawee (Section 7). He is the person on whom the bill of exchange is drawn and who accepts it. Before its acceptance by the drawee, the bill of exchange is sometimes called 'draft' the 'draft' is called a bill of exchange. The drawee, therefore, is also called 'acceptor' of the bill of exchange.

**3. Payee:** The person named in the instrument, to whom or to whose order the money is directed to be paid, is called the payee (Section 7). The term 'payee' is used in a restricted sense and it does not include the term 'endorsee'. Neither does it include the term 'endorser'.

It may be noted that in some cases, the drawer and the payee may be the same person, for example, when a person draws a bill stating as 'Pay to me or my order' the drawer and the payee are the same person. Similarly, where during its circulation the bill is subsequently (afterwards) endorsed in favour of the drawer. The only requirement in the case of a bill of exchange is that the three parties mentioned above must be pointed out in the bill with certainty. Thus, it is not necessary that the drawer, the drawee and the payee must be three separate persons.

**Drawee in case of need:** According to Section 7, when in the bill or in any endorsement thereon, the name of any person is given in addition to the drawee, to be resorted to in case of need such person is called a 'drawee in case of need'. The purpose of such an additional drawee is that he should be approached for acceptance or payment of the bill if it is dishonoured by the original drawee either by non-acceptance or by non-payment.

**Acceptance for honour**: Section 7 states that when a bill of exchange has been noted and protested for non-acceptance or for better security, and any person accepts it for 'honour of the drawer' or of any one of the endorsers, such person is called the 'acceptor for honour'. Thus, any person may voluntarily become a party to a bill of exchange as a 'acceptor for honour'.

**Acceptance of a bill:** The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The essentials of a valid acceptance are that: (i) it must be written on the bill, and (ii) it must be signed by the drawee. The usual form in which the drawee accepts the bill is by writing the word 'accepted' across the face of the bill and signing his name underneath. However, the mere signature of the drawee without the addition of the word 'accepted' is a valid acceptance. What is material is the true intention of the drawee when he signs the bill.

**Specimen of a Bill of Exchange**

Rs. 5,000

Nagpur

November 20, 2018

Three months after date, pay to Sharad Kumar or order, the sum of Rs. 5,000 (rupees five thousand only), for value received.

To,

| | | |
|---|---|---|
| Rakesh Kumar | Accepted | (Stamp) |
| 47, Esplanade Road, | Sd. Rajesh Kumar | Sd. Ganesh Laj |
| Bhopal | | |

In the above bill, Ganesh Lal of Nagpur is the drawer, Rakesh Kumar of Bhopal is the drawee and acceptor, and Sharad Kumar is the payee. If it is to be made 'a bill with a drawee in case of need,' then the word's in case of need with: 'The Central Bank of lndia, Bhopal' shall be written below the name and address of the drawee in the bill.

**Essentials of a Bill Of Exchange**

It has to be noticed that the fundamental ingredients of a bill of exchange are also the same as those of promissory note and for most purposes, the rules as applied to promissory notes are applicable to bills of exchange. Thus, the essential requirements of a bill may be summarised as follows:

**1. The bill of exchange must be in writing:** It may be written in any language and any form of words may be used.

**2. The bill of exchange must contain an order to pay:** It is of essence of a bill that the drawer orders the drawee to pay the money to the payee and the presumption is that there are funds in the hands of drawee to whom the order is given, which are payable in any case to the drawer or his order. It is necessary that an order must be in imperative terms.

**3. The order must be unconditional:** The order to pay must not depend upon a condition or upon the happening of an uncertain event. However, it has to be noted that according to Section 5 an order to pay does not become conditional if the time for payment of the amount is expressed to be on the lapse of a certain period after the occurrence of a specified event which is certain to happen according to the ordinary expectation of mankind, although the time of its happening may be uncertain. The following instruments are not bills of exchange, which contain an order to pay:

(i) 'Sixty days after the arrival of 'Vijay' ship at Kolkata;'

(ii) 'Thirty days after sight or when realised;'

(iii) 'When you are in prosperous circumstances.'

**4. The bill must be signed by the drawer:** If a bill without the drawer's signature is accepted by the drawee and is negotiated to a third party, such an instrument is not bill of exchange. However, the signature may be added at any time after the issue of the bill; but until it is so added, the instrument remains inchoate and ineffectual.

**5. The parties to the bill must be certain persons:** The drawee must be named or otherwise indicated in the bill with reasonable certainty. A bill cannot be addressed to two or more drawees in the alternative, because it could create difficulties as to recourse. A bill cannot be drawn payable to bearer on demand (Section 31; Reserve Bank of lndia Act, 1934).

6. The sum payable must be certain.

7 The bill must contain an order to pay money and money only

8. The bill must comply with the formalities as regards date, consideration, place attestations, stamp, etc.

It has to be noted that of exchange being an order upon the drawee to pay the money, is not binding on him unless he accepts it. However, the acceptance of a bill is not necessary for its validity. In case a bill is not accepted, it does not become invalid, but it only becomes dishonoured by non-acceptance.

**Distinction between a Bill of Exchange and a Promissory Note**

The following points of distinction between a bill and a promissory note may be identified:

**1. Number of parties:** In a pro-note, there are only two parties–maker and payee; whereas in a bill, there are three parties–drawer, drawee and payee. However, in a bill of exchange the drawer and payee may be the same person; and in that case there will be only two parties. It may be noted that in a pro-note the maker and payee cannot be the same person.

**2. Promise and order to pay:** In a pro-note, there is an unconditional 'promise to pay' to the payee or his order; while in a bill there is an unconditional 'order to pay' to the payer or his order.

**3. Acceptance:** A pro-note does not require any acceptance of the maker before it is presented for payment because it is signed by the person who is primarily and absolutely liable to pay; but a bill generally requires the acceptance of the drawee before it is presented for payment.

**4. Maker's position:** It may be noted as follows: (i) If a pro-note, the maker stands in an immediate relationship with the payee, whereas in a bill, the maker (i.e., the drawer) stands in an immediate relationship with the drawee (i.e., the acceptor) and not the payee.

(ii) The liability of the maker of a pro-note in primary and absolute; while the liability of the drawer of bill is only secondary and conditional because it arises only when the acceptor does not pay the bill (Section 30)

(iii) As the maker of a pro-note is himself the creator of it, he cannot make it conditional; whereas in the case of a bill, the acceptor may accept it conditionally. (Section 86)

**5. Notice of dishonour:** In case of a promissory note, there is no need to give a notice of dishonour to the maker because he himself dishonour it; whereas in case of dishonour of a bill either by non-acceptance or by non-payment, due notice of dishonour must be given to all the persons who are to be made liable to pay. (Section 93)

**6. Payable to maker:** A promissory note cannot be made payable to the maker himself as he himself is the originator or creator of it and promise to pay on it; while in a bill, the drawer and payee may be one and the same person.

**7. Payable to bearer:** A promissory note cannot be drawn 'payable to bearer', whereas a bill exchange can be made payable to bearer though f cannot be made payable to bearer on demand'.

**8. Exclusive applicability of certain provisions:** The following provisions relating to bills do not apply to promissory notes, namely : (i) presentment for acceptance Section 61), (ii) acceptance (Section 75), (iii) acceptance for honour (Section 108), and (iv) bills in sets (Section 132).

**9 Copies:** Only one copy of promissory note is drawn; whereas foreign bills of exchange are drawn in sets of three.

**10. Protest:** No protest is required m case of a pro-note; while foreign bills must be protested for dishonour when such protest is required by the law of the place where the bills are drawn.

**Bills in Sets**

Section 132 provides that a bill, instead of being as one document, sometimes drawn in several parts, especially when it has to be sent from on country to another. This is known as drawing a bill 'in a set'. The object of drawing a bill in a set is to avoid the delay and inconvenience which may arise from

the loss or miscarriage of it, and to facilitate the most prompt and speedy presentment for acceptance and payment. It is entirely the drawer's option whether the bill is to drawn in a set or not.

According to Section 132, each of the part of a bill in a set, is required to be numbered and must refer to the other parts but all the parts together make a set, in law the whole set constitutes a bill. If one part of a set omits reference to the rest, that part becomes a separate bill if it gets into the hands of a bona fide holder, because the reference in each of these parts to the other parts of the set, is in the nature of a condition of payment, i.e., that it shall be payable only so long as the other parts remain unpaid. The entire bill is discharged when payments is made on one of the parts.

Where a bill is drawn in a set, the drawer should sign each part and must deliver all the parts, but the acceptance is to be conveyed only on one of the parts. But where one part is sent to the drawer for acceptance, all the remaining parts must be handed over to the payee. Only one part is required to be stamped.

According to Section 7, the acceptance of a bill, having more parts than one (i.e., drawn in a set), may be written on any on part but one part only. Thus, if the drawee accepts more than one part, and such accepted parts get into the hands of different holders in due course the drawee is liable on every such part as if it were a separate bill. Similarly, an endorser would be liable on all such parts when he endorses two or more parts in favour of different persons.

Section 133 provides that as between holders in due course of different parts of the same set, he who first acquired title to his part is entitled to the other parts and the money represented by the bill as the true owner of the bill. However, this right will not affect the rights of the person who in due course accepts or pays the first part presented to him.

**Specimen of a Bill in a Set**

First copy Delhi

Rs. 5,000 December 15, 2018

Three months after sight of this FIRST OF EXCHANGE (second and third of the same tenor and date being unpaid), pay to David Hampton or order the sum of Rs. 5,000 (rupees five thousand only), for value received.

To Harold Joan (Stamp)

California Satendra Kumar

### 16.3.3 CHEQUE

Section 6 defines a 'cheque' as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

**Explanation** 1(a) to Section 6 states that for the purpose of this Section, the expression "a cheque in the electric form" means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

**Explanation** 1(b) to Section 6 of the Negotiable instrument Act states that "a truncated cheque" means a cheque which is truncated (cut short in processing steps) during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payments, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

The above definition implies that it must be drawn in accordance with the requirements of Section 5 of the Act. Accordingly, a cheque must be signed by the drawer, and must contain an unconditional order on a specified banker for payment on demand of a certain sum of money to or to the order of a specified person or to the bearer of the instrument. All cheques are bills of exchange, but all bills of exchange are not cheques. It means that all cheques are bills of exchange because they possess all the essential requirements of a bill, but all bills of exchange are not cheques because cheques have their distinctive features which are not found in bills of exchange.

This may be explained as follows:

1. A cheque is always drawn on a banker.

2. It is always payable on demand.

3. A cheque does not require acceptance.

4. Cheques can be drawn on the bank with which the drawer has an account. Bank usually provides printed cheques bound in the form of a book to their customers. The drawer has only to fill it up and sign.

5. Cheques may be made payable to 'self' i.e., the drawer himself, unlike a bill or pro-note, a cheque may be made payable to bearer on demand.

6. If a cheque is dishonoured, the holder has no remedy against the bank who is liable only to the drawer.

7. A cheque is not invalid simple because it is post-dated or ante-dated. Usually, it is valid for a period of 6 months. If follows that cheque must be dated. Such a date may be the date of Sunday or a holiday.

8. A cheque may be crossed and then its payment cannot be received at the bank counter, and has to be credited in the account of the payee.

9. A cheque may be in the form of an electronic image of a truncated cheque.

10. A cheque may be in the electronic form.

A cheque has three main parties: a drawer who is the maker of the cheque; a drawee who is a bank with which the drawer has his funds deposited in an account; and a payee to whom the amount of cheque is payable. The payee may be the drawer himself.

**Distinction between a Cheque and Bill of Exchange**

Although a cheque is kind of a bill exchange and therefore, it must satisfy the essential requirements of a bill, yet the following points of difference between the two may be noted with care:

**1. Drawee:** A cheque is always drawn on a bank and hence only a bank can be a drawee; whereas a bill may be drawn on any person including a bank.

**2. Acceptance:** A cheque does not require any acceptance by the drawee before the demand of the payment. It is presented for payment and not for acceptance. It is intended for immediate payment; while a bill must be accepted by the drawee before he can be made liable to pay upon it.

**3. Payment:** A cheque is always drawn payable on demand; while a bill either can be payable on demand or after the expiry of a certain period after date or sight.

**4. Presentment:** The drawer of a cheque is not discharged from liability if the cheque is not presented to the bank unless he suffers injury or damage by delay in presentment for payment, for example, by the failure of bank, whereas a bill must be duly presented for payment otherwise the drawer will be completely discharged from liability.

**5. Days of grace:** A cheque is payable immediately on demand without any days of grace being allowed because it is always payable immediately on presentation for payment; while in the case on a time bill, 3 days of grace are allowed from the due date within which the payment can be made. However, in the case of a bill payable on demand, no days of grace are allowed.

**6. Payable to bearer on demand:** A cheque can be drawn payable to bearer on demand; whereas a bill payable to bearer on demand is absolutely void and illegal under Section 31 of the Reserve Bank of India Act, 1934.

**7. Notice of dishonour:** If a cheque is dishonoured, no notice of dishonour is required; while notice of dishonour of a bill is to be given to all the parties liable to pay upon it and if such notice is not given, neither the drawer nor any other party will be liable for payment.

**8. Noting and protest:** In the case of dishonour of a cheque, it is not required to be noted and protested for dishonour; whereas in the case of dishonour of a bill there is a system of noting and protest for dishonour.

**9. Countermanding the payment:** A cheque is a revocable mandate and the authority may be revoked by the drawer by countermanding the payment, i.e., the drawer can ask the bank to stop the payment of the issued cheque. The payment of the bill cannot be counter mended by the drawer; i.e., the drawer cannot stop the other parties from making payment.

**10. Crossing:** A cheque may be crossed; but a bill cannot be crossed.

**11. Stamp:** A cheque does not require any stamp to be affixed thereupon; while a bill must be properly stamped under the provisions of the Indian Stamp Act, 1899.

**12. Use:** A cheque is generally used for inland payments; whereas a bill may be used both for inland or foreign payments.

**13. Forged signature:** In the case of a cheque, if the signature of the drawer has been forged and the bank has made payment of such a cheque in due course, then statutory protection is available to the paying banker and it is relieved from its liability; whereas if there is forged signature upon a bill on any party to the bill, then the person who pays the amount of the bill, does not get any statuary protection.

**14. Bank account:** A cheque can be drawn only by that person who has his current of savings account with the bank; while a bill can be drawn by any person whether he has account with the bank or not.

## 16.4 PARTIES TO A NEGOTIABLE INSTRUMENT

**Parties to a Promissory Note**

**1. The Maker:** The person who makes or executes the promissory note is called 'make'.

It should be noted that the maker of a bill or a cheque is called 'drawer'.

**2. The Payee:** The person to whom the payment of the instrument is to be made is called Payee.

**3. The Holder:** The original payee or any other person to whom the payee has indorsed the instrument is called the 'holder'. In case of bearer instrument, the bearer will be the holder.

**4. The Indorser:** 'Indorser' is the person who indorses or transfers the instrument. When the holder transfers the instrument he becomes the indorser.

**5. The Indorsee:** 'Indorsee' is the person to whom the instrument is indorsed or transferred.

**Parties to a Bill of Exchange**

**1. The Drawer:** The person who draws the bill or cheque.

**2. The Drawee:** The person on whom the bill is drawn.

**3. The Acceptor:** The person who accept the bill. The drawee when accepts a bill becomes 'the acceptor'. Ordinarily it is the drawee who accepts the bill. However, a stranger may accept a bill on behalf of the drawer.

He is called 'drawee' in case of need. Refer to the 'drawee in case of need' discussed later.

**4. The Payee:** The person to whom or to whose order the bill or note is payable. The drawer or any other person may be the payee.

**5. 6 & 7:** The Holder, Indorser and Indorsee are the same as in the case of a Promissory Note.

Drawer, Drawee and Payee–The maker of a bill of exchange or cheque is ca1led "drawer"; the person thereby directed to pay is called the "drawee" [section 7 para1]. .. The person named in the instrument, to whom, or to whose order the money is by the instrument directed to be paid, is called the "payee" [section 7 para 5]. ..However, a drawer and payee can be one person as he can order to pay the amount to himself.

**8. The Drawee in case of need:** Where the drawer is afraid that the drawee may not accept the bill, he may give the name of any person in addition to the drawee. Such a person is called 'drawee in case of

need'. In such a case it would be obligatory for the holder to present the bill to the drawee in case of need, if the original drawee refuses to accept the bill. Only when the drawee in case of need also refuses to accept or pay the bill, the bill will be considered dishonoured for non-acceptance or non-payment.

**9. The acceptor for honour:** As a rule, it is the drawee who can accept a bill. However, Sec. 7 provides that when a bill has been noted or protested for non-acceptance or for better security, any person who is not already liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour'.

**Parties to a cheque**

The drawer, drawee, payee, holder, indorser and indorsee are the same as discussed in case of a bill or note. However, it should be noted that in case of a cheque, drawee is always a specified bank in which the drawer has opened the account. Again in a cheque or bill the drawer and the payee may be one and the same person.

## 16.5 CHECK YOUR PROGRESS

State whether the following statements are true or false:

1. Negotiable instruments are easily transferable from one person to another without complying with any special formalities like writing a transfer dead, stamping.
2. The presumption of Negotiable Instrument Act is that the holder of a negotiable instrument is not a holder in due course.
3. Promissory note is an instrument in writing (note being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument.
4. The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer.
5. A cheque has five main parties.

