# UNIT 1 ESSENTIALS OF A CONTRACT

**Structure**



## 1.0 OBJECTIVES

After studying this unit, you should be able to:

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

## 1 . INTRODUCTION

The law of contract is the most important branch of Mercantile Law. Without such a law it would be difficult, if not impossible, to carry on any trade or business in a smooth manner. The law of contract is applicable not only to business but also to all day-to-day personal dealings. In fact, each one of us enter into a number of contracts from sunrise to sunset. When a person buys a newspaper or rides a bus or purchases goods or gives his radio for repairs or borrows a book from library, he is actually entering into a contract. All these transactions are subject to the provisions of the law of contract. In this introductory unit you will learn, first of all, why we need law and what its various branches are. Then you will learn about the meaning of mercantile law, its sources, and the basic aspects of the law of contract viz., the meaning of contract, its classification and the essentials of a valid contract.

## 1.2 WHAT IS LAW?

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

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

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

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

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

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

## 1.3 MEANING AND SOURCES OF MERCANTILE LAW

You have learnt that mercantile law is a part of civil law and it governs and regulates the trade and commerce in a country. In other words, the mercantile law groups together laws that are considered important for men in business and includes laws relating to various contracts, partnerships, companies, negotiable instruments, insurance, carriage of goods, arbitration, etc.

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

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

2) **Indian Statute Law:** The Acts passed by the Indian Legislature are the main source of Indian mercantile law. The important Acts passed by the Indian

Legislature are the Indian Contract Act 1872, The Negotiable Instruments Act 1881, The Sale of Goods Act 1930, The Indian Partnership Act 1932, The Companies Act 1956, and so on.

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

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

## 1.4 THE LAW OF CONTRACT

The law of contract is the most important part of mercantile law in India. It determines the circumstances in which the promisel, made by the parties to a contract shall be binding on them and provides for the remedies available against a person who fails to perform his promise. The law of contract is contained in the **Indian Contract *Act*, 1872,** which deals with the general principles of law governing all contracts 'and covers the special provisions relating to contracts like bailment, pledge, indemnity, guarantee and agency. Before 1930, this Act also contained the special provisions relating to contracts of sale of goods and partnership. In 1930, however, these provisions were repealed and separate Acts called the 'Sale of Goods Act' and the 'Indian Partnership Act' were passed governing the contracts of sale of goods and partnership respectively. Similarly, there are separate Acts for contracts relating to negotiable instruments, insurance, carriage of goods, etc.

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

## 1.5 WHAT IS A CONTRACT?

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

> ***A contract is an agreement,*** *creating and defining* ***the obligation between parties.*** – Salmond
>
> ***A contract is an agreement*** *enforceable* ***at*** *law* ***made between*** *two or more* ***persons by which rights are acquired by*** *one* ***or more to acts or*** *forbearances* ***on the part of others.*** – Sir William Anson
>
> ***Every agreement and promise enforceable at law is a contract.***
> – Sir Fredrick Pollock

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

Let us discuss these two elements in detail.

### 1.5.1 Agreement

Section 2(e) of the Contract Act defines agreement as ***every promise and every set of promises forming the consideration for each other.*** In this context a promise refer to a proposal (offer) which has been accepted. For example, Ramesh offers to sell his scooter for Rs. 8,000 to Shyam. Shyam accepts this offer. It becomes a promise and treated as an agreement between Ramesh and Shyam. In other words, an agreement consists of an offer by one party and its acceptance by the other. Thus,

Agreement = Offer + Acceptance.

From the above analysis it is clear that there must be at least two parties to an agreement, one making an offer and the other accepting it. No person can enter into agreement with himself. There is another important aspect relating to an agreement i.e., the parties to an agreement must have an identity of minds in respect of the subject matter. They must agree on the same thing in the same sense. This is also called ***consensus-ad-idern.*** Suppose A has two houses, one situated in South Delhi and the other in North Delhi. He offers to sell his North Delhi house to B while B is under the impression that he is buying the South Delhi house. Here., there is no identity of minds. Both the parties are thinking about different houses. Hence there is no agreement.