## 16.6 SUMMARY

A written document which creates a right in favor of some person and which is freely transferable is a negotiable instrument. The Negotiable Instrument Act deals with the three specific classes of negotiable instruments namely promissory notes, bills of exchange and cheque. The Act does

not consider other kinds of instruments which have an element of negotiability in them. Easy negotiability is the unique features of negotiable instruments.

## 16.7 KEYWORDS

**Negotiable Instrument:** A written document which creates a right in favor of some person and which is freely transferable.

**Bills of Exchange:** As an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

**Cheque:** Cheque is defined as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

**The Payee:** The person to whom the payment of the instrument is to be made is called Payee.

## 16.8 SELF ASSESSMENT TEST

1. What is a negotiable instrument? What are its essential characteristics?
2. Mention the presumptions in respect of a negotiable instrument.
3. Define Bills of exchange. How does it differ from a Promissory Note.
4. What is a promissory note? What are its essential elements? Give a specimen of promissory note.
5. Define a cheque. What are its distinctive features? How does it differ from a bill of exchange?

## 16.9 ANSWERS TO CHECK YOUR PROGRESS

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

## 16.10 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 17 | |

# NEGOTIATION AND CROSSING OF CHEQUE

## STRUCTURE



## 17.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define negotiation and explain the different modes of negotiation.
- Understand the importance of different kinds of indorsements.
- Explain the different modes of crossing of cheques.

## 17.1 INTRODUCTION

When a negotiable instrument is transferred to any person with a view to constituting that person the holder thereof, the instrument is deemed to have been negotiated. A negotiable instrument may be transferred in either of the two ways, viz., (1) by negotiation under the Negotiable Instruments Act and

(*ii*) by assignment of the instrument as an ordinary chosen in action under the Transfer of Property. Transfer by negotiation, however, is the only mode of transfer recognized by the Act.

## 17.2 TRANSFER OF NEGOTIABLE INSTRUMENT AND MODES OF NEGOTIATION

**Transfer of Negotiable Instrument**

Easy transferability is one of the important characteristics of a negotiable instrument.

An instrument may be transferred:

1. by assignment, or

2. by negotiation.

**1. Transfer by assignment.** A negotiable instrument can also be transferred by assignment. Assignment means transfer of ownership by a written document under the provisions of the Transfer of Property Act, 1882.

**Example.** A executed a promissory note in favour of B. B sold this note by assignment under a sale deed to C. C sued A to recover the amount. A contended that since C was not a holder in due course, no suit was maintainable. The Court held, although C was not a holder in due course, yet he is a holder within the meaning of See. 8 as he is in possession of the note and as an assignee entitled to recover the amount in his own name. Hence, an instrument can be transferred by assignment. But a transferee acquires only those rights which the transferor had at the time of assignment and no more. [*Narshing Panda v. N. Narsimha Murthy* (1966) Orissa 194].

**2. Transfer by negotiation (Sec. 4).** When a note, bill or cheque is transferred to any person, so as to make that person holder of the instrument, the instrument is said to be negotiated.

**Mode of Negotiation**

Following are the modes of negotiation:

**(i) Negotiation by delivery** (Sec. 47). The transfer of a negotiable instrument payable to bearer can be effected by mere delivery.

**Example**. A, the holder of a negotiable instrument payable to bearer, delivered it to B's agent to keep it for B. The instrument has been negotiated.

**(ii) Negotiation by indorsements and delivery** (Sec. 48). A negotiable instrument, payable to order, is negotiable by the holder, by indorsement and delivery thereof.

**Example.** A holds a cheque payable to order. A signs on the back of the cheque and writes 'Pay B'. Thereafter, A delivers the cheque to B. It is negotiation by indorsement and delivery.

**Significance of Delivery**

The term 'delivery' is very important in negotiation. Delivery here means actual or constructive delivery with an intention of transferring property in the instrument. If the instrument is executed but is not delivered, there is no negotiation.

**Examples. 1.** A person executed a promissory note but died before delivering it to the payee. The promissory note was found in his papers and it was delivered to the indorsee. There is no negotiation and payee cannot recover the amount.

**2.** Similarly, when an instrument payable to bearer was accidentally list and picked up by a passer-by X, the passer-by did not acquire any title. However, if he transfers it, say, to Mr. Y, who takes it for value and in good faith, he (Y) will acquire a good title to the instrument.

**Kinds of Delivery**

Delivery may be (1) actual, (2) constructive, (3) conditional, or for special purpose.

**1. Actual delivery.** Actual delivery means physical transfer.

**2. Constructive delivery.** Constructive delivery means delivery in effect. It may happen when the instrument is held by one party as an agent for both the parties.

**Example.** Both A and B have their accounts in X Bank. A, the holder of a negotiable instrument payable to bearer, directs the banker to transfer the instrument to B's credit IN B's account, with the bank. The banker does so, and accordingly now possesses the instrument as B's agent. In this case there is a constructive delivery.

**3. Conditional delivery or delivery for a special purpose.** It is common to deliver-instrument conditionally or for a special purpose. If condition is not fulfilled, the transferee will not acquire any title. However, if it is negotiated to a holder in due course, he will acquire a good title.

**Example.** A, the holder of a bearer negotiable instrument, gave it to a bank for collection. The bank, negotiated it by delivery to B. B will not acquire any title. However, if B transfers the instrument to C, a holder in due course, C will acquire a good title.

**Distinction between Negotiation and Assignment**

| | Negotiation | Assignment |
|---|---|---|
| **1. Act** | It is effected under the Negotiable Instruments Act, 1881**.** | It is effected under the Transfer of Property Act, 1882. |
| **2. Formality** | No formality is necessary as such it can be effected by delivery or by indorsement and delivery. | It must be in writing under the provisions of the Transfer of Property Act, 1882. |
| **3. Notice** | No notice of negotiation by the transferor to the debtor is necessary. | Notice of assignment to the debtor must be given to make assignment legally effective. |
| **4. Defect of title** | A holder in due course, i.e., the transferee is not affected by the defect of title of - the transferor, as such he acquires a better title. | A holder i.e., the transferee is affected by the defect of title of the transferor, as such transferee will not get a better title than that of the transferor. |
| **5. Consideration** | Consideration is presumed in case of negotiation. | Consideration is not presumed but has to be proved in case of assignment. |

## 17.3 INDORSEMENT

Indorsement is the means of negotiation, i.e., negotiation is effected by indorsement.

When the maker or holder of a negotiable instrument signs the same, otherwise than such maker, for the purpose of negotiation on the back or face thereof or on a slip of paper annexed thereto, he is said to indorse the same.

This slip of paper is called ‘allonge’. The person who indorses is called the ‘indorser’. The person to whom the instrument is indorsed is called the ‘indorsee’.

**Essentials of a valid indorsement**

**1. Indorsement must be on the instrument.** It may be on the face or back of the instrument. In case there is no space left, then it may be on a slip of a paper called allonge. But assignment of a note by a separate writing is not Indorsement.

**2. It must be signed.** The indorsement must be signed for the purpose of negotiation. Mere signature without any additional words are sufficient. It should be noted that where the name of the indorsee is spelt wrongly, the signature must be done in the same spellings and correct spellings be given within brackets. If the additional words like 'assign or "made over" etc. are used, intention of the parties is to be seen. An express promise in writing by indorser of a bill is not an indorsement.

**3. Indorsement of an instrument is completed only by delivery** by the indorser with the intention of passing the property in the instrument. The delivery may be actual or constructive. In case the delivery of an instrument is not given, the indorsement will not be effective. Delivery must be made by the indorser himself or by someone on his behalf, otherwise it will not be valid.

**Example.** A executed a promissory note but before delivering it, he died. Held, his legal representative could not deliver the promissory note, so as to complete the. instrument. Legal representative is not an agent of the deceased, as such he cannot complete the delivery.

**Who can make indorsement ?** As a rule, only the parties to the negotiable instrument can make indorsement. A stranger, therefore, cannot make indorsement in our country. However, the English Bills Act recognises a stranger and he will be liable as an indorser. Sec. 15 provides that when the maker or holder of the negotiable instrument signs the same, otherwise, than as such maker, for the purpose of negotiation on the back or face of the instrument or on a slip, he is said to indorse the instrument.

*The following persons can make indorsement:*

1. Thus maker or holder can indorse an instrument. It should be noted in the case of maker that when he signs for the first time as a maker, he is not indorsing the instrument. It is only the second time, when he signs for the purpose of negotiation, he is said to make the endorsement.

2. In case the maker does not make the endorsement, the payee can make the first endorsement. Thereafter, any subsequent holder can indorse and negotiate the instrument.

3. Every maker, drawer, payee or indorsee can indorse.

4. In case of joint makers, drawers, payees or indorsers of the instrument, indorsement can be made by all or several joint makers, etc.

It should be noted that a payee or indorsee can indorse the instrument only if he is a holder, otherwise not.

**Kinds or types of indorsements**

An indorsement may be: 1. blank or general, 2. full or special, 3. restrictive, 4. partial, or 5. conditional or qualified.

**1. Blank or general** [Sees. 16(1) and 54]. If the indorser signs his name only on the instrument, the indorsement is said to be in blank. It is also celled general indorsement because blank indorsement does not specify the name of any particular indorsee but is indorsed in general. By a blank or general indorsement an instrument becomes payable to bearer. As such, property in the instrument passes merely by its delivery, even if the instrument was originally payable to order.

It should be noted that a crossed cheque cannot be indorsed in blank, so as to make it payable to bearer (Sec. 54).

**2. Full or Special Indorsement** (Sec. 16). If the indorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the instrument is said to be indorsed in full.

**Example.** X received a cheque 'pay X or order'. X writes on the back of the cheque 'pay Y' and below it puts his signature. It is a full or special indorsement.

**SPECIMEN**

| | |
|---|---|
| Pay Y | Pay Y or order |
| Sd/-X | Sd/-X |

**Conversion of blank or general indorsement into full or special indorsement** (Sec. 49). A blank or general indorsement can easily be converted into a full or special indorsement. The holder of a negotiable instrument indorsed in blank may, without signing his own name, write the name of any person above the signature of the indorser. It should be noted that to convert a blank indorsement into full, the holder has not to sign the instrument, he has only to write the name of any person above the signature of the indorser. Since his signature does not appear on the instrument, he is not liable to any party on the instrument.

**Examples.** A holds a cheque indorsed in blank by B.

Sd/- B

Now A can write C's name above B's signature as follows:

| | |
|---|---|
| Pay C | Pay C or order |
| or | |
| Sd/-B | Sd/-B |

From the above, it would be noticed that A has not put his signature on the cheque, he has only added the words 'pay C' above B's signature. A is not liable to B or C as his name 'does not appear on the instrument.

Needless to say that when an instrument is converted from blank indorsement into full, it ceases to be payable to bearer and it becomes payable to order. It cannot be negotiated by mere delivery but by endorsement and delivery.

**Effect of blank indorsement followed by an indorsement** in full (Sec. 55). Distinction should be made between a blank indorsement being converted into a full indorsement and a blank indorsement followed by an indorsernent in full. In the latter case, i.e., indorsement in blank followed by an indorsement in full, the instrument continues to be payable to bearer as the rule is "once a bearer always a bearer". As such ownership of the instrument can be transferred by mere delivery and it still remains payable to bearer, as against all parties prior to the indorsement in full. The indorser in full only is liable to a holder, who got title directly through his indorsement and person deriving title through such holder.

**Example.** A is the payee-holder of a bill. A indorsed it in blank and delivered it to B. B indorsed it in full to C or order. C without indorsement transfers the bill to D. D as the bearer is entitled to receive payment or to sue the drawer, acceptor or A who indorsed the bill in blank, but he cannot sue B or C.

It may be recalled that D derives his title through the blank indorsement by A and neither from the full indorsement by B nor from the blank transfer by C.

Accordingly, an amendment has been made in Sec. 85 by adding Clause (2). The object of this amendment is to provide that cheques originally drawn to bearer shall not lose their bearer character notwithstanding any indorsement thereon whether in full or in blank and whether such indorsement purports to restrict or exclude further negotiation or not. As such the bank is justified to ignore or disregard any subsequent indorsement in full or in blank on a cheque, originally payable to bearer.

**3. Restrictive Indorsement.** An indorsement which restricts or prohibits further negotiability is a restrictive indorsement.

The indorsement (or indorser), may by express words, restrict or exclude such right, or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser, or for some other specified person (Sec. 50).

**Examples.** B signs the following indorsements on different negotiable instruments payable to bearer:

(a) "Pay the contents to C only". (b) "Pay C for my use". (c) "The within must be credited to C".

The above indorsements exclude the right of further negotiation by C.

(a) "Pay C". (b) "Pay C value in account with the Oriental Bank". (c) Pay the contents to C, being part of the consideration in a certain deed of assignment by C to the indorser and others"

The above indorsement do not exclude the right of further negotiation by C. The effect of restrictive indorsement is that the indorsee has the right to receive payment but he cannot further negotiate it. Again, it should be noted that such an instrument can further be transferred but the transferee will not acquire a good title. Thus it will lose its negotiability.

**4. Partial Indorsement.** An indorsement which purports to transfer only a part of the amount, of the instrument, to the indorsee, is a partial indorsement.

Such an indorsement is not valid in view of the provisions of Sec. 56 which prohibits partial indorsement.

**Example.** A holds a bill accepted by B for Rs. 100. He indorses it "Pay C Rs. 50". This is not valid.

The underlying reason is that it is not practicable to transfer part of the amount. The instrument can be transferred as a whole. However, in case amount due on the instrument has been partly paid, it may be negotiated for the balance by noting the fact of part payment on the instrument.

**Example.** If in the above bill, acceptor B, pays Rs. 50 it may be indorsed for Rs. 50 by writing on the bill, "Received rupees fifty only and indorsed for the same".

Sd/-A.

**5. Conditional or qualified indorsement.** An indorsement which limits or negatives the liability of the indorser is a conditional indorsement. It is also called qualified indorsement.

It should be noted that there is a distinction between a restrictive indorsement and a conditional indorsement. A restrictive indorsement restricts negotiability of the instrument, whereas conditional indorsement does not restrict the negotiability, it only restricts the liability. Therefore, an instrument bearing restrictive indorsement, cannot further be negotiated. On the other hand, an instrument bearing conditional indorsement, can further be negotiated.

An indorsement may be made conditional or qualified in any of the following ways:

**(a) Sans recourse or without recourse indorsement (Sec. 52).** "Sans recourse" means without recourse or without liability. An indorser who does not want to take risk on the instrument may, indorse it sans recourse by adding the words "sans recourse" or "without recourse"

The indorsee is not liable to any party in case the instrument is dishonoured.

"Pay A or order sang recourse".

"Pay A or order without recourse to me".

Sec. 52 further provides that where an indorser after excluding his liability, again, subsequently, becomes the holder of the instrument, all intermediate indorsers are liable to him.

**Example.** A is the payee-holder of a negotiable instrument He transfers the instrument to B, excluding his liability by "without recourse" indorsement. B indorses it to C who indorses it to A. A is not liable to B and C but A as an indorser, can hold B and C liable.

**(b) Sans frais indorsement.** An indorser who wants to exempt himself from any liability for any expenses incurred on the instrument by any subsequent holder may make "Sans frais" indorsement.

"Pay B or order "Sans frais".

Sd/-A.

**(c) Liability dependent upon a contingency.** An indorser may make his liability dependent, upon the happening of an event, which may or may not happen.

It is generally done in the case of marine contracts. For example, where A purchases goods from B on board a particular ship coming from London to Mumbai, he may indorse a bill like this "Pay B on arrival of S. S. Himalaya" at Mumbai.

The liability of the purchaser is conditional on the happening of the event, i.e., arrival of 'S. S. Himalaya' at Mumbai. If the ship does not arrive, he is not liable.

It should be recalled that a promissory note cannot be made conditional and a bill cannot be drawn conditionally.

**(d) Facultative indorsement.** Just as an indorser can limit his liability, similarly, he may curtail or waive his rights.

"Pay A or order, Notice of dishonour waived" is a facultative indorsement. A can hold the indorser liable even if no notice of dishonour is given to him i.e., indorser, as he (A) has waived his right to such notice.

**Effect of cancellation of indorsement by the holder** (Sec. 40). Where the holder of a negotiable instrument, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability to the holder to the same extent, as if the instrument had been paid at maturity.

This rule is based on justice and equity. If the indorser's remedy is destroyed by the holder, he must suffer the loss.

**Example.** A is the holder of a bill of exchange made payable at the order of B, which contains the following indorsements in blank:

First, indorsement, "B".

Second indorsement, "Peter Williams".

Third indorsement, "Wright & Co".

Fourth indorsement, "John Rozario".

If A strikes out without *John Rozario's* consent the name of *Peter Williams* and Wright & Co., A cannot recover anything from *John Rozario*.

It should be noted that this section applies only to the liability of the indorser. It does not affect the liability of drawer, maker, etc.