### 1.5.2 Legal Obligation

In order that an agreement may be regarded as a contract, it must give rise to a legal obligation i.e., it must be enforceable by law. Any obligation (duty) which is not enforceable by law is not regarded as a contract. Social, moral or religious agreements do not create any legal obligation. For example, an agreement to take lunch together or to go to a picnic is not a contract because it does not create a duty enforceable by law. Such agreements are purely of a social nature where there is no intention to create legal relationship. Hence, they do not result in contracts. In case of business agreements, however, the usual presumption is that the parties intend to create a legal relationship. For example, an agreement to sell a scooter for Rs. 8,000 is a contract because it gives rise to an obligation enforceable by law. In this agreement if there is default by either party, an action for breach of contract can be enforced through a court of law provided all the essentials of a valid contract are present in the agreement.

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

### 1.5.3 Distinction between an Agieement and a Contract

| | Agreement. | | Contract |
|---|---|---|---|
| 1) | Offer and its acceptance constitute an agreement. | 1) | Agreement and its enforceability constitute a contract. |
| 2) | An agreement may not create a legal obligation. | 2) | A contract necessarily creates a legal obligation. |

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| 3) Every agreement may not be a contract. | 3) All contracts are agreements. |
| 4) Agreement is not a concluded or a binding contract. | 4) Contract is concluded and binding on the concerned parties. |

**Check Your Progress A**

1) What is Law?

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2) State the sources of mercantile law.

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3) Define an agreement.

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4) What do you mean by legal obligation?

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

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

ii) Mercantile law is applicable to business community only. .....

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

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

v) All contracts are agreements. .....

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

## 1.6 CLASSIFICATION OF CONTRACTS

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

1) On the basis of creation.

2) On the basis of execution.

3) On the basis of enforceability.

### 1.6.1 On the Basis of Creation

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

i) **Express Contract:** An express contract is one where the terms are clearly stated in words, spoken or written. For example, A wrote a letter to B stating "I

offer to sell my car for Rs. 30,000 to you", B accepts the offer by letter sent to A. This is an express contract. Similarly, when A asks a scooter mechanic to repair his scooter and the mechanic agrees, it is an express contract made orally by spoken words.

ii) Implied Contract: A contract may be created by the conduct or acts of parties (and not by their words spoken or written). It may result from a continuing course of conduct of the parties. For example, where a coolie in uniform carries the luggage of A to be carried out of railway station without being asked by A to do so and A allows it, the law implies that A has agreed to pay for the services of the coolie. This is a case of an implied contract between A and the coolie. Similarly, when A boards a D.T.C bus, an implied contract comes into being. A is bound to pay the prescribed fare.

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

### 1.6.2 On the Basis of Execution

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

i) Executed Contracts: It is a contract where both the parties have fulfilled their respective obligations under the contract. For example, A agrees to sell his book to B for Rs. 30. A delivers the book to B and B pays Rs. 30 to A. It is an executed contract.

ii) Executory Contracts: It is a contract where both the parties to the contract have still to perform their respective obligations. For example, A agrees to sell a book to B for Rs. 30. If the book has not been delivered by A and B has not paid the price. the contract is executory.

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

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

### 1.6.3 On the Basis of Enforceability

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

i) Valid Contract: A contract which satisfies all the conditions prescribed by law is a valid contract. (These conditions are discussed in Section 1.8.) If one or more of these elements is/are missing, the contract is either void, voidable, illegal or unenforceable.

ii) Void Contract: According to Section 2 (j) A *contract which ceases to be*

***enforceable by law becomes void when it ceases to be enforceable.*** It is a contract without any legal effects and is a nullity. You should note that a contract is not void from its inception. It is valid and binding upon the parties when made, but subsequent to its formation, due to certain reasons, it becomes unenforceable and so treated as void. A contract may become void due to impossibility of performance, change of law or some other reasons. For example, A promised to marry B. Later on, B dies. This contract becomes void on the death of B. A void contract should be distinguished from void agreement. Section **2(g)** says that an ***agreement nor enforceable by law is said to be void.*** In the case of void agreement no contract comes into existence. Such an agreement confers no rights on any person and creates no obligations. It is void ***ab-initio*** **i.e., from** the very beginning. For example an agreement with a minor is void because a minor is incompetent to contract.