**Negotiation back.** When an indorser of an instrument after negotiating it, again becomes its holder before its maturity, the instrument is said to be negotiated back to that indorser (or holder). In this case none of the intermediate holders, is liable to that holder.

The reason for this rule is very simple. The object of this rule is to prevent a circuitry of action.

**Example.** A, the payee-holder of a bill, indorsed it to B, B to C, C to D and D to E. E again indorsed the bill to A.

The bill has negotiated back to A who is a holder in due course. Now A cannot sue B or any of them.

Thus, it will be seen that if A is allowed to sue B, B to C and so on there will be circuity of action. There is no point in making intermediate indorsers (A, B, C etc.) liable to A as A himelf is ultimately liable. It will be an abuse of law which is not permitted by law. Hence, the rule of negotiation back will prevent circuity of action.

**Taking up of a bill.** A holder to whom a bill is negotiated back, may cancel the same or may further negotiate it with or without cancelling all the earlier indorsements. In case he further negotiates it, it is called taking up of a bill.

**Exception to Negotiation Back.** It should be recalled that in case of the above example, if A has made 'Sans recourse' indorsement, A can hold the other parties B, C, D and E liable but the other parties cannot hold A liable.

**Negotiation of Lost Instruments and Instruments Obtained By Unlawful Means Lost Instrument**

In case an instrument is lost, the following rules are applicable:

1. A finder does not acquire any title, as such he cannot recover payment from any party to the instrument, i.e., maker drawer, acceptor. The true owner can get it back.

2. If the instrument is payable to bearer, e.g., indorsed in blank and the finder indorses it to a holder in due course, the holder in due course will get a good title to it.

3. In case the person liable on the instrument, i.e., the maker or acceptor, makes payment of the lost instrument to the finder in due course, he is discharged. However, the true owner can recover the amount of the instrument from the finder of the instrument.

4. In case the lost instrument is payable to order and the signature of the payee are forged, the transferee will not acquire any title even if he is a holder in due course. For, a forgery can confer no title. As such payment made by the party liable to a person, who derives his title from a forged instrument, even if made in good faith will not discharge him.

5. A notice of loss to the public in general and to the parties to the instrument in particular, should be given to check its misuse.

6. The person who has lost a bill must make an application to the drawee for payment, at the time of maturity and give due notice of dishonour to all the parties liable, lest he should lose his remedy against the drawer and indorsers.

**Holder's right to get duplicate copy of lost bill** (Sec. 45 A). Where a bill of exchange has been lost, before maturity, the person who was the holder of it may apply to the drawer to give him another bill of the same tenor, giving security to the drawer, if required, to indemnify him against all persons, whatever due to the lost bill.

If the drawer on request refuses to give such duplicate bill, he can be compelled to do so in a Court.

It should be noted that this section applies to bills only and does not apply to notes. So far as cheques are concerned, those have been dealt with in the Chapter on 'Negotiable Instruments'

**Payer's right to have delivery of instrument on payment and of indemnity in case of loss** (Sec. 81). Any person liable to pay and called upon by the holder to pay the amount due on a note, bill or cheque is, before payment, entitled to have it shown, and on payment is entitled to have it delivered up, to him. In case the instrument is lost or cannot be produced, he is entitled to be indemnified, against any further claim against him.

**Instruments Obtained by Unlawful Means**

**Stolen Instruments**

If a person steals a negotiable instrument, he can neither enforce payment against any party to the instrument nor he can keep it with him. The true owner can always recover it from him. In case the thief gets the payment of the instrument, the true owner can recover the same from him.

**Effect of Negotiation**

**(a) Payable to bearer.** Where the stolen instrument is payable to bearer and the thief indorses it by delivery, the transferee, if he is a holder in due course, will acquire a good little.

**(b) Payable to order.** Where the stolen instrument is payable to order, a thief cannot transfer it, unless he forges the signature of the payee. A forgery does not convey any title; hence, even a holder in due course will not acquire a good title.

**Instruments obtained by fraud.** So far as a person other than a holder in due course is concerned, he does not acquire any title. However, in case the instrument is payable to bearer and reaches the hands of a holder in due course, he acquires a good title to the instrument. But in case the instrument is payable to order and the signature of the payee-are forged, even the holder in due course will not acquire any title.

**Instruments obtained for unlawful consideration.** A negotiable instrument given for unlawful consideration, creates no obligation between the parties e.g., a note given for bribery. The position is more or less the same as discussed in above cases.

**Instruments obtained without consideration** (Sec. 43). The position is the same even when there is partial failure of consideration. Where a party obtains an instrument without consideration, it cannot claim the amount of the instrument. However, if a holder in due course gets the instrument he acquires a good title and any party claiming thereafter, also gets a good title as it is purged of its defects.

**Forged Instruments.** An instruments is forged when it is made falsely or its writing is altered fraudulently.

**Example.** A indorses a bill to B. 'Pay B or order" and signs it. B erases the words 'Pay B or order" and thereby converts the special indorsement into a blank indorsement. This bill is a forged instrument.

It should be noted that a man's signature of his own name may amount to forgery.

**Example.** One Ram Lal picks up a bill of exchange, payable to another Ram Lal. He indorses the bill, intending to cause it to be believed that it was indorsed by the real Ram Lal to whose order it was payable.. Rain Lal has committed forgery.

A forgery is a nullity and does not convey any title. Even a holder in due course is not an exception. In case of forgery there is an absence of title as against defect of title. When an instrument passes through the hands of a holder in due course it is purged of all defects. In ease of forgery there is no defect of title but complete absence of title. Hence, forgery does not convey any title even to a holder in due course.

**Example.** A forged the signature of B on a cheque. Later on, he transferred the cheque to C. C takes it *bonafide* and for value. Although C is a holder in due course, yet he does not acquire any title.

**Forged Indorsements**

1. If the indorsement is in blank, the instrument can be indorsed by delivery only. Thus, A finds a cheque payable to bearer. He indorses it by delivery to B. B takes it bona fide and for value, i.e., B is a holder in due course. B will get a good title.

2. If the instrument is indorsed in blank originally and subsequently, any person forges further indorsement, in such a case, holder in due course will acquire a good title. The reason is that instrument is transferable by mere delivery and the holder claims his title, not because of forged indorsement but because of blank indorsement.

**Example** A holds a bill indorsed in blank by Rain.

Sd/- Ram

A delivers it to B. B delivers it to C. C forges B's signature and indorses it to D. D in the above case does not claim his title because of forged indorsement made by C but because of the blank indorsement by Rain. As such he can claim payment from any of the prior parties, in spite of the forged indorsement.

3. If the indorsement is in full, it can be negotiated by indorsement and delivery. In case of forged indorsement, the signature of the payee are forged, even the holder in due course will not acquire a good title in that case because forgery does not convey any title.

**Example.** A finds a bill payable to B or order. A forged B's signatures and indorsed it to C. C takes it bona fide and for value. C will not acquire a good title.

It should be noted that the term forged indorsement strictly speaking; means forging payees signature and it has no effect on an instrument which is indorsed in blank and is transferable by mere delivery.

## 17.4 CROSSING OF CHEQUES

Crossing is a device by which cheques are made payable only through a bank or a particular bank. It is a kind of direction to the paying bank to pay the money to bank or a particular bank, as the case may be. A cheque is said to be crossed when two parallel transference lines are drawn across the face of a cheque. Such lies are usually drawn on the top left hand corner of the cheque as show in the specimen below:

**Specimen of Crossing of a Cheque**

**____20**

**Pay ……OR BEARER**

**Rupees……Rs.**

**……..**

**A/c No. L.F INTES**

**Central Bank of india**

**Chandni Chowk, Delhi-110006**

**"094325" 110002245 10**

It may be noted that crossing may be written, stamped, printed or perforated on the face of a cheque.

**Effect of Crossing of a Cheque**

The crossing of a cheque affects the mode of its payment to the payee. Crossed cheques cannot be directly presented to the drawee banker for payment across the counter. They are required to be presented through a banker. In other words, the payment of a crossed cheque can be obtained through a bank account only. Thus, the holder of a crossed cheque must have got his personal account with some banker to receive its payment. The crossed cheque is, then deposited in the holder's account, and the bank collects its payment from the drawee bank on behalf and the credit of the holder. Then, the holder can withdraw money from his account. It has to be remembered that crossing is invariably done on the face of the cheque.

In case of a crossed cheque, the bank which collects the payment on behalf and for the account of the holder is called 'collecting bank'; and the bank which makes its payment is called 'paying bank' which is in fact the drawee of such a cheque.

It has to be noted that crossing of a cheque does not affect its negotiability (transferability). Thus, crossed cheques are negotiable by simply delivery if they are payable to bearer, and by endorsement and delivery if they are payable to order. Holder of a crossed cheque who has no account in any bank, can obtain his payment (if he does not want to open a bank account) by endorsing it in favour of some person who has got an account in the bank.

**Objects of Crossing of a Cheque**

The object of crossing is to secure payment to a collecting bank and not to any person at the counter of the paying bank, so that it may be easily traced, if so required, for whose use the money was received and to compel the holder to present it through a medium of known respectability and credit. Crossing operated as a caution to the paying bank. If a crossed cheque is paid at the counter of the paying bank, such bank has to make further payment of same amount to the true owner of the cheque. As a matter of fact, cheques are crossed in order to avoid losses most likely to arise from open cheques falling into the hands of wrong person, such as thieves, dishonest finders of lost cheques, etc. Such a wrong person may easily by traced in case of a crossed cheque, since he has to operate through a bank in every ease to obtain its payment.

**Forms or Modes of Statutory Crossing**

The Negotiable Instrument Act provides for two types of crossing of a cheque as follows:

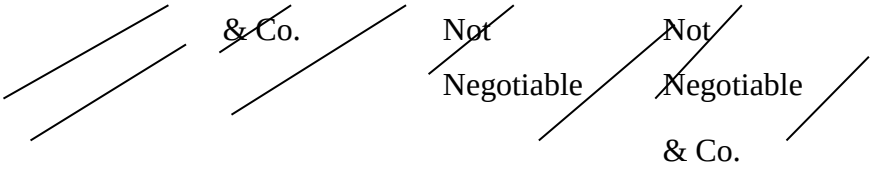
**1. General crossing:** Section 123 lays down that a cheque is said to be crossed generally when it bears across its face:

(i) an addition of the words "and company" or any abbreviation there of (such as '& Co.') between two parallel transverse lines, either with or without the words 'not negotiable'; or

(ii) two parallel transverse lines simply, either with or without the words 'not negotiable'

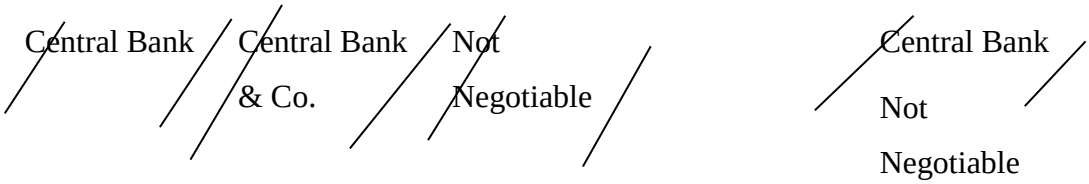
Such an addition on the face of a cheque shall be deemed a crossing, and the cheque shall be deemed to be crossed generally. However, it may be noted that there should not be the name of any bank between the parallel lines.

**Specimen of General Crossing of a Cheque**




**2. Special crossing:** According to Section 124, where a cheque bears on its face an addition of the name of a banker, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker. It may be noted here that the two parallel lines required for a general crossing are not necessary for special crossing.

**Specimen of Special crossing of a cheque**

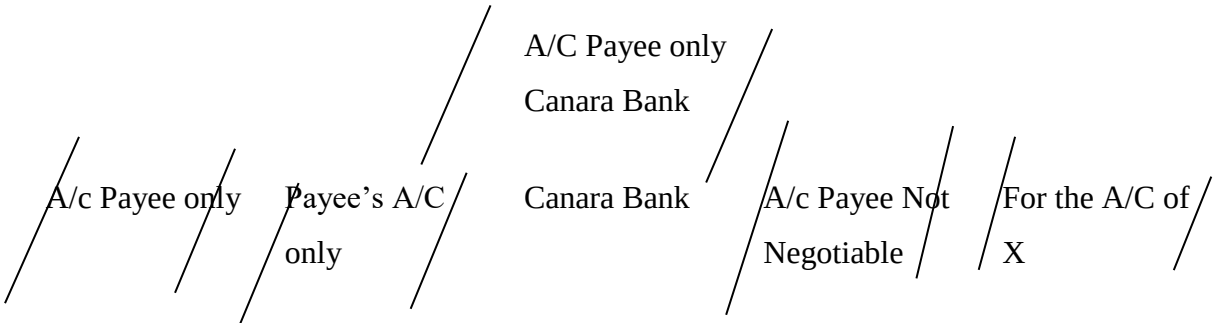



**Effect of the 'not negotiable' crossing:** The words 'not negotiable' used in a crossing of a cheque provide a further protection to the drawer or holder of a cheque against the dishonesty of wrong persons or against actual miscarriage in the course of transit. The words 'not negotiable' make it difficult to get cheque encashed until it reaches its destination. The addition of the words 'not negotiable' entirely takes away the main feature of negotiability, which is, that a holder with a defective title can give a good title to a subsequent 'holder in due course'. It means a person who takes up a cheque crossed 'not negotiable' has no better title than that of his immediate transferor. In other words, if the title of the transferor is defective, the title of the holder will also be defective. Section 130 clearly lays down that a person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable', shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from he took it had. It means that it the transferor of such a cheque is a thief, the holder in that case shall also be treated as thief and the true owner can always reclaim it or the amount of it, no matter what has been done to it. However, in such a case, the bank who pays the cheque and the bank who collects it both are protected, it the payment and the collection have been made in good faith and without negligence. It must be clearly understood that the crossing of cheque 'not negotiable' does not render the instrument-transferable, it only deprives the instrument of the incident of negotiability. Thus a 'not negotiable' crossed cheque remains transferable but loses the main characteristics of negotiability, that is, a 'better title'; if the transferor has a defective title, his transferee is affected by such defects and he cannot claim the rights of a 'holder in due course' by proving that he purchased the instrument in good faith and for value.

"It is very important that everyone should know that people who take a cheque which is upon its face not negotiable and treat it as a negotiable security, must recognize the fact that it they do so they take the risk of the person for whom they negotiate it, having no title to it."

As indicated above, the object of not negotiable' crossing is to protect the rights of the drawer or true owner of a cheque, because if such a cheque falls into the hands of a wrong person and from there it is transferred to a holder in good faith and for value, the true owner shall not lose his claim.

**Restrictive crossing:** In addition to the above mentioned two types of statutory crossing, the practice of crossing the cheques 'Account Payee' or 'Account payee only' or 'Payee's A/c only' has been in vogue for a long time. This type of crossing in usage is called 'restrictive crossing'. It may be done in case of general crossing or special crossing as follows:




Restrictive crossing acts as a warning to the collecting banker that the proceeds of the cheque are to be credited only to the account of the payee. If the collecting banker allows the proceeds of such a cheque to be credited to any other account, he may he held guilty of negligence in the event of an action for wrongful conversion of funds being brought against him. These words are not an addition to the crossing, but a mere direction to the collecting or receiving bank. They do not affect the paying bank who is under no duty to ascertain that the cheque in fact has been collected for the account of the person named as payee. The object of the words 'A/c Payee only' in a crossing is to give protection to the payee. Even if such a cheque is lost, no person other than the payee can get the payment of the same. It has to be noted that merely by restrictive crossing there is no prohibition on the endorsement of the cheque.

In actual practice the restrictive crossing operates as a hindrance to negotiability of the cheque because no bank would like to collect it on behalf and for the account of any other person except the named payee. In the case of a cheque bearing 'Account Payee' general crossing, the paying bank needs only see that the cheque bears no other endorsement but that of the payee only, and that it is otherwise in order. But where the cheque bears 'Account Payee' special crossing, the paying bank must make the payment only to the bank named in the crossing.

The 'Account Payee' crossed cheque is different from a 'not negotiable' cheque to the effect that the transferee of such a cheque gets better title if he has taken it in good faith and for value, However, the negotiation (transfer) of such a cheque will not be effective in practice; because it has been proved that if any collecting bank collects the proceeds on an 'Account Payee' cheque for a person whose name does not appear on the cheque, then it will remain liable for negligence.

**Who may cross a Cheque?**

The following persons are authorised to cross a cheque:

**1. The drawer:** A cheque may be crossed generally or specially by the drawer. As per usage, he may cross it 'account payee' also.

**2. The holder:** Section 125 provides that where a cheque is issued uncrossed by the drawer, the holder may cross it generally or specially (and by usage, also restrictively i.e. 'account payee'). Where a cheque is crossed generally the holder may cross it specially. Where a cheque is crossed generally or specially, the holder may add the word 'not negotiable' (or the words 'Account payee only').

**3. The banker:** Section 125 provides that where a cheque is crossed specially the banker to whom it is crossed may again cross it specially to another bank, his agent, for collection. This is the only case whore the Negotiable Instrument Act allows a second special crossing by a banker and for the purpose of collection.

Thus, a holder and a banker are allowed for crossing after issue of a cheque. The crossing authorized by the Act is a material part of the cheque and it is, there for unlawful for any person to obliterate (remove completely) add to, or alter the crossing, except as allowed by Section 125 discussed above. It may be noted that a general crossing can be converted into special crossing by the holder but the special crossing cannot be converted into general crossing. If the holder converts the special crossing into general crossing by striking out the name of the banker, it will amount to material alteration which will render the cheque void under Section 87.

**Double crossing:** Where a cheque bears two separate special crossings on its face, it is said to have been crossed doubly. Section 127 allows a second special crossing only in one case where the banker in whose favour the second special crossing is made, is an agent of the first banker for collection purposes. It is necessary to specify in the second special crossing that the banker in whose favour it is made, is an agent for collection on behalf of the first banker. A paying bank will pay the cheque bearing double

crossing only when the second bank is acting in the role capacity of an agent of the first (collecting) bank and this fact has been made clear on the instrument. Double crossing is used by the bank in whose name the cheque has been crossed specially does not have a branch at the place where the cheque is to be paid, or intends to utilize some business opportunity by collecting through another bank. In all other cases, the paying bank should refuse to pay a cheque bearing double crossing.

**Specimen of Double Crossing of a Cheque**

Double Crossing

(Face of a Cheque)

| | | |
|---|---|---|
| Bank of Baroda | Bank of India | Canara Bank Delhi |

OR

Not Double Crossing

(Face of a Cheque)

| |
|---|
| Syndicate Bank<br>To<br>Bank of India<br>As agent for collection |

It may be noted from the above specimens that if a cheque has been crossed specially in the names of two branches of the same bank, then it is not deemed as double crossing, or when two name of separate banks appear on the face of the cheque but second bank is clearly indicated to be acting as agent of he first bank for collection, then also it is not to be treated as double crossing.

**Obliteration of a crossing:** When a wrong or unauthorized person removes or erases the crossing made on the face of a cheque in such a way that it may not be noticed in a normal or usual manner, such an act is called 'obliteration of crossing'. The sole purpose of obliteration of crossing is to commit dishonesty and to deceive the paying bank, because if the true holder of the cheque wants to remove the crossing, then he has a legal right to cancel or open the crossing.

Section 89 affords protection to a paying bank and he is discharged from his liability on a cheque the crossing of which has been obliterated or erased provided the following conditions are fulfilled: (i) the cheque does not appear at the time of its presentment for payment, to be crossed or to have had a

crossing which has been obliterated, and (ii) the payment is made in due course according to the apparent tenor of the cheque.

**Cancellation or opening of crossing of a cheque:** When the crossing of a cheque is legally deleted or taken away in an authorised and legal manner, it is called 'cancellation or opening' of crossing. Such a cancellation renders the cheque open, the payment of which may then be received at the counter of the bank. The drawer of a cheque can cancel its crossing. For the purpose of cancelling or opening the crossing, the drawer shall write the word 'pay cash' between two transverse parallel lines and then put his signature under them. Where the cheque is crossed specially without using two parallel lines, the drawer may write the words 'pay cash' under the name of the bank in whose name the cheque has been crossed, and also put his signature there. This procedure may be adopted after deleting the crossing by drawing by a pen a line through it. The drawer cancels the crossing usually on the request of the payee who makes such a request when he does not have a personal account with any bank and also does not want to open such an account. Cancellation of crossing is a 'material alteration' and therefore, the paying bankers should with the object of its own safety, satisfy himself by enquiring from the drawer regarding the cancellation of crossing.

**Payment of Crossed Cheques**

It has been indicated that the payment of a crossed cheque is not made in cash at the counter of the paying bank. The procedure for collection of payment differs on the basis of the type of crossing, which may be discussed as follows:

**1. Payment of cheque crossed generally:** Section 126 lays down that where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker (who is known as collecting banker).

**2. Payment of cheque crossed specially:** Section 126 provides that where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed or his agent for collection.

It may be noted that as there is no privity of contract between the holder and the drawee of a cheque, a bank incurs no liability to the holder for refusing to pay a crossed cheque. The bank is liable only to his customer, the drawer. Still Section 126 casts upon the banker the duty to pay the crossed cheque in a particular manner, and a breach of its provisions renders him liable to the true owner under Section 129.

**3. Payment of cheque crossed specially more than once:** Section 127 lays down that where a cheque is crossed specially to more than one bank, the bank on whom it is drawn shall refuse payment thereof. However, the drawee bank shall have to make payment to the second bank when the second bank to whom it is crossed is clearly mentioned on the face of the cheque as an agent of the first bank for the purpose of collection. In other words, payment of a cheque bearing double crossing will not be made by the paying bank in any case except when the second special crossing is made to an agent bank for the purpose of collection.

**Protection to Paying Banker**

A paying bank is one who makes payment of a crossed cheque. Thus, a paying bank is the drawee of a crossed cheque. Section 128 lays down that where the banker on whom a crossed cheque is drawn, has paid the same in due course, the banker paying the cheque, and (in case such cheque has come to the hands of the payee) the drawer thereof, both shall respectively be entitled to the same rights and be placed in the same position in all respects as they would have respectively entitled to and placed in, had the amount of the cheque been paid to and received by the true owner thereof. Thus, the bank on whom a crossed cheque is drawn must pay it in due course. In order that payment of a crossed cheque may amount to a payment in due course, it is necessary that the bank on whom it is drawn should pay it in good faith, during business hours, and without negligence, and in accordance with the aforesaid provisions of Section 126 i.e., if crossed generally then to any bank, or if crossed specially then to the banker to whom it is crossed or his agent bank for collection.

If a bank pays a crossed cheque in due course, he can debit his customer, the drawer, with the amount so paid, even though the amount of the cheque does not reach the hands of the true owner and is received by some wrong person from the collecting banker to whom the paying banker had made the payment. However, if the paying banker makes the payment in contravation of Sections 10 and Section 126 his protection is gone, and any loss occurred falls upon him. Section 129 provides for the consequences of contravening the rules laid down in Section 126 concerning the payment of cheques crossed generally or specially Section 129 states that the paying banker shall, if it makes payment of crossed cheque out of due course, i.e., makes an irregular payment, be liable to the true owner of the cheque for any loss which he may sustain owing to the cheque having been paid irregularly. It will happen so in either of the following two sets of circumstances, since in these cases the payment by the paying banker is considered to be out due course:

(i) Where a cheque bears a general crossing and even then it is paid by the paying banker at its counter, and not to a bank;

(ii) Where a cheque bears a special crossing and even then the paying banker makes its payment to banker other than the banker to whom the cheque is crossed or his agent bank for collection.

Another protection to the paying banker is provided under Section 89 that were at the time of presentment for payment, a cheque does not appear to be crossed or to have had a crossing which has been obliterated (removed completely), the banker making the payment thereof good faith, during business hours, and without negligence, shall be discharged from his liability on the cheque.

**Protection to Collecting Banker**

Section 131 affords protection to a collecting banker, i.e., a banker who collects a crossed cheque on behalf of a customer. It lays down that a banker who has in good faith and without negligence, received payment for a customer of a cheque crossed generally or specially to himself, shall not, in the case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.

Thus, the law provides that where a banker receives a crossed cheque from a customer for collection, and obtains payment of it on his customer's behalf, the fact that the customer's title to the cheque was defective would not render the banker liable in conversion to the true owner. The analysis of Section 131 reveals that the following essential conditions must be satisfied in order to avail the statutory protection by the collecting banker:

**1. The cheque must be a crossed one:** The protection applies only to crossed cheques, and the crossing must have been made before the cheque gets into the hands of the collecting banker. A banker to whom an uncrossed cheque is sent for collection, cannot claim the protection by crossing it himself.

**2. The payment must be collected for a customer:** The collecting banker must receive the payment of the crossed cheque for a customer. If the banker receives the payment for a person who is not a customer, he cannot obtain the protection.

**3. The banker must act as an agent of the customer:** The collecting bank must collect the payment of a crossed cheque as an agent of his customer. It means that the bank should not collect the cheque for himself as a holder in due course. It is, however, immaterial that the banker credits the customer's account before the amount is actually collected from the paying banker. In such cases also, the

collecting banker is protected, provided that the customer is not allowed to withdraw the amount until it is actually collected.

**4. The banker must act in good faith and without negligence:** The statutory protection to the collecting banker is available only when such banker acts in good faith and without negligence. An act is done in good faith when it is done honestly. The good faith is said or taken to be absent when there is recklessness indicative of want of proper care and attention.

## 17.5 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. Assignment means transfer of ownership by a written document under the provisions of the Negotiable Instrument Act.
2. Indorsement is the means of negotiation.
3. A blank or general indorsement can easily be converted into a full or special indorsement.
4. Where the stolen instrument is payable to order, a thief can transfer it, unless he forges the signature of the payee.
5. The crossing of a cheque affects the mode of its payment to the payee.

## 17.6 SUMMARY

Negotiation of an instrument is a process by which the ownership of the instrument is transferred by one person to another. There are two methods of negotiation i.e. negotiation by mere delivery and negotiation by indorsement. Indorsement means the writing of a person's name on the face or back of the negotiable instrument or on a slip of paper annexed thereto, for the purpose of negotiation. The person to whom the instrument is indorsed is called the indorsee. A cheque is said to be crossed when two parallel transverse lines, with or without any words, are drawn on the left-hand top corner of the cheque.

## 17.7 KEYWORDS

**Assignment:** Assignment means transfer of ownership by a written document under the provisions of the Transfer of Property Act, 1882.

**Indorsement:** It is the means of negotiation.

**Restrictive Indorsement.** An indorsement which restricts or prohibits further negotiability is a restrictive indorsement.

**Conditional or qualified indorsement.** An indorsement which limits or negatives the liability of the indorser is a conditional indorsement.

**Double crossing:** Where a cheque bears two separate special crossings on its face, it is said to have been crossed doubly.

## 17.8 SELF ASSESSMENT TEST

1. Define negotiation. Explain and illustrate the various types of indorsements.
2. Discuss the effect of forgery on a negotiable instrument.
3. Distinguish between
    a) Negotiation and assignment
    b) Restrictive and conditional indorsement
4. What is crossing of a cheque? Explain the modes of crossing by giving their respective specimens.
5. What are the objects of crossing of a cheque? Who may cross a cheque? Explain.

## 17.9 ANSWER TO CHECK YOUR PROGRESS

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

## 17.10 REFERENCES/SUGGESTED READINGS

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| Course Code: BCOM 303 | Author: Prof. Mahesh Chand Garg |
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| Lesson No.: 18 | |

# DISHONOUR AND DISCHARGE OF NEGOTIABLE INSTRUMENTS

## Structure



## 18.0 LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Describe the modes and consequences of dishonour of negotiable instruments.
- Explain the various ways in which discharge of parties may take place.
- Appreciate the importance of noting and protesting.
- Understand the consequences of dishonour of a cheque on account of insufficiency of funds.

## 18.1 INTRODUCTION

A bill of exchange may be dishonoured by non-acceptance (since only bills require acceptance) or by non-payment. A promissory note or cheque be dishonoured only by non-payment. Thus, 'dishonour' means to refuse to accept or pay a negotiable instrument when duly presented for the purpose. An instrument is dishonoured when a presentment is duly made and due acceptance or payment is refused, or cannot be obtained within prescribed time. So dishonour is refusal to accept or failure to pay a negotiable instrument.

When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties so as to make them liable on the instrument. However, in certain cases, which are mentioned below, such notice need not be given. Where it is necessary to give such a notice, and the holder fails to do so, he loses his right of action against the prior parties entitled to the notice of dishonour.

## 18.2 DISHONOUR

### 18.2.1 DISHONOUR BY NON-ACCEPTANCE

Section 91 lays down that a bill of exchange is said to be dishonoured by non-acceptance in the following cases:

1. When the drawee makes default in acceptance upon being duly required to accept the bill, or

2. Where presentment is excused, and the bill is not accepted; or

3. Where the drawee is incompetent to contract, the bill may be treated as dishonoured; or

4. Where the acceptance is qualified, the bill may be treated as dishonoured; or

5. Where the drawee does not accept the bill within 48 hours (exclusive of public holiday) from the time of presentment for acceptance (Section 63); or

6. Where the drawee is a fictitious person, or reasonable search the drawee is not found.

It is to be noted that where a 'drawee in case of need' is named in a bill of exchange or in any endorsement thereon, the bill is not dishonoured until is has been dishonoured by such drawee (Section 115).

Where a bill is dishonoured by non-acceptance, the holder gets an immediate right of recourse against the drawer and the endorsers, i.e., to hold the prior parties liable, without any need to wait till the maturity of the bill or to present it for

### 18.2.2 DISCHARGE BY NON PAYMENT

Section 92 provides that a promissory note, a bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same.

Again, a negotiable instrument is also dishonoured by non-payment when presentment is excused, and the instrument when overdue remains unpaid (Section 76). Moreover, when 'drawee in case of need' has also accepted the bill, the bill is to be treated as dishonoured when he also refuses to pay it.

### 18.2.3 EFFECT OF DISHONOUR

When a negotiable instrument is dishonoured, either by non-acceptance or bay non-payment, the holder thereof becomes entitled to sue the parties liable to pay thereon. The holder may sue the drawer and the endorser of a bill or cheque or the endorsers of a promissory note, either severally or jointly. However, he has to give a notice of dishonour to all parties liable to him under the instrument. He may also get the instrument 'noted' or 'protested' for dishonour. The holder then files a suit against the part liable, to recover the amount.

### 18.2.4 NOTICE OF DISHONOUR

When a negotiable instrument is dishonoured either by non- acceptance or by non-payment, the holder or some party liable thereto must give notice of dishonour to all other parties whom he seek to make liable thereon. If such notice is not given, all the prior parties liable thereon are discharged of their liability, unless the notice of dishonour has been excused. Further, each receiving the notice of

dishonour must, in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time after receiving it.

The object of notice of dishonour is to inform the party liable on the instrument about the fact of its dishonour and the liability which accrues as a consequence of such dishonour. The notice of dishonour is so essential that failure to give notice discharges all parties other than the maker or the acceptor. These parties are discharged not only on the instrument but also in respect of the original consideration. Notice must be give in all cases, for example, whether the instrument is payable on demand, at sigh, after date, after sight, or whether it is an accommodation bill.

**Rules regarding Notice of Dishonour**

The rules for giving notice of dishonour are the same whether it is dishonour by non-acceptance or by non-payment. The rules are as follows:

**1. Notice by whom:** Section 93 lays down that notice of dishonour may be given by the holder or by any of the parties liable on the instrument to the prior parties. The agent of any such party may also give notice. Notice may also be given by the party liable on the instrument to other parties whom the holder intends to make liable.

Section 96 provides that when an instrument is deposited with an agent for presentment and the same is dishonoured on presentment, the agent may either himself give notice of dishonour to the parties liable on the bill, or he may give notice to his principal. He must do so within the same time as if he were the holder, and the principal upon receipt of such notice has himself the same time for giving notice as if the agent had been an independent holder.

**2. Notice to whom:** According to Section 93, notice of dishonour must be given to all the prior parties whom the holder seeks to make liable on the instrument. Where there are two or more persons jointly liable as drawers or endorsers, notice to any one of them is sufficient. Such notice need not be given to the maker of a note, acceptor of a bill, or drawee of a cheque, since they are primarily liable on the instrument. As a matter of a fact they themselves dishonour the instrument.

**3. Form and mode of notice:** Section 94 lays down that notice may be oral or written, or it may be partly oral and partly written. Notice does not mean knowledge, but actual formal notification. Notice of dishonour may be given in person, or through a messenger, or by post. It should be put in the post-box. In the case of notice by post, if it is duly addressed, stamped and posted, then delay or miscarriage of

such notice by the post office does not render the notice invalid, and the party giving it, is exonerated from liability for omission to give notice.

No special form of words is necessary for a notice of dishonour. However, mere statement in the notice that the payment was demanded is not enough. According to Section 94, the notice must inform the party to whom it is given, either by express terms:

(i) the instrument has been dishonoured; the instrument should be identified in the notice, otherwise the notice will be invalid;

(ii) in what way the instrument has been dishonoured whether by non-acceptance or by non-payment; and

(iii) that he will be held liable on the dishonoured instrument.

A mere demand for payment is not a sufficient notice that the instrument in respect of which the demand is made has been dishonoured. Mere knowledge that the instrument has been dishonoured is not notice.

**4. Time and place of notice:** Section 94 lays down that the notice of dishonour must be given within a reasonable time after dishonour. When the person to whom notice is to be given, has a place of business, the notice must be addressed to him at his place of business. But if he has no place of business, then it should be sent to his residence. If the holder not know of the place of business or residence of the person entitled to notice, he must exercise due diligence to ascertain the place.

**What is reasonable time:** Section 105 lays down that in determining what is a reasonable time for giving notice of dishonour and for noting, regard shall be had to the nature of the instrument and the usage of trade with regard to similar instruments, In addition to these, regard should be had to the situation and interest of the parties, and the distance between the places of giving and receiving notice. In the calculation of reasonable time, public holidays shall be excluded. Following are the rules for determining reasonable time for giving notice of dishonour, as given under Section 106:

(i) If the holder and the party to whom notice of dishonour is given carry on business or live in different places, such notice is deemed to be given in reasonable time if it is despatched by the next post or on the next day, after dishonour.