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

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

Distinction between Void Agreement and Voidable Contracts

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

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| valid contract, it always remains void. | reasonable time, it may become valid. |
| 6) Question of damages does not arise. | 6) The aggrieved party can also claim damages. |

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

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

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

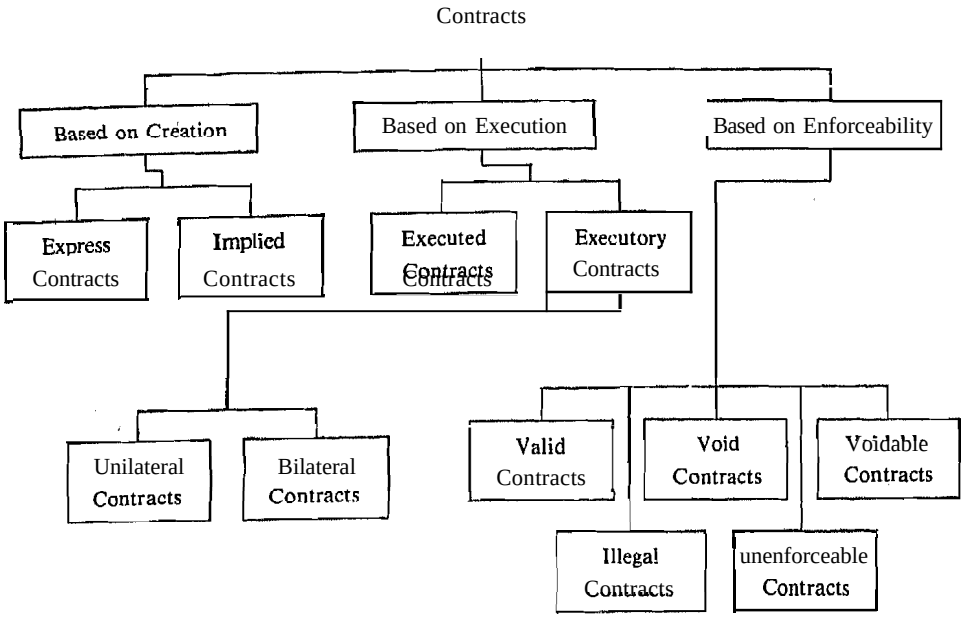
Difference between Void and Illegal Agreements

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

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

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

**Figure 1.1 Classification of Contracts**




Check Your Progress B

1) What is a void contract?

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2) When is a contract voidable?

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3) What is an illegal agreement?

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

i) A puts a one rupee coin in a public telephone booth. .....

ii) A boards a D.T.C bus for Meerut. .....

iii) A engages B to smuggle goods into India. .....

iv) A invites B for dinner at his house. .....

v) A engages B to do some sanitary work for Rs. 20. .....

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

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

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

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

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

v) A promises to pay B Rs. 200 if B beats C. B beats C. Can B recover the amount from A?

## 1.7 ESSENTIALS OF A VALID CONTRACT

You have learnt that an agreement enforceable by law is a contract. An agreement in order to be enforceable must have certain essential elements. According to Section 10 – ***All agreements are contracts if they are made*** by ***the free consent of the parties competent to contract, for a lawful consideration and with a lawful*** object, ***and are not hereby expressly declared to be void.*** Thus, an agreement becomes a valid contract if it has the following elements.

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

Let us now discuss these essential elements one by one.

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

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

In commercial or business transactions the usual presumption is that the parties intend to create legal relations. However, this presumption may' be negatived by express terms to the contrary. The case of **Rose & Frank Co. v. Crompton Brothers** is relevant here. In this case there was an agreement between Rose & Frank Company and Crompton Brothers Ltd. whereby the former was appointed as selling agents in North America. One of the clauses in the agreement read, "This agreement is not entered into as a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts." It was held, that this agreement was not a legally binding contract as there was no intention to create legal relations.

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

3) **Free consent:** For a contract to be valid, it is essential that there must be free and genuine consent of the parties to the contract. They must have made the contract of their own free will and not under any fear or pressure. According to Section 14, ***consent is said to be free when it is not caused by (i) coercion,' (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake.*** In case the consent is obtained by any of the first four factors, the contract would be voidable at the option of the aggrieved party. But if the agreement is induced by mutual mistake which is material to the agreement, it would be void. You will learn about free consent in detail in Unit 4.