(ii) If the said parties carry on business or live in the same place, such notice is deemed to be given within a reasonable time if it is despatched in such a time as to reach its destination on the day next after the day of dishonour.

**5. Duty to transmit notice of dishonour and reasonable time for such transmission:** Section 95 states that any party receiving notice of dishonour must, in order to render any party liable to himself, give notice of dishonour to such party within a reasonable time, unless such party otherwise receives due notice as provided by Section 93 discussed above. He cannot sue any prior party to whom he has not transmitted the notice and who has also not received the notice from some other valid, source. According to Section 107, a party receiving notice of dishonour, and seeking to enforce his right against a prior party, is deemed to have transmitted the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder. It means that he is entitled to a clear day for transmitting the notice of dishonour to prior parties.

**Effect of Default in Giving Notice of Dishonour**

The consequence of not giving due notice of dishonour is that all parties who are entitled to require such notice, are discharged from their liability. In fact, the liability of the drawer and that of the endorser arises only after notice of dishonour being given to them unless the notice is excused. Thus, the holder cannot sue the party to whom the notice of dishonour has not been given. However, the acceptor of a bill, the maker of a promissory note, or the drawer of a cheque remains liable without notice, since they are primarily liable on the instrument. As a matter of fact, they themselves dishonour instrument.

**When the Notice of Dishonour is Excused**

According to Section 98, no notice of dishonour is necessary in the following cases:

1. When it if dispensed with by the party entitled thereto. For example, where an endorser makes a facultative endorsement on the instrument by writing such words as 'notice of dishonour waived'.

2. In order to charge the drawer, when he has countermanded (stopped) the payment.

3. When the party charged could not suffer damage for want of notice. For example, where the drawer did not have any funds in the hands of the drawee at the time when the instrument was drawn, suffers no damage and is not entitled to notice of dishonour.

4. When the party entitled to notice cannot after due search be found; or the party bound to give notice is, for any other reason, unable without any fault of his own to give to give notice.

5. To charge the drawer, when the acceptor is also a drawer, since the dishonour of the bill must have been necessarily known to that drawer who is also the acceptor.

6. In the case of a promissory note which is not negotiable, because the endorsee gets no claim against the maker or endorsers. The instrument being not negotiable, no one would be prejudiced by its non-presentment for payment or want of notice of dishonour.

7. When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

8. When omission to give notice is caused by unavoidable circumstances, for example, death, accident or serious illness of the holder or his agent.

**Duties of a Holder on the Dishonour of a Negotiable Instrument**

When a negotiable instrument is dishonoured, the following duties fall upon the holder of it:

**1. Notice of dishonour:** On the dishonour of a negotiable instrument, the holder must give notice of dishonour to such parties whom he wants to make liable thereon.

**2. Noting and protest:** On the dishonour of a negotiable instrument, the holder may also get the instrument noted and protested for dishonour. Noting and protesting is done only in case of promissory notes and bills of exchange.

**3. Suit for money:** After observing the formality of noting and protesting, the holder may proceed to the recourse of bringing a suit against one or more patties liable for the recovery of the amount due on the instrument.

**Negotiable Instrument Acquired after its Dishonour**

Section 59 lays down that the holder of a negotiable instrument who has acquired it after dishonour, whether by non-acceptance or non-payment, with notice thereof, has only the rights thereon of his transferor as against the other parties. Same is the case when instrument is acquired after maturity. Thus, such a transferee cannot become a holder in due course of the instrument. It may be noted that this is an exception to the general rule that the holder in due course gets better title than that of his transferor.

**18.2.5 DISHONOUR OF A CHEQUE**

Dishonour of a cheque means when the drawee banker of the cheque refuses to honour or pay the amount as stated in the cheque.

Sections 138 to 142, constituting Chapter XVII, were inserted by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988. These new provisions are intended to prevent the issue of cheques which the drawers know to be worthless. The drawing of such a cheque would, in certain circumstances specified by these provisions, be deemed to be an offence punishable with imprisonment and/or fine. These provisions deal with the drawer's criminal liability for the issue of a worthless cheque (i.e., which is dishonoured, if certain conditions are fulfilled. These may be discussed as follows:

**Dishonour of cheque for insufficiency etc. of funds in the account**

According to Section 138, where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by bank unpaid, either because of the amount of money standing to the credit of the account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may extent to two years, or with fine which may extend to twice the amount of the cheque or with both. However, for the drawer to be prosecuted under this Section, the following conditions must be fulfilled:

**1. Issuing of the cheque for payment of money to a person other than the drawer:** The cheque must have been drawn for payment of money to a person other than the drawer for the full or partial discharge of any legally enforceable debt or other liability. A cheque to be brought within the purview of Section 138 should presumable have been issued, and not merely drawn, for payment in discharge, wholly or partly, of a debt or other liability. A cheque given as a gift or donation, or in discharge of a mere moral obligation, or for an unlawful or illegal consideration, would not fall within the purview of this Section.

**2. Presentment of the cheque within six months:** The cheque must have been presented to the drawee bank within a period six months from the date on which it is drawn, or within the period of its validity, whichever is earlier. These dates would differ if the cheque is ante-date or post-dated.

**3. The cheque must have been returned unpaid:** The cheque must have been returned unpaid by the drawee bank either because of insufficiency of funds on the drawer's account in question or because the cheque exceeds the amount arranged to be paid from that account by an agreement made with the bank. It means that Section 138 would not apply to cheques returned unpaid for technical reasons,

**4. Demand on drawer after dishonour of the cheque:** The payee or holder in due course of the cheque, as the case may be, must make a demand for the payment of the amount of money as represented by the cheque by giving a notice in writing to the drawer of the cheque, within thirty days of receipt of information by him from the bank regarding the return of the cheque as unpaid.

**5. Failure of the drawer to make payment of the dishonoured cheque:** The drawer of the dishonoured cheque must have failed to make the payment of the said amount of money to the payee or, as the case may be, to the holder is due course of the cheque, within fifteen days of the receipt of the said notice.

**6. Written complaint to the proper legal authority:** A written complaint should have been made to a metropolitan or a first class judicial magistrate by the payee or the holder in due course of the cheque within one month from the date on which the cause of action arose on the failure of the drawer to make payment of the dishonoured cheque on demand if no complaint is made within the said period of 1½ months by the payee or the holder in due course, no Court shall take cognizance of the drawer's offence committed under Section 138. However, the payee may agree with the drawer not to make a complaint.

**Presumption in favour of holder:** Section 139 lays down that unless the contrary is proved, it shall be presumed that the holder of a cheque received the cheque of the nature as referred to in Section 138 for the whole or partial discharge of any debt or other liability.

**Defence which may not be allowed in any prosecution under Section 138:** Section 140 provides that in a prosecution for an offence under Section 138, it shall not be allowed as a defence that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reason stated in that Section, i.e., due to insufficiency of funds or the shortage of financial arrangements made by the drawer with the bank.

**Offences by companies:** Section 141 expressly extends the provision of Section 138 to corporate bodies including partnerships, companies, or other associations of individuals. It lays down as follows:

1. If the person committing an offence under Section 138 is a company, every person who at the time the offence was committed, was in charge of and was responsible to the company for the conduct of the business of the company, as well as the company itself, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, nothing contained in this Section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the committing of such offence.

Further, where a person is nominated as a Director of Company by virtue of his holding any office or employment in the Central Government or State Government or financial corporation owned or controlled by the Central Government or the State Government (as the case may be), he shall not be liable for prosecution under this chapter XVII (Sections 138 to 142).

2. Where any offence has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officers of the company, then such director, manager, secretary or other officers shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

**Cognizance of offences:** Section 142 lays down that in spite of anything contained in the Code of Criminal Procedure, 1973, the following provisions shall apply:

1. No Court shall take cognizance of any offence punishable under Section 138 except upon a complaint in writing made by the payee of the holder in due course of the cheque, as the case maybe.

2. Such complaint is made within one month of the date on which the course of action arises under Clause (c) of the proviso to Section 138 i.e., on the expiry of fifteen days from the receipt by the drawer of the written demand from the payee or the holder in due course for the payment of the amount represented by the dishonoured cheque.

However, the cognizance of a complaint may be taken by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making a complaint within such period.

3. No Court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first calls shall try any offence punishable under Section 138.

It has to be noted that the reference in Sections 138 and 142 to the 'holder in due course' (where he is not the payee) gives rise to the interpretation that a dishonoured cheque in the hands of a holder who is not the payee and cannot claim as a holder in due course, will not fall within the ambit of Section 138. There could be situation where the holder is a holder for value but not a holder in due course.

The existing provisions in the Negotiable Instrument Act, namely Sections 138 to 142 in chapter VII were found deficient in dealing with dishonour of cheques. Not only the punishment provided in the Act proud to be inadequate, but also the procedure prescribed for the courts to deal with such matter was found to be cumbersome. The courts were unable to dispose of such cases expeditiously in a time bound manner in view of the procedure contained in the Act. In order to facilitate early disposal of cases relating to dishonour of cheques by the courts and also to enhance punishment for offenders, the following new Sections 143 to 147 have been inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002:

**Power of the Court to try cases summarily:** There are three provisions in this regard as follows:

(1) According to Section 143(1), in spite of anything contained in the code of Criminal Procedure, 1973, all offences under this chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate. Further, the provisions of Sections 262 to 265 (both inclusive) of the said code (which deal with Summary Trials), shall apply to such trials, as far as may be. However, in the case of any conviction in a summary trial under this Section (143), it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding fine thousand rupees. Further, when at the commencement of, or in the course of, a summary trial under this Section (143), it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is undesirable to try the case summarily due to any other reason, then after hearing the parties, the magistrate shall record an order to that effect and thereafter recall any witness who may have been examined, and proceed to hear or rehear one case in the manner provided by the said code.

(2) Section 143(2) states that so far as practicable, consistently with the interests of justice, the trial of a case under this section shall be continued from day to day until its conclusion, except that the court finds the adjournment of the trial beyond the following (i.e., next) day to be necessary for reasons to be recorded in writing.

(3) According to Section 143 (3), every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

**When Banker Must Refuse Payment of Cheques**

There are certain circumstances in which banker's authority is determined and he is bound to refuse payment of cheques without incurring and liability for such refusal. In these cases, there is all possibility that the Court may decide that the payment made by the banker is not good as against the drawer and therefore, the banker may not be allowed to debit the account of the drawer (customer) with the amount of the cheque concerned.

**1. When customer countermands payment:** Where a customer issues instructions to the bank not to honour a particular cheque issued by him, it is known as 'countermanding payment or 'stop payment order'. It has been held that until a cheque has been paid by the banker, its control remains in the hands of the drawer. Hence, he can send a 'stop payment order' to the banker be for the payment of the cheque by the banker, no matter that the cheque has been endorsed by the payee during the period before its payment. An oral countermanding is also sufficient.

**2. On the death of a customer:** Notice of customer's death terminates the authority of the banker to honour his cheques. A payment made before receiving the notice of death is valid and the banker can properly debit the deceased customer's account.

**3 On the insolvency of a customer:** When an order of adjudicating has been passed against the customer by insolvency Courts, the banker must refuse to pay his cheques. This is because on adjudication, the entire property of the insolvent including 'bank balance' stands vested in the Official Assignee or Receiver.

**4. On the insanity of a customer**: When a banker receives notice that his customer has become insane or lunatic, he must not pay the cheques drawn by such customer, because insanity affects the contractual capacity of a person.

**5. On Garnishee Order:** Garnishee order means an order by any court attaching the money in customer's account and prohibiting any payment out of his bank balance. On receiving a garnishee order, the banker must refuse to honour the cheques issued by the customer.

**6. On receiving a notice of assignment of the credit balance:** According to Section 130 of the Transfer of Property Act, 1882, the customer can assign the credit balance of his bank account in the name of any person. If he does so, he sends proper intimation to this effect to his banker also. When the banker receives a notice of assignment of the credit balance of his account by a customer, he must refuse payment of cheques drawn by the customer after such notice of assignment.

**7. In case of crossed cheques:** The banker must refuse payment of cheques : (i) when a crossed cheque is presented for payment at its counter, and (ii) when a cheque is crossed specially to more than one banker and the other banker is not an agent for the purpose of collection.

**8. When cheque is issued against the rules of the Trust:** The money of a Trust cannot be used by any Trustee for his own benefit. If the banker comes to know that his customer is a Trustee also, who operates the Trust Account, and who intends to misuse the fund of the Trust, then in such a case the banker must refuse the payment of a cheque drawn by him of the Trust Account.

**9. When the title of the possessor is doubted to be defective:** When the banker has reason to believe or becomes aware of the fact that the title of the holder presenting the cheque is defective (for example, where he seems to be a thief), the banker must refuse the payment of the cheque.

**10. Other conditions:** In the following conditions also, the banker must refuse the payment of a cheque:

(i) When the drawer, payee, or holder has informed the banker that the cheque has been lost. It maybe noted that if the notice of loss of cheque is received from the payee or the endorsee (holder), the banker may require obtaining a countermanding order from the drawer.

(ii) When there is an apparent material alteration in the cheque and that is not properly confirmed.

(iii) When the signature of the drawer of the cheque does not tally with the specimen signatures kept by the banker.

(iv) When the customer has given a notice to the banker to close his account or has closed his account.

(v) When the cheque is postdated and has been presented for payment before that date.

(vi)When cheque is irregular or ambiguous, or has been drawn in such a manner as creates doubt with regard to its legality.

(vii) When cheque has been drawn on a branch of the banker where the drawer has no account, although he has his account with the other branch of the banker.

(viii) When the amount of cheque crosses the limit (of the overdraft) sanctioned to the customer.

(ix) When cheque has not been presented during the usual banking hours.

(x)When there are not efficient funds in the customer's account to pay the cheque.

**When Banker cannot Refuse Payment**

The banker has no authority to refuse payment in the following circumstances:

1. When the writing of the signature of the drawee, not match with the writing of the other facts and figures existent in the cheque, but it matches with the specimen signature of the drawer kept with the banker.

2. When the amounts written in words and figures differ with each other.

3. When the cheque has been presented after the expiry of 6 months from the date of its issue.

4. When the bank has refused the payment of a cheque due to insufficiency of funds, then he cannot refuse another cheque which is within the limit of the available balance in the customer's account, only on the ground that he had refused the payment of the first cheque.

5. When a crossed cheque has been converted into an open cheque by properly cancelling its crossing and has been presented for payment at the counter.

6. When the cheque has been specially crossed in the name of two bankers, but the second banker is an agent of the first banker, for collection (Section 127)

7. When bearer cheque has been presented at the counter by any person (excepting, of course, an insane etc. person).

8. When there are sufficient funds in the account of the drawer, cheques is regular, and that has been presented during banking hours and the banker has no valid reason to refuse its payment.

## 18.3 SOME RELATED CONCEPTS

### 18.3.1 NOTING

The term 'noting' means 'the formal recording of the fact of dishonour by a Notary Public upon the negotiable instrument.' It is the process of attaching a memorandum to an instrument by a Notary Public, giving reasons for its having been dishonoured. It is a first step to 'Protest'.

Where the promissory note or bill is dishonoured, the holder is entitled, after giving the notice of dishonour, to sue drawer and the endorsers. But before doing this, the holder may get the fact of dishonour authenticated by 'noting by a Notary Public. Noting is the authentic and official proof of presentment and dishonour of a negotiable instrument. It is a memorandum of the minute recorded by a Notary Public after the Dishonour of the instrument. In case of a dishonour of a bill or pro-note, the Notary Public makes formal demand upon the maker or drawee or acceptor for acceptance or payment is the case may be, and on the refusal by the concerned party, he records the noting on the instrument.

Noting of the dishonour of a cheque is not required because in such a case, the bank while refusing the payment returns the cheque along with a memorandum giving reasons in writing for the dishonour of the cheque. Such memorandum in itself acts as an authentic evidence of the fact of dishonour. Even in case of inland bills or pro-notes, noting is not compulsory absence of noting will not, in any way, affect the rights of the holder thereon. However, foreign bills must be be got protested if it is so required by the law of the place where they were drawn

Section 99 lays down that where a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument. Such note must be made within a reasonable time after dishonour and it must specify and contain the following particulars: (i) the fact of dishonour, (ii) the date of dishonour, (iii) the reason, if any, assigned for such dishonour, (iv) if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and (v).the notary's charges. In determining what is a reasonable time for noting, regard shall be had to the nature of the instrument and the usual course of dealing with respect to similar instruments. In calculating such time, public holidays shall be excluded.

### 18.3.2 PROTEST

Section 100 lays down when a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest. Thus, protest is a notaries act, being a formal statement in writing made by a notary under his seal of office, at the request of the holder of a

bill or pro-note, in which it is declared that the bill or pro-note, described was on a certain day presented for acceptance or payment, and that such acceptance or payment was refused, and stating the reasons, if any, given for such refusal, whereupon the notary protests against all parties to such instrument, and declares that they will be held responsible for all loss or damage arising from its dishonour. A protest is a certificated of dishonour made under the hand and seal of a notary public.

**Distinction between Noting and Protest**

Noting is merely recording with necessary details of the fact of dishonour of the instrument by non-acceptance or by non-payment, such recording being made on the instrument itself. When the notary public issues a certificate stating therein the particulars regarding dishonour, it is called a protest. Thus, protest is a formal certificate of dishonour issued by the notary public to the holder of the bill or his demand, protest follows noting. Protest is not compulsory in case of inland bills, but foreign bills must be got protested for dishonour.

**Protest for better Security:** Section 100 further provides that when the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached (declared doubtful), before the maturity of the bill, the holder may within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused may cause such facts to be noted and certified as aforesaid within a reasonable time. Such certificate is called a protest for better security. It may be noted that the acceptor is not bound to give such security, nor can the holder sue the drawer and the endorsers before maturity of the bill in spite of such protest. The holder has to wait till the maturity of the bill. The special advantage of protest for better security is that it enable the bill to be accepted for honour when placed before the acceptor for honour. This is a additional advantage over and above the inherent advantage of having the facts of the circumstances placed on record for the information of the drawer.

**Contents of Protest:** A protest under Section 100 must contain the following particulars as required by Section 101:

(a) Either the instrument itself, or a literal transcript of the instrument and of everything written or printed thereupon;

(b) The name of the person for whom and against whom the instrument has been protested;

(c) A statement that payment or acceptance, or better security has been demanded of such person by the notary public; the terms of his answer, if any, or a statement that he gave no answer, or that he could not be found;

(d) When the note or bill has been dishonoured, the place and time of dishonour and when better security has been refused, the place and time of refusal;

(e) The subscription (charges) or the notary public making the protest;

(f) In the event of an acceptance for honour or of a payment for honour, the name of the person by whom, of the person for whom and the manner in which such acceptance or payment was offered and effected.

(g) The place and time of dishonour;

(h) The signature of notary.

A notary public may make the demand mentioned in clause (c) above, either in person or by his clerk or, where authorized by agreement or usage, by registered letter.

**Notice of Protest:** According to Section 102, when a promissory note or bill of exchange is required by law to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions; but the notice may be given by the notary public who makes the protest, or by the holder. It may be noted here that the foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn.

**Protest for non-payment after dishonour by non-acceptance:** Section 103 lays down that all bills of exchange drawn payable at some other place than the place mentioned as the residence of the drawee, and which are dishonoured by non-acceptance may, without further presentment to the drawee, be protested for non-payment in the place specified for payment, unless they are paid before or at maturity. For example, a bill is drawn on Ramesh in Kolkata and is payable in Mumbai. The bill is dishonoured by non-acceptance. It may then be protested in Mumbai of non-payment without it being presented again to Ramesh in Kolkata.

**Protest of foreign bills:** According to Section 104, foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Thus, all bills drown out of India must be protested, because by the law of most countries a protest has been made essential in case of dishonour of a bill. But a foreign bill drawn in India need not be protested in spite of the fact that protest

may be required by the law of the place where it is payable. Protest is absolutely necessary in the case of foreign bill, and the Courts will not allow any evidence of dishonour except the evidence in the form of protest. It may be noted that this Section does not apply to foreign promissory notes.

**When noting equivalent to protest:** Section 104 A lays down that for the purposes of this Act, where a bill or note is required to be protested within a specified time or before some further proceeding is taken, it is sufficient that the bill has been noted for protest before the expiration of the specified time or the taking of the proceeding and the formal protest may be extended at any time thereafter as of the date of noting. In other words, the notary public, after he has made his minute, may draw up the formal protest at his leisure (i.e., it may be drawn up later on), Whenever the protest is drawn up, it relates back to the date of noting. Hence, if a bill is properly protested and noted at the time, the protest may be made by the notary at any future time.

**Advantages of Protest:** (1) According to Section 119, in a suit upon an instrument which has been dishonoured, the Court shall presume the fact of dishonour on proof of the protest, unless and until such fact is disproved.

(2) Protest enables a bill to accepted or paid for honour by the acceptor or payer for honour.

(3) Protest provides authentic evidence of presentment and dishonour and enables the holder to have his remedy soon.

**Rules regarding Compensation for Dishonour**

Section 117 lays down the following rules for determining the amount of compensation payable to the holder or an endorser in case the instrument is dishonoured:

**1. Compensation to holder:** The holder is entitled to recover the amount due upon the instrument, together with the expenses properly incurred in its presenting, noting and protesting it.

**2. Compensation to endorser:** Where an endorser liable on the instrument has paid the amount due on the same, in such cases he is entitled to the amount so paid, with interest at 18% per annum from the date of payment until tender (offer) or realization thereof, together with all expenses caused by the dishonour and payment.

**3. Re-exchange:** Re-exchange is the measure of damages resulting from the dishonour of a bill in a country different from that in which it was drawn or endorsed. When the person sought to be charged resides at a place different from that at which the instrument was payable, the holder or endorsee is

entitled to recover from the drawer or prior endorsers the sum at the current rate of exchange between the two countries on the date of such dishonour.

**4. Re-draft:** The party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand for the amount due to him, together with all expenses properly incurred by him. Such a bill is called a re-draft. The re-draft must be accompanied by the instrument dishonoured and the protest thereof, if any if such redrafted bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner is in the case of original bill.

### 18.3.3 DISCHARGE OF INSTRUMENT

In the case of negotiable instruments, the term discharge form liability has two meanings, these are, (1) the discharge of the instrument itself, or (2) the discharge of one or more parties from liability upon the instrument. It is to be noted 'discharge of instrument' differs from 'discharge of a party form liability upon the instrument'. Discharge simply means extinguishment of the right of action. So long as a negotiable instrument is in existence and is valid, there are certain rights or action upon it. However, when these rights are extinguished, the instrument is discharged and it ceases to be negotiable. Then, ever a holder in due course cannot acquire any right of action upon it. An instrument is said to be discharged only when the party which is ultimately liable on it, is discharged from liability. It may be noted that the discharge of one or more of the parties to an instrument does not discharge the instrument itself. When the liability of the primary (i.e., ultimately responsible) party comes to an end, only then the instrument is said to be discharged. Thus, in the case of a promissory note or bill of exchange, the discharge of the endorser of drawer would not discharge the instrument, but the discharge of the maker or acceptor will have such an effect. The most obvious and general method of the discharging or extinguishing the right of action upon a negotiable instrument is payment by the acceptor or the maker according to tenor of the instrument.

An instrument is said to be discharged when all the rights under it are extinguished and therefore it remains of no use. After being discharged, the instrument ceases to be negotiable and cannot be negotiated further. As stated earlier, ever a holder in due course does not acquire any rights on the discharged instrument, nor can be claim the amount of the instrument from any party thereto.

An instrument is discharged in each of the following cases:

**1. By payment in due course:** When the party primarily liable on the instrument (i.e., maker of promissory note, acceptor of the note or the bill, or drawee of the cheque) makes the payment in due course to the holder of the instrument at or after maturity, the instrument is discharged. (Section 78)

**2. By the primarily liable party becoming the holder:** When the acceptor of a bill of exchange becomes its holder in his own right at or after its maturity, in such a case the bill is discharged and all rights of action thereon are extinguished. (Section 90) It is to be noted that the acceptor is required to become the holder of the bill at or after maturity ; further that he becomes the holder 'in his Own right', because if a bill is negotiated back to its acceptor as executor, administrator or trustee or the holder, then the bill is not discharged. Though the provisions of Section 90 are not extended to promissory note, yet precisely the same consideration apply to the maker of a note as to the acceptor of a bill.

**3. By materia1ateration:** When the party primarily liable on the instruments is discharged.(Section 87).

**4. By cancellation:** When the holder of the instrument cancels the name of the acceptor or the endorser with an intention to discharge him and all parties claiming under such holder, the instrument is discharged. [Section 82 (a)] Cancellation may take place by crossing out signatures on the instrument or by physical destruction of the instrument itself with the intention to terminate the liability of all the parties to be instrument.

**5. By discharges as a simple contract:** A negotiable instrument may also the discharged in the same way as a simple contract. Thus the instrument may be discharged by agreement of the parties in the form of a novation or by rescission or by substitution of another instrument or obligation. The instrument may also be discharged by operation of law in case of insolvency or by lapse of period of limitation.

**6. By renunciation:** Where the holder of an instrument at or after maturity renounces (gives up) his right against all the parties to the instrument, the instrument is discharged. The renunciation must be made absolutely and unconditionally. It must be in writing, unless the instrument is also surrendered to the party primarily liable. This is also knows as discharge by express waiver.

**Discharge of one or more Parties**

A party to an instrument is said to be discharged when its liability under the instrument comes to an end. When one or more of the parties to an instrument is/are discharged, it continues to be negotiable

and the remaining parties continue to be liable on it. Thus, discharge of one or more parties to an instrument does not discharge the instrument and the rights under it can still be enforced against the undischarged parties.

### 18.3.4 MODES OF DISCHARGE

One or more parties to a negotiable instrument may be discharged from liability in either of the following ways:

**1. Discharge by cancellation:** Section 82(a) provides that the maker, acceptor or endorser or a negotiable instrument is discharged from his liability to holder if his name is cancelled by the holder with the intention of discharging him from his liability. Moreover, all the parties claiming under such holder. As a result, the holder cannot recover the amount from such parties and the person who gets the instrument from such holder can also not recover the amount from the party whose name was cancelled by the holder. It has to be noted that two conditions must be satisfied to discharge a party from liability, which are as follows: (A) The cancellation of party's name must be with the intention of discharging that party from his liability. (B) Cancellation be made by drawing a line through the name in such a way as leaves it legible. The cancellation should also be apparent on the face of the instrument, otherwise the instrument remains valid in the hands of a holder in due course. In a nutshell, the cancellation of the acceptor's or maker's name is the discharge of all the other parties, whereas the cancellation of a middle party's name is the discharge of only that party and the parties subsequent to him but the parties prior to him remain liable.

Section 40 also lays down that where the holder, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged form liability.

**2. Discharge by release:** Section 82(b) lays down that the maker, acceptor or endorser of a negotiable instrument may be discharged from liability by a holder by any method other than cancellation of name. For instance, the holder may release any party to the instrument by a separate agreement of waiver, release, or remission and the party so released and all parties subsequent of him, who have a right of action against the party so released, are discharged from liability. The effect of release is the same as that of cancelling the name of a party. Similarly, substitution of an old instrument with a new instrument will also discharge the parties concerning with the old instrument. It has to be noted that the release of one the joint parties will not release all others.

**3. Discharge by payment:** Section 82(c) provides that when the instrument is payable of bearer, whether originally or subsequently by an endorsement in blank, the payment in due course to the person in possession of such instrument discharges the parties liable on such instrument. However, when the instrument is payable to order, the payment must be made to the genuine endorsee. If payment is made to person who obtained such instrument under a forged endorsement, it will not discharge the payer, who will remain liable to the owner of the instrument, It is also to be noted that the payment must be made by the party primarily liable on the instrument. A payment by a party who is secondarily liable, does not discharge all the parties to the instrument, and hence the person making payment can recover the amount from the party primarily liable on the instrument.

**4. Discharge by allowing drawee more than 48 hours:** Section 83 lays down that if the holder of a bill of exchange allows the drawee more than 48 hours exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder. However, extension of time with the consent of the parties will not operate as a release of discharge of the parties to an instrument,

**5. Discharge by delay in presenting cheque:** Section 84(1) provides that where a cheque is not presented for payment within a reasonable time of its issue and the bank fails the drawer suffers actual damages through such delay he is discharged from the liability to the holder to the extent of such damage. For example, Manav draws a cheque for 2,000 and has funds at bank to meet it at the time when it ought of be presented. However, the bank fails before the cheque is presented. Manav is discharged. However, the holder of the cheque can prove his claim against the bank in its insolvency proceedings.

**6. Cheque payable to order:** Section 85 lays down that where a cheque payable to order purports to be endorsed by or on behalf of the payee, the banker is discharged by payment is due course. For example, a cheque is payable to Raman or order. It is stolen and Raman's endorsement is forged. The banker pays the cheque in due bourse. The banker is discharged from liability and can debit the drawer's account with the amount of the cheque.

Where a cheque is originally expressed to be payable of bearer, the drawee (i.e., the bank) is discharged by payment in due course to the bearer thereof, in spite of any endorsement whether in full or in blank appearing thereon, and in spite of the fact any such endorsement purports to restrict or exclude further negotiation.

**7. Drafts drawn by one branch of a bank on another payable to order:** Section 85A provides that where any draft that is, an order to pay money, drawn by one branch of a bank upon another branch of the same bank for a sum of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course.

**8. Parties not consenting discharged by qualified or limited acceptance:** Section 86 lays down that if the holder of bill of exchange acquires (accepts) a qualified acceptance, or the acceptance limited to a part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which is not signed by all the drawees if such drawees are not partners, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those who claim under him, unless the holder gives notice there of and the parties give their assent to such qualified or limited acceptance.

**9. Discharge by default of the holder:** Parties are discharged by default of holder in the following cases:

(a) When the instrument is not presented for payment by the holder within a reasonable time, all the other parties are discharged thereby.

(b) Where on presentation, the instrument is dishonoured and the holder fails to give notice of dishonour to any party to the instrument (other than the party primarily liable), such party shall be discharged from liability as against the holder, unless the circumstances are such that on notice of dishonour is required to be sent.

**10. Discharge by operation of law:** In certain cases the parties are also discharged from their liability by operation of law. For example:

(i) By an order of insolvency Court: when a debtor is declared an insolvent, he is discharged from liability; or

(ii) By lapse of period of limitation when the time prescribed by the Limitation Act, 1963 for the recovery f debt is expired; or

(iii) By merger of the instrument into the judgement debt; or

(iv) By merger of a lesser security into a higher security, etc.

**11. Discharge by material alteration:** Section 87 lays down that any material alteration of a negotiable instrument renders the same as void as against any one who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties. And any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof.

It may be noted that material alteration discharges only those who were parties to the instrument at the time of making such alteration and who did not consent to such alteration. Thus, persons who become parties to the instrument after the alteration, are liable under the instrument as altered. Section 88 lays down that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement in spite of any previous alteration of the instrument.

**What is Material Alteration**

'Material alteration' means an alteration is any of the material parts of the instrument. It is the alteration which destroys the identity of the original instrument, and affects the rights and liabilities of the parties to the instrument. As a matter of fact, any change in an instrument which causes it to speak a different language in legal effect from that which it originally spoke, or which changes the legal identity of the instrument either in its terms or in the relation of the parties to it. It makes no difference whether the alteration is beneficial or prejudicial. Thus, in order to know whether an alteration is material or not, the nature of the alteration must be examined. An alteration is material:

(i) if it alters the character or identity of the instrument, or which shakes the very foundation of the instrument; or

(ii) if it changes the rights and liabilities of the parties, or any of the parties to the instrument; or

(iii) if it alters the operation of the instrument.

The person making a material alteration in the instrument cannot enforce his claim. He cannot even recover the original debt or the consideration for which the instrument was given. It simply renders the instrument inoperative and discharges all prior parties from liability over the instrument.

**Instances of material alteration:** (i) Alteration in the date of the instrument. (ii) Alteration of the sum payable. (iii) Alteration in the time of payment. (iv) Alteration in the place of payment. (v) Alteration in the rate of interest payable. (vi) Alteration by adding the name of a new party, without the consent of the existing parties. (vii) Alteration by tearing the instrument in a material part. (viii) Alteration in the

dates of endorsements. (ix) Alteration in the relationship of parties. (x) Alteration in the legal character of the instrument. (xi) Alteration of an order cheque to a bearer cheque, except by or with the consent of the drawer. (xii) Subsequent affixing of stamps, without the promisor's knowledge, to a note which was executed on an unstamped paper. Likewise, addition stamping of an insufficiently stamped note.

These instances are not exhaustive, but only illustrative.

**12. Discharge by negotiation back:** Where a bill of exchange comes back to the acceptor by a process of negotiation and he becomes its holder, it is called negotiation back. Section 90 provides that if a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished. Thus, in the following cases a bill of exchange is discharged: (i) on its negotiation back to the acceptor, or (ii) when the acceptor takes up the bill by making payment to the holder, or (iii) when the acceptor becomes the holder of the bill at or after maturity.

## 18.4 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties so as to make them liable on the instrument.
2. A negotiable instrument is also dishonoured by non-payment when presentment is not excused, and the instrument when overdue remains unpaid.
3. Dishonour of a cheque means when the drawee banker of the cheque refuses to honour or pay the amount as stated in the cheque.
4. Garnishee order means an order by any court attaching the money in customer's account and prohibiting any payment out of his bank balance.
5. Noting is merely recording with necessary details of the fact of dishonour of the instrument by non-payment only.
6. An instrument is said to be discharged when all the rights under it are extinguished and therefore it remains of no use.

## 18.5 SUMMARY

A negotiable instrument may be dishonoured by (i) non-acceptance or (ii) non-payment. As presentment for acceptance is required only in case of bills of exchange, it is only bills of exchange which may be

dishonoured by non-acceptance. Of course, any type of negotiable instrument may be dishonoured by non-payment. When a negotiable instrument is dishonoured either by non- acceptance or by non-payment, the holder or some party liable thereto must give notice of dishonour to all other parties whom he seek to make liable thereon. Noting is the process of attaching a memorandum to an instrument by a Notary Public, giving reasons for its having been dishonoured. It is a first step to Protest. A protest is a certificated of dishonour made under the hand and seal of a notary public. A cheque is said to be dishonoured by non-payment when the drawee of the cheque makes default in payment being required to pay the same.