4) **Capacity of parties:** The parties to an agreement must be competent to contract i.e., they must be capable of entering into a contract. If any party to the contract is not competent to contract, the contract is not valid. Now the question arises as to who are competent to contract? Answer to this question is provided by Section 1I of the Act which says that ***every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind, and is not disqualified from contracting by any law to which he is subject.***

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

5) **Lawful consideration:** An agreement must be supported by consideration. Consideration means something in return. It is also defined as the price paid by one party to buy the promise of the other. However, this price need not always be in terms of money. For' example, A agrees to sell his book to B for Rs. 20. Here the consideration for A is Rs. 20, and for B it is the book.

The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something, The consideration may be past, present or future, consideration must be real i.e., it must have some value in the eyes of law. However, the consideration need not be adequate. For example, A sells his car worth Rs. 50,000 to B for Rs. 10,000 only. This is a valid promise provided the consent of A is free.

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

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

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

For example, A agreed to pay Rs. 1,000 to B if he (B) does not marry throughout his life. B promised not to marry at all. This agreement shall not

be valid because it is in restraint of marriage which has been expressly declared void under Section **26.**

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

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

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

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

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

## 1.8 LET US SUM UP

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

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

Contracts can be classified according to their (i) creation, (ii) execution, and (iii) enforceability. From the point of view of creation a contract may be either express or implied. From the point of view of execution it may be

executed/executory or it may be unilateral/bilateral, and from the point of view of enforceability it may be a valid, void, voidable, illegal or unenforceable contract.

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

For an agreement to become a contract enforceable by law, it must have certain essential elements. These are: (i) there must be proper offer and its proper acceptance, (ii) there must be an intention to create legal relationship, (iii) the consent of the parties must be free, (iv) the parties must be competent to contract, (v) it must be supported by lawful consideration, (vi) the object of the agreement must be lawful, (vii) the agreement must not have been expressly declared void, (viii) the terms of the agreement inust be certain and unambiguous, (ix) the act involved should be such as is capable of performance, and (x) if there are certain formalities like registration, etc., they should be duly complied with.

## 1.9 KEY WORDS

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

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

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

**Contract:** An agreement enforceable by law.

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

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

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

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

**Promise:** An accepted proposal.

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

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

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

**Void Agreement:** An agreement not enforceable by law.

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

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

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

## 1.1 ANSWERS TO CHECK YOUR PROGRESS

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

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

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

## 1.11 TERMINAL QUESTIONS/EXERCISES

1) Define contract. Explain the essentials of a valid contract.

2) Comment on the following statements.

a) "All contracts are agreement but all agreements are not contracts."
b) "The law of contract is not the whole law of agreements nor is it the whole law of obligations."
c) "In commercial and business agreements, the presumption is that the parties intend to create legal relations."

3) Distinguish between

a) Void and Voidable contracts
b) Void and Illegal agreements

4) Answer the following questions giving suitable reasons:

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

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

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

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

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

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

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

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

v) A promises to give a gift of Rs. 1,000 to B on his marriage. A fails to keep his promise. Can B recover the money?

*(Hint: B* cannot recover the money because there is consideration from B.)

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

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

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

# UNIT 2 OFFER AND ACCEPTANCE

**Structure**



## 2.0 OBJECTIVES

After studying this unit you should be able to:

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

## 2.1 INTRODUCTION

In Unit 1 you learnt that an agreement enforceable by law is a contract and that an agreement to become enforceable by law must have certain essential elements. You also learnt that there must be at least two parties to an agreement, one making an offer and the other accepting that offer. Thus, an offer and its

acceptance are the starting points in the making of an agreement. In this unit you will learn about the various rules regarding a valid offer and a valid acceptance. You will also learn how an offer and its acceptance are to be communicated and when they can be revoked.