## 18.6 KEYWORDS

**Noting:** Formal recording of the fact of dishonour by a Notary Public upon the negotiable instrument.

**Protest:** A formal certificate of dishonour issued by a Notary Public to the holder of a bill or note on his demand.

**Material Alteration:** Any change in the negotiable instrument which causes to speak a different language in legal effect from that which it had originally spoken.

## 18.7 SELF ASSESSMENT TEST

1. What is meant by dishonour of negotiable instrument? State the types of dishonour. What is the effect of dishonour?
2. What is notice of dishonour? State the rules regarding notice of dishonour.
3. What is noting and what are its contents? Is noting of dishonour of negotiable instrument compulsory under law?
4. What is protest? What are its contents?
5. Discuss the provisions of negotiable Instrument Act with regard to the dishonour of cheques for insufficiency of funds in the account of the drawer?
6. What are the various modes of discharge of a party from his liability upon a negotiable instrument?

## 18.8 ANSWERS TO CHECK YOUR PROGRESS

1. True

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

## 18.9 REFERENCES/SUGGESTED READINGS

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| Course Code: BC 403 | Author: Prof. Mahesh Chand Garg |
|---|---|
| Lesson No.: 19 | |

# IMPORTANT PROVISIONS OF INFORMATION TECHNOLOGY ACT, 2002

## Structure



## 19.0 LEARNING OBJECTIVES

After studying this lesson, you should be able to:

- Understand the objectives and application of the Act.
- State the meaning and procedure applicable to “Digital Signature”.
- Enumerate the rules applicable to electronic governance and electronic records.
- Explain the procedure for securing electronic records and digital signatures.
- State the provisions applicable to Appellate Tribunal.

- State the activities which will be considered as offences under the Act and the relevant provisions for penalties and adjudication.

## 19.1 INTRODUCTION

The technological revolution in the field of communication has brought out revolutionary changes in the mode of carrying out business and commerce. The exchange of physical documents is no longer necessary for carrying out business transactions. The electronic commerce is the new buzzword in both national and international trade. Electronic commerce involves carrying out of business transactions by means of electronic data interchange and other means of electronic communication involving the use of alternatives to paper based methods of communication and storage of information. The international trade is growing at a vast pace and the whole world has become almost a global village. The World Trade Organization (WTO) has further contributed towards the blast growth in trade, commerce and other fields amongst different countries of the world.

The General Assembly of the United Nations, recognizing this fact also resolved on 30.01.1997, to adopt a model law on electronic commerce framed by United Nations Commission of International Trade Law. The resolution recommends that all states give favourable consideration to the said model law when they communicate or revise their laws in view of the need of uniformity in the law applicable to alternatives to paper based methods of communication and storage of information. The Government of India, keeping in view the above facts, got enacted by Parliament the Information Technology Act, 2000.

The Act has been framed keeping in view the following objectives

(i) to bring uniformity in the law applicable to paperless methods of communication and storage of information prevalent in India on the pattering international law.

(ii) to promote efficient delivery of government services by means. of reliable electronic records.

## 19.2 SCOPE AND APPLICATION OF THE ACT

The Information Technology Act, 2000 has come into effect from 17$^{th}$ October, 2000. It extends to whole of India. It also applies to any offence or contravention committed under the Act by any person outside India except as otherwise provided in the Act.

The Act does not apply to the following

(a) a negotiable instrument as defined in section 1A of the Negotiable Instruments Act, 1881

(b) a power-of-attorney as defined in section 1 A of the Powers-of-Attorney Act, 1882.

(c) a trust as defined in section 3 of the Indian Trusts Act, 1882

(d) a will as defined in clause and section (2) (h) of the Indian Succession Act, 1925 including any other testamentary disposition by whatever name called;

(e) any contract for the sale or conveyance of immovable property or any interest in such property;

(f) any such class of documents or transactions as may be notified by the Central Government in the Official Gazette.

## 19.3 DIGITAL SIGNATURE AND ELECTRONIC GOVERNMENT

Section 3 deals with the mode of verifying the electronic records through digital signature. The relevant provisions are summarized below:

(1) Any subscriber may authenticate an electronic record by affixing his digital signature.

(2) The authentication of the electronic record shall be effected by the use of asymmetric crypto system and hash function which envelop and transform the initial electronic record into another electronic record.

Hash function is an algorithm mapping that translates a sequence of bits into smaller sequence of bits called "Hash Result". Algorithm mapping whenever executed with the same electronic record produces the same hash result. Whenever the above algorithm is executed with the same electronic record as its input, it becomes infeasible:

(i) that two electronic records can produce the same hash result.

(ii) to get back the original electronic record from the hash result obtained from algorithm.

(3) Any person by the use of a public key of the subscriber can verify the electronic record.

(4) The private key and the public key are unique to the subscriber and constitute a functioning key pair.

Sections 4 to 10 deal with provisions relating to electronic governance as summarized below:

**1. Legal recognition of electronic records (Sec. 4):** Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything

contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is –

(a) rendered or made available in an electronic form; and

(b) accessible so as to be usable for a subsequent reference.

**2. Legal recognition of digital signatures (Sec. 5):** Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person, then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government.

**Explanation:** For the purposes of this section, "signed", with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing of his hand written signature or any mark on any document and the expression "signature" shall be construed accordingly.

**3. Use of electronic records and digital signatures in Government etc. (Sec. 6):**

(1) Where any law provides for –

(a) the filing of any form, application or any other document with any office, authority, body or agency owned or controlled by the appropriate Government in a particular manner;

(b) the issue or grant of any licence, permit, sanction or approval by whatever name called in a particular manner;

(c) the receipt or payment of money in a particular manner then, notwithstanding anything contained in any other law for the time being in force, such requirement shall be deemed to have been satisfied if such filing, issue, grant, receipt or payment, as the case may be, is effected by means of such electronic form as may be prescribed by the appropriate Government.

(2) The appropriate Government may, for the purposes of sub-section (1), by rules,

prescribe –

(a) the manner and format in which such electronic records shall be filed, created or issued;

(b) the manner or method of payment of any fee or charges for filing, creation or issue any electronic record under clause (a).

**4. Retention of electronic records (Sec. 7):** Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form, if –

(a) the information contained therein remains accessible so as to be usable for a subsequent reference;

(b) the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated to .represent accurately the information originally generated, sent or received;

(c) the details which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record are available in the electronic record:

Provided that this clause does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record to be despatched or received.

**5. Publication of rule, regulation, etc., in Electronic Gazette (Sec. 8):** Where any law provides that any rule, regulation, order, bye-law, notification or any other matter shall be published in the Official Gazette, then, such requirement shall be deemed to have been satisfied if such rule, regulation, order, bye-law, notification or any other matter is published in the Official Gazette or Electronic Gazette

Provided that where any rule, regulation, order, by-law, notification or any other matter is published in the Official Gazette or Electronic Gazette, the date of publication shall be deemed to be the date of the Gazette which was first published in any form.

**6. Acceptance of electronic documents cannot be insisted (Sec. 9:** Nothing contained in sections 6, 7 and 8 shall confer a right upon any person to insist that any Ministry or Department of the Central Government or the State Government or any authority or body established by or under any law or controlled or funded by the Central or State Government should accept, issue, create, retain and preserve any document in the form of electronic records or effect any monetary transaction in the electronic form.

**7. Power of Central Government to make rules (Sec. 10):** The Central Government may, for the purposes of this Act, by rules, prescribe –

(a) the type of digital signature;

(b) the manner and format in which the digital signature shall be affixed;

(c) the manner or procedure which facilitates identification of the person affixing the digital signature;

(d) control processes and procedures to ensure adequate integrity, security and confidentiality of electronic records or payment; and

(e) any other matter which is .necessary to give legal effect to digital signatures.

## 10.4 ATTRIBUTION, ACKNOWLEDGEMENT AND DESPATCH OF ELECTRONIC RECORDS AND OTHER IMPORTANT PROVISIONS

Sections 11 to 13 provide for attribution, acknowledgement and dispatch of electronic records. These provisions are enumerated below:

**1. Attribution of electronic records (Sec. 11):** An electronic record shall be attributed to the originator –

(a) if it was sent by the originator himself;

(b) by a person who had the authority to act on behalf of the originator in respect of that electronic record; or

(c) by an information system programmed by or on behalf of the originator to operate automatically.

**2. Acknowledgement of receipt (Sec. 12):** (1) Where the originator has not agreed with the addressee that the acknowledgement of receipt of electronic record be given in a particular form or by a particular method, an acknowledgement may be given by –

(a) any communication by the addressee, automated or otherwise; or

(b) any conduct of the addressee, sufficient to indicate to the originator that the electronic record has been received.

(2) Where the originator has stipulated that the electronic record shall be binding only on receipt of an acknowledgement of such electronic record by him, then, unless acknowledgement has been so received, the electronic record shall be deemed to have been never sent by the originator.

(3) Where the originator has not stipulated that the electronic record shall be binding only on receipt of such acknowledgement, and the acknowledgement has not been received by the originator within the

time specified or agreed or, if no time has been specified or agreed to within a reasonable time, then, the originator may give notice to the addressee stating that no acknowledgement has been received by him and specifying a reasonable time by which the acknowledgement must be received by him and if no acknowledgement is received within the aforesaid time limit he may after giving notice to the addressee, treat the electronic record as though it has never been sent.

3. Time and place of dispatch and receipt of electronic record (Sec. 13):

(1) Save as otherwise agreed to between the originator and the addressee, the dispatch of an electronic record occurs when it enters a computer resource outside the control of the originator.

(2) Save as otherwise agreed between the originator and the addressee, the time of receipt of an electronic record shall be determined as follows, namely:

(a) if the addressee has designated a computer resource for the purpose of receiving electronic records

(i) receipt occurs at the time when the electronic record enters the designated computer resource; or

(ii) if the electronic record is sent to a computer resource of the addressee that is not the designated computer resource, receipt occurs at the time when the electronic record is retrieved by the addressee;

(b) if the addressee has not designated a computer resource along with specified timings, if any, receipt occurs when the electronic record enters the computer resource of the addressee.

(3) Save as otherwise agreed to between the originator and the addressee, an electronic record is deemed to be dispatched at the place where the originator has his place of business, and is deemed to be received at the place where the addressee has his place of business.

(4) The provisions of sub-section (2) shall apply notwithstanding that the place where the computer resource is located may be different from the place where the electronic record is deemed to have been received under sub-section (3).

(5) For the, purposes of this section –

(a) if the originator or the addressee has more than one place business, the principal place of business, shall be the place of business;

(b) if the originator or the addressee does not have a place of business, his usual place of residence shall be deemed to be the place of business;

(c) "usual place of residence", in relation to a body corporate, means the place where it is registered.

## SECURE ELECTRONIC RECORDS AND SECURE DIGITAL SIGNATURES

Sections 14 to 16 of the Act provide the circumstances under which electronic records and digital signatures can be considered as secure. There provisions are under:

**1. Secure electronic record (Sec. 14):** Where any security procedure has been applied to an electronic record at specific point of time, then such record shall be deemed to be a secure electronic record from such point of time to the time of verification.

**2. Secure digital signature (Sec. 15):** If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed, was –

(a) unique to the subscriber affixing it;

(b) capable of identifying such subscriber;

(c) created in manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated,

then such digital signature shall be deemed to be secure digital signature.

**3. Security Procedure (Sec. 16):** The Central Government shall, for the purposes of this Act, prescribe, the security procedure having regard to commercial circumstances prevailing at the time when the procedure was used, including –

(a) the nature of the transaction;

(b) the level of sophistication of the parties with reference to their technological capacity;

(c) the volume of similar transactions engaged in by other parties;

(d) the availability of alternatives offered to but rejected by any party;

(e) the cost of alternative procedures; and

(f) the procedures in general use for similar types of transactions or communications.

## REGULATION OF CERTIFYING AUTHORITIES

Following are the various authorities created under the Act for enforcement of different requirements under the Act.

**1. Appointment of Controller and Other Officers (Sec. 17):** (1) The Central government may, by notification in the Official Gazette, appoint a Controller of Certifying Authorities for the purposes of this Act and may also by the same or subsequent notification, appoint such number of Deputy Controllers and Assistant Controllers as it deems fit.

(2) The Controller shall discharge his functions under this Act subject to the general control and directions of the Central Government.

(3) The Deputy Controllers and Assistant Controllers shall perform the functions assigned to them by the Controller under the general superintendence and Control of the Controller.

**2. Functions of Controller (Sec. 18):** The Controller may perform all or any of the following functions:

(a) exercising supervision over the activities of the Certifying Authorities;

(b) certifying public keys of the Certifying Authorities;

(c) laying down the standards to be maintained by the Certifying Authorities;

(d) specifying the qualifications and experience which employees of the Certifying Authority should possess;

(e) specifying the conditions subject to which the Certifying Authorities shall conduct their business;

(f) specifying the contents of written, printed or visual materials and advertisements that may be distributed or used in respect of a Digital Signature Certificate and the public key;

(g) specifying the form and content of a Digital Signature Certificate and the key;

(h) specifying the form and manner in which accounts shall be maintained by the Certifying Authorities;

(i) specifying the terms and conditions subject to which auditors may be appointed and the remuneration to be paid to them;

(j) facilitating the establishment of any electronic system by a Certifying Authority either solely or jointly with other Certifying Authorities and regulation of such systems;

(k) specifying the manner in which the Certifying Authorities shall conduct their dealings with the subscribers;

(1) resolving any conflict of interests between the Certifying Authorities and the subscribers;

(m) laying down the duties of the Certifying Authorities;

(n) maintaining a database containing the disclosure record of every Certifying Authority containing such particulars as may be specified by regulations, which shall be accessible to public.

**3. Recognition of Foreign Certifying Authorities (Sec. 19):** (1) Subject to such conditions and restrictions as may be specified, by regulations, the Controller may, with the previous approval of the Central Government, and by notification in the Official Gazette, recognize any foreign Certifying Authority as a Certifying Authority for the purposes of this Act.

(2) The Controller may, if he is satisfied that any Certifying Authority has contravened any of the conditions and restrictions subject to which it was granted recognition under subsection (1) he may, for reasons to be recorded in writing, by notification in the Official Gazette, revoke such recognition.

**4. Controller as Repository (Sec. 20):** (1) The Controller shall be the repository of all Digital Signature Certificates issued under this Act.

(2) The Controller shall –

(a) make use of hardware, software and procedures that are secure from intrusion and misuse;

(b) observe such other standards as may be prescribed by the Central Government; to ensure that the secrecy and security of the digital signatures are assured.

(3) The Controller shall maintain a computerised data base of all public keys in such a manner that such data base and the public keys are available to any member of the public.

**5. Power to Delegate (Sec. 27):** The Controller may, in writing, authorise the Deputy Controller, Assistant Controller or any officer to exercise any the powers of the Controller under this Chapter.

**6. Power to Investigate Contraventions (Sec. 28):** (1) The Controller or any officer authorized by him in this behalf shall take up for investigation any contravention of the provisions of this Act, rules or regulations made thereunder.

(2) The Controller or any officer authorized by him in this behalf shall exercise the like powers which are conferred on Income-tax, authorities under Chapter XIII of the Income Tax Act, 1961, and shall exercise such powers, subject to such limitations laid down under that Act.

**GRANTING OF LICENCE**

Sections 21 to 26 empower, the Controller to issue licence to persons authorizing them to issue Digital Signature Certificates. The various provisions are explained below:

**1. Licence to issue Digital Signature Certificates (Sec. 21):** (I) Subject to the provisions of sub-section (2), any person may make an application to the Controller for a licence to issue Digital Signature Certificates.

(2) No licence shall be issued under sub-section (1), unless the applicant fulfils such requirements with respect to qualification, expertise, .manpower, financial resources and other infrastructure facilities, which are necessary to issue Digital Signature Certificates as may be prescribed by the Central Government.

(3) A licence granted under this section shall –

(a) be valid for such period as may be prescribed by the Central Government;

(b) not be transferable or heritable;

(c) be subject to such terms and conditions as may be specified by the regulations.

**2. Application for licence (Sec. 22):** (1) Every application for issue of a licence shall be in such form as may be prescribed by the Central Government.

(2) Every application for issue of a licence shall be accompanied by –

(a) a certification practice statement;

(b) a statement including the procedures with respect to identification of the applicant;

(c) payment of such fees, not exceeding twenty-five thousand rupees as may be prescribed by the Central Government;

(d) such other documents, as may be prescribed by the Central Government.

**3. Renewal of licence (Sec. 23):** An application for renewal of a licence shall be –

(a) in such form;

(b) accompanied by such fees, not exceeding five thousand rupees, as may be prescribed by the Central Government and

(c) shall be made not less than forty-five days before the date of expiry of the period of validity of the licence.