## 2.2 OFFER

### 2.2.1 What is an Offer?

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

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

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

i) It must be an expression of readiness or willingness to do or to abstain from doing something. Thus, it may involve a 'positive' or a 'negative' act. For example, A offers to sell his book to B for Rs. 30. **A** is making a proposal to do something i.e., to sell his book. It is a positive act on the part of the proposer **A.** On the other hand, when A offers not to file a suit against B if the latter pays **A** the outstanding amount of Rs. 1,000, the act of A is a negative one i.e., he is offering to abstain from filing a suit.

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

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

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

### 2.2.2 How is an Offer Made?

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

**Express Offer:** When an offer is made by words, spoken or written, it is termed as an express offer. When **A** says to B that he wants to sell his book to B for Rs. 20, it is an express offer. Similarly, when A writes a letter to B offering to sell his car to him for Rs. 40,000, it is also an express offer by **A.** The oral offer may be made either in person or over telephone. Section **9** of the Contract Act reads: ***"In so far as the proposal or acceptance of any promise is made in words, the promise is said to be express."***

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

## 2.2.3 To Whom an Offer is Made?

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

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

## 2.2.4 Legal Rules for a Valid Offer

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

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

   Terms of offer must be certain, **definite** and not vague: No contract can be formed if the terms of the offer are vague, loose and indefinite. The reason is quite simple. When the offer itself is vague or loose or uncertain, it will not be clear as to what exactly the parties intended to do. A vague offer does not convey what it exactly means. For example, A promises to buy one more horse from B if the horse purchased earlier proves lucky. This promise cannot be enforced because it is loose and vague. Similar is the case when A agrees to sell his car to B for Rs. 30,000 after making necessary repairs. What are necessary repairs is a debatable question and as such the offer is not valid.

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

quite clear that he wants to sell coconut oil. Hence, his offer is not vague. It is a valid offer.

Sometimes, the parties agree to enter into a contract on some future date, Such agreement is not valid because the terms of the offer are uncertain and they are yet to be settled. The law does not allow making of an agreement to agree in future. In the case of Loftus v. Roberts, an actress was engaged for a provincial tour. The agreement provided that if the party went to London, the actress will be engaged at a salary to be mutually agreed upon. It was held that there was a contract as the terms were not definite.

3) **The offer** must be distinguished **from** a **mere declaration of intention:** Sometimes a person may make a statement without any intention of creating a binding obligation. Such statement or declaration only indicate that he is villing to negotiate and an offer will be made or invited in future. For example an auctioneer advertised in a newspaper that a sale of office furniture will be held on a certain date. A person with the intention to buy furniture came from a distant place for the auction, but the auction was cancelled. He cannot file a suit against the auctioneer for his loss of time and expenses because the advertisement was merely a declaration of intention to hold auction, (Harris v. N Nieversion). Similarly, a notice that goods will be sold by tender does not amount to an offer. When a person calls for tenders, it is only an attempt to ascertain whether an offer can be obtained within such a margin as the seller is willing to adopt (Spencer v. Harding). The tenderers by submitting their tenders make offers and it is for the person inviting tenders to accept them or not. In case of Farina v. Fickus, a father wrote to his would be son-in-law that his daughter would have a share of what he left. It was held that the letter was a mere statement of intention and not an offer.

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

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

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

5) The offer must be **communicated:** An offer must be communicated to the person to whom it is made. The first part of the definition of proposal emphasises this fact by saying that "When one person signifies to another his

willingness to or to abstain....." It means that an offer is complete only when it is communicated to the offeree. You should note that a person can accept the offer only when he knows about it. An offer accepted without his knowledge does not confer any legal rights on the acceptor. There can be no valid acceptance unless there is knowledge of the offer.

In the case of **Fitch v. Snedakar, S** offered a reward to any one who returns his lost dog. F brought the dog without any knowledge of the offer of reward. It was held that F was not entitled to the reward because F cannot be said to have accepted the offer which he was not aware of. In another important case of **Lalman Shukla v. Gauri Dutt, *G*** sent his servant L to trace his lost nephew. When the servant had left, ***G*** announced a reward of Rs. 501 to anyone who traces the boy. L found the boy and brought him home. When L came to know of the reward, he decided to claim it. It was held that L was not entitled to the reward because he did not know about the offer when he found the missing boy. It is also necessary that tlie offer is communicated by the offerer himself or by his authorised agent. If a person comes to know about the offer from some ot' er source, he cannot make it a binding contract by accepting it. For example, A writes a letter to B at Bombay offering to sell his house. This letter is misplaced and it never reaches B. But, a common friend P had informed B about the said letter of A containing the offer. B sends his letter of acceptance to A. In such a situation, no contract will be formed.