**4. Procedure for grant or rejection of licence (Sec. 24):** The Controller may, on receipt of an application under sub-section (1) of section 21, after considering the documents accompanying the application and such other factors, as he deems fit, grant the licence or reject the application:

Provided that no application shall be rejected under this section unless the applicant has been given a reasonable opportunity of presenting his case.

**5. Suspension of licence (Sec. 25):** (1) The Controller may revoke the licence if he is satisfied after making such inquiry, as he may think fit, that a Certifying Authority has –

(a) made a statement in, or in relation to, the application for the issue or renewal of the licence, which is incorrect or false in material particulars;

(b) failed to comply with the terms and conditions subject to which the licence was granted;

(c) failed to maintain the standards specified under clause (b) of sub-section (2) of section 20;

(d) contravened any provisions of this Act, rule, regulation or order made thereunder;

Provided that no licence shall be revoked unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed revocation.

(2) The Controller may, if he has reasonable cause to believe that there is any ground for revoking a licence under sub-section (1), by order, suspend such licence pending the completion of the enquiry ordered by him.

Provided that no licence shall be suspended for a period exceeding ten days unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed suspension.

(3) No Certifying Authority whose licence has been suspended shall issue any Digital Signature Certificate during such suspension.

**6. Notice of suspension or revocation of licence (Sec. 26):** (1) Where the licence of the Certifying Authority is suspended or revoked, the Controller shall publish notice of such suspension or revocation, as the case may be, in the data base maintained by him.

(2) Where one or more repositories are specified, the Controller shall publish notices of such suspension or revocation, as the case may be, in all such repositories:

Provided that the data base containing the notice of such suspension or revocation, as the case may be, shall be made available through a web site which shall be accessible round the clock.

Provided further that the Controller may if he considers necessary, publicise the contents of data base in such electronic or other media, as he may consider appropriate.

**7. Certifying Authority to follow certain procedures (Sec. 30):** Every certifying Authority shall –

(a) make use of hardware, software, and procedures that are secure from intrusion and misuse;

(b) provide a reasonable level of reliability in- its services which are reasonably suited to the performance of intended functions;

(c) adhere to security procedures to ensure that the secrecy and privacy of the digital signatures are assured; and

(d) observe such other standards as may be specified by regulation.

**8. Certifying Authority to ensure compliance of the Act, etc. (Sec. 31):** Every Certifying Authority shall ensure that every person employed or otherwise engaged by it complies, in the course of his employment or engagement, with the provisions of this Act, rules, regulations or orders made thereunder.

**9. Display of licence (Sec. 32):** Every Certifying Authority shall display its licence at a conspicuous place of the premises in which it carries on its business.

**10. Surrender of licence (Sec. 33):** (1) Every Certifying Authority whose licence is suspended or revoked shall immediately after such suspension or revocation, surrender the licence to the Controller.

(2) Where any Certifying Authority fails to surrender a licence under sub-section (1), the person in whose favour a licence is issued, shall be guilty of an offence and shall be punished with imprisonment which may extend up to six months or a fine which may extend up to ten thousand rupees or with both.

**11. Disclosure (Sec. 34):** Every Certifying Authority shall disclose in the manner specified by regulations –

(a) its Digital Signature Certificate which contains the public key corresponding to the private key used by that Certifying Authority to digitally sign another Digital Signature Certificate;

(b) any certification practice statement relevant thereto;

(c) notice of the revocation or suspension of its Certifying Authority certificate, if any; and

(d) any other fact that materially and adversely affects either the reliability of Digital Signature Certificate, which that Authority has issued, or the Authority's ability to perform its services.

**DIGITAL SIGNATURE CERTIFICATES**

Sections 35 to 38 provide for the issue and suspension of digital certificate. The provisi.ori are explained below:

**1. Certifying authority to issue Digital Signature Certificate (Sec. 35):** (1) Any person may make an application to the Certifying Authority for the issue of a Digital Signature Certificate in such form as may be prescribed by the Central Government.

(2) Every such application shall be accompanied by such fee not exceeding twenty five thousand rupees as. may be prescribed by the Central Government, to be paid to the Certifying Authority

Provided that while prescribing fees under sub-section (2), different fees may be prescribed for different classes of applicants.

(3) Every such application shall be accompanied by a certification practice statement or where there is no such statement, a statement containing such particulars, as may be specified by regulations.

(4) On receipt of an application under sub-section (1), the Certifying Authority may, after consideration of the certification practice statement or the other statement under sub-section (3) and after making such enquiries as it may deem fit, grant the Digital Signature Certificate or for reasons to be recorded in writing, reject the application:

Provided that no Digital Signature Certificate shall be granted unless the Certifying Authority is satisfied that –

(a) the applicant holds the private key corresponding to the public key to be listed in the Digital Signature Certificate;

(b) the applicant holds a private key, which is capable of creating a digital signature;

(c) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the applicant:

Provided further that no application shall be rejected unless the applicant has been given a reasonable opportunity of showing cause against the proposed rejection.

**2. Representations upon issuance of Digital Signature Certificate (Sec. 36):** A Certifying Authority while issuing a Digital Signature Certificate shall certify that –

(a) it has complied with the provisions of this Act and the rules and regulations made thereunder;

(b) it has published the Digital Signature Certificate or otherwise made it available to such person relying on it and the subscriber has accepted it;

(c) the subscriber holds the private key corresponding to the public key listed in the Digital Signature Certificate.;

(d) the subscriber public key and private key constitute a functioning key pair;

(e) the information contained in the Digital Signature Certificate is accurate; and

(f) it has no knowledge of any material fact, which if it had been included in the Digital Signature Certificate would adversely affect the reliability of the representations in clauses (a) to (d).

**3. Suspension of Digital Signature Certificate (Sec. 37):** (1) Subject to the provisions of sub-section (2), the Certify Authority which has issued a Digital Signature Certificate may suspend such Digital Signature Certificate –

(a) on receipt of a request to that effect from –

(i) the subscriber listed iii the Digital Signature Certificate; or

(ii) any person duly authorised to act on behalf of that subscriber;

(b) if it is of opinion that the Digital Signature Certificate should be suspended in public interest.

(2) A Digital Signature Certificate shall not be suspended for a period exceeding fifteen days unless the subscriber has been given an opportunity of being heard in the matter.

(3) On suspension of a Digital Signature Certificate under this section, the Certifying Authority shall communicate the same to the subscriber.

**4. Revocation of Digital Signature Certificate (Sec. 38):** (1) A Certifying Authority may revoke a Digital Signature Certificate issued by it –

(a) where the subscriber or any other person authorized by him makes a request to that effect; or

(b) upon the death of the subscriber, or

(c) upon the dissolution of the firm or winding up of the company where the subscriber is a firm or a company.

(2) A Digital Signature Certificate shall not be revoked unless the subscriber has been given an opportunity of being heard in the matter.

(3) On revocation of a Digital Signature Certificate under this section, the Certifying Authority shall communicate the same to the subscriber.

**5. Notice of suspension or revocation (Sec. 39):** Where a Digital Signature Certificate is suspended or revoked under section 37 or section 38, the Certifying Authority shall publish a notice of such suspension or revocation, as the case may be, in the repository specified in the Digital Signature Certificate for publication of such notice.

**PENALTIES AND ADJUDICATION**

Sections 43 to 47 provide for Penalties and Adjudication in case of contravention of various offences committed under the Act. The provisions are explained below:

**1. Penalty for damage to computer, computer system, etc. (Sec. 43):** If any person without permission of the owner or any other person who is incharge of a computer, computer system or computer network, commits any of the following acts he shall be liable to pay damages by way of compensation not exceeding one crore rupees to the person so affected.

(a) Accesses or secures access to such computer, computer system or computer network;

(b) Downloads, copies or extracts any data, computer data base or information from such computer, computer system or computer network including information or data held or stored in any removable storage medium;

(c) Introduces or causes to be introduced any computer contaminant or computer virus into any computer, computer system or computer network;

(d) Damages or causes to be damaged any computer, computer system or computer network, data, computer data base or any other programmes residing in such computer, computer system or computer network;

(e) Disrupts or causes disruption of any computer, computer system or computer network:

(f) Denies or causes the denial of access to any person authorised to access any computer, computer system or computer network by any means;

(g) Provides any assistance to any person to facilitate access to a computer, computer system or computer network in contravention of the provisions of this Act, rules or regulations made thereunder;

(h) Charges the services availed of by a person to the account of another person by tempering with or manipulating any computer, computer system, or computer network.

**2. Penalty for failure to furnish information, return, etc. (Sec. 44):** If any person who is required under this Act or any rules or regulations made thereunder to –

(a) furnish any document, return or report to the Controller or the Certifying Authority, fails to furnish the same, he shall be liable to .a penalty not exceeding one lakh and fifty thousand rupees for each such failure;

(b) file any return or furnish any information, books or other documents within the time specified therefore in the regulations, fails to file return or furnish the same within the time exceeding therefore in the regulations, he shall be liable to a penalty not exceeding five thousand rupees for every day during which such failure continues;

(c) maintain books of account or records, fails to maintain the same, he shall be liable to a penalty not exceeding ten thousand rupees for every day during which the failure continues.

**3. Residuary penalty (Sec. 45):** Whoever contravenes any rules or regulations made under this Act, for the contravention of which no penalty has been separately provided, shall be liable to pay a. compensation not exceeding twenty-five thousand rupees to the person affected by such contravention or a penalty not exceeding twenty-five thousand rupees.

**4. Power to adjudicate (Sec. 46):** (1) For the purpose of adjudging under the Act, whether any person has committed a contravention of any of the provisions of this Act or of any rule, regulation, direction or order made thereunder the Central Government shall, subject to the provisions of sub-section(3), appoint any officer not below the rank of a Director to the Government of India or an equivalent officer of a State Government to be an adjudicating officer for holding an inquiry in the manner prescribed by the Central Government.

(2) The adjudicating officer shall, after giving the person referred to in sub-section(1), a reasonable opportunity for making representation in the matter and if, on such inquiry, he is satisfied that the person has committed the contravention, he may impose such penalty or award such compensation as he thinks fit in accordance with the provisions of that section.

(3) No person shall .be appointed as an adjudicating officer unless he possesses such experience in the field of Information Technology and legal or judicial experience as may be prescribed by the Central Government.

(4) Where more than one adjudicating officers are appointed, the Central Government shall specify by order the matters and places with respect to which such officers shall exercise their jurisdiction.

**5. Factors to be taken into account by the adjudicating officer –** While adjudging the quantum of compensation under the Act, the adjudicating officer shall have due regard to the following factors, namely :-

(a) the amount of gain of unfair advantage, wherever quantifiable made as a result of the default;

(b) the amount of loss caused to any person as a result of the default;

(c) the repetitive nature of the default.

**OFFENCES**

Sections 65 to 78 provide the following penalties for various offences committed under the Act:

**1. Tampering with computer source documents (Sec. 65)**

Whoever knowingly or intentionally conceals, destroys or alters or intentionally or knowingly causes another to conceal, destroy or alter any computer source code used for a computer, computer programme, computer system or computer network, when the computer source code is required to be kept or maintained by law for the time being in force, shall be punishable with imprisonment up to three years, or with fine which may extend up to two lakh rupees, or with both.

**2. Hacking with Computer System (Sec. 66) –**

1. Whoever with the intent to cause or knowing that he is likely to cause wrongful loss or damage to the public or any person destroys or deletes or alters any information residing in a computer resource or diminishes its value or utility or affects it injuriously by any means, commits hacking.

2. Whoever commits hacking shall be punished with imprisonment up to three years, or with fine which may extend upto two lakh rupees, or with both.

**3. Publishing of information which is absence in electronic form (Sec. 67)**

Whoever publishes or transmits or causes to be published in the electronic form, any material which is lascivious or appeals to the prurient interest or if its effect is such as to tend to deprave and corrupt

persons who are likely, having regard to all relevant circumstances, to read, see or hear the matter contained or embodied in it, shall be punished on first conviction with imprisonment of either description for a term which may extend to five years and with fine which may extend to one lakh rupees and in the event of a second or subsequent conviction with imprisonment of either description for a term which may extend to ten years and also with fine which may extend to two lakh rupees.

**4. Protected system (Sec. 70)**

1. The appropriate Government may, by notification in the Official Gazette, declare that any computer system or computer network to be a protected system.

2. The appropriate Government may, by order in writing, authorise the persons who are authorized to access protected systems notified under sub-section (1).

3. Any person who secures access or attempts to secure access to a protected system in contravention of the provisions of this section shall be punished with imprisonment of either description for a term which may extend to ten years and shall also be liable to fine.

**5. Penalty for misrepresentation (Sec. 71)**

Whoever makes any misrepresentation to, or suppresses any material fact from, the Controller or the Certifying Authority for obtaining any licence or Digital Signature Certificate, as the case may be, shall be punished with imprisonment for a term which may extend to two years, or with fine which may extend to one lakh rupees, or with both.

**6. Breach of confidentiality and privacy (Sec. 72)**

Save as otherwise provided in this Act or any other law for the time being in force, any person who, in pursuance of any of the powers conferred under this Act, rules or regulations made thereunder, has secured access to any electronic record, book, register, correspondence, information, document or other material without the consent of the person concerned discloses such electronic record, book, register, correspondence, information, document or other material to any other person shall be punished with imprisonment for a term which may extend to two years, or with fine which may extend to one lakh rupees, or with both,

**7. Penalty for publishing Digital Signature Certificate false in certain particulars**

**(Sec. 73)**

1. No person shall publish a Digital Signature Certificate or otherwise make it available to any other person with the knowledge that;

(a) the Certifying Authority listed in the certificate has not issued it; or

(b) the subscriber listed in the certificate has not accepted it; or

(c) the certificate has been revoked or suspended,

unless such publication is for the purpose of verifying in digital signature created prior to such suspension or revocation.

2. Any person who contravenes the provisions of sub-section (1) shall be punished with imprisonment for a term which may extend to two years, or with fine which may extend to one lakh rupees, or with both.

**8. Publication for fraudulent purpose (Sec. 74)**

Whoever knowingly creates, publishes or otherwise makes available a Digital Signature Certificate for any fraudulent or unlawful purpose shall be punished with imprisonment for a term which may extend to two years, or with fine which may extend to one lakh rupees, or with both.

**9. Confiscation (Sec. 76)**

Any computer, computer system, floppies, compact disks, tape drives or any other accessories related thereto, in respect of which any provision of this Act, rules, orders or regulations made thereunder has been or is being contravened, shall be liable to confiscation.

**10. Penalties and confiscation not to interfere with other punishments (Sec. 77)**

No penalty imposed or confiscation made under this Act shall prevent the imposition of any other punishment to which the person affected thereby is liable under any other law for the time being in force.

## 19.5 CHECK YOUR PROGRESS

State whether the following statements are True or False:

1. The Information Technology Act, 2000 has come into effect from 17th October, 2000.
2. Digital Signature means signatures downloaded from the internet.
3. Public Key is the key of key-pair used to verify a digital signature

4. The application for a licence to issue digital signature certificate should be made to the Central Government.

## 19.6 SUMMARY

The law relating to information technology is contained in Information Technology Act, 2000. Information Technology Act, 2000 has been designed to give boost to electronic commerce, e-transactions and similar activities associated with commerce and trade, and also to facilitate electronic governance by means of reliable electronic records. With a view to making the citizens interaction with the Government office hassle free, the Information Technology Act, 2000 provides for the use and acceptance of electronic records and digital signatures in the Government offices. To prevent the possible misuse arising out of the transactions and other dealings concluded over the electronic medium, the IT Act also provides for a regulatory regime to supervise the Certifying Authorities.

## 19.7 KEYWORDS

**Addressee:** A person who is intended by the originator to receive the electronic record but does not include any intermediary.

**Certifying Authority:** A person who has been granted a licence to issue a Digital Signature Certificate.

**Digital Signature:** Authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of IT Act.

## 19.8 SELF ASSESSMENT TEST

1. Define the term 'Digital Signature'. State the mode of authentication of an electronic record through digital signature.

2. State the provision of the Information Technology Act regarding:

   (a) Electronic Governance; and

   (b) Attribution, Acknowledgement and Dispatch of Electronic Records.

3. State the considerations which are kept in mind by the Central Government while prescribing the security procedure for securing procedure for securing electronic records or digital signatures.

4. Enumerate the procedure for appointment of the Controller of Certifying Authorities. State his functions and duties.

5. State the provision of the Information Technology Act regarding issue, suspension and revocation of Digital Signature Certificates.

6. State the duties of the subscribes listed in the Digital Signature Certificate.

7. Explain the consequences in case of:

   (a) Tempering with computer source documents.

   (b) Hacking with computer system.

   (c) Publishing of information which is passing in electronic form.

8. Explain the duties of "Certifying Authority" under the Information Technology Act, 2000.

## 19.9 ANSWERS TO CHECK YOUR PROGRESS

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

## 19.10 REFERENCES/SUGGESTED READINGS

1. M C Kuchhal and Vivek Kuchhal, Business Legislation for Management, Vikas Publishing House Pvt. Ltd, Noida.
2. S N Maheshwari and S k Maheshwari, Business Laws, Himalaya Publishing House, Mumbai.
3. S S Gulshan, Mercantile Law, Excel Books, Delhi.

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