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

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

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

exemption clause because there was no indication on the face of the ticket to draw his attention to the special terms printed on the back of the ticket.

You must note that if the special terms and conditions have been brought to the notice of the offeree, he will be bound by them even if he has not read them or is an illiterate. In the case of Parket v. South Eastern Railway Company, P deposited his bag in the cloakroom at a railway station. On the face of the receipt the words "see back" were printed. One of the conditions printed on the back limited the liability of the railway company for any package to £ 1. The bag was lost and P claimed £ 24. Sh. 10, the actual value of the bag. P admitted knbwledge of the conditions printed on the back, but denied having read it. It was held-that P was bound by the print on the back side even though he had not read them because the railways had given reasonably sufficient notice on the face of the ticket as to the existence of conditions. Therefore, P could recover £ 10 only.

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

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

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

### 2.2.5 Cross Offers

Two offers which are similar in all respects, made by two parties to each other, in ignorance of each other's offer are known as 'cross offers". Cross offers do not amount to acceptance of one's offer by the other and as such no contract is concluded. For example, A of Delhi, by a letter offers to sell his house to B of Bombay for Rs. 10 lakh. At the same time, B of Bombay also makes an offer to A to buy A's house for Rs. 101 lakh. The two letters cross each other. There is no concluded contract between A and B because both the parties are making offers. If they want to conclude a contract, at least one of them must send his acceptance to the offer made by the other.

### 2.2.6 Standing Offers

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

An advertisement inviting tenders is not an offer but a mere invitation to offer. It is the person submitting the tender to supply goods or services who is deemed to have made the offer, when a particular tender is accepted or approved, it becomes

a standing offer. The acceptance or approval of a tender does not however, amount to acceptance of the offer. It simply means that the offer will remain open during a specified period and that it will be accepted from time to time by placing specific orders for the supply of goods. Thus each order placed creates a separate contract. The offerer can however withdraw his offer at any time before an order is placed with him. Similarly, the party who has accepted the tender is also not bound to place any order unless there is an agreement to purchase a specified quantity. For example,

A agrees to supply coal of any quantity to B at a certain price as will be ordered by B during the period of 12 months. It is a standing offer. Each order given by B will be an acceptance of the offer and A will be bound to supply the ordered quantity of coal. A can however, revoke the offer for future supplies at any time by giving a notice to the offeree.

Check Your Progress A

1) What is an offer?

.....

.....

.....

2) What do your mean by a general offer?

.....

.....

.....

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

.....

.....

.....

4) Fill in the blanks :

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

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

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

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

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

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

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

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

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

iv) An advertisement offering reward to anyone who finds the lost dog of the advertiser is nbt an offer. .....

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

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

## 2.3 ACCEPTANCE

### 2.3.1 . What is an Acceptance?

You have learnt that when an offer is accepted, it results in an agreement. Let us

now study what exactly an acceptance is. Acceptance is an expression by the offeree of his willingness to be bound by the terms of the offer. This results in the establishment of legal relations between the offerer and offeree. Section 2(b) of the Indian Contract Act defines the term 'acceptance' as ***"when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.''*** For example, A offers to sell his book to B for Rs. 20. B agrees to buy the book for Rs. 20. This is an acceptance of A's offer by B.

## 2.3.2 Who Can Accept?

An offer can be accepted only by the person or persons to whom it is made. An offer made to a particular person (specific offer) can be accepted only by him and none else. The rule of law is that if A wants to enter into a contract with B, then C cannot substitute himself for B without A's consent. In the case of Boulton v. Jones, A sold his business to B but this fact was not known to an old customer C. C sent an order for goods to A by name. B supplied the goods to C. It was held that there was no contract between B and C because C never made any offer to B. If an offer is made to the world at large (general offer) any person can accept the offer provided he has the knowledge of the offer. You have seen in Carlill v. Carbolic Smoke Ball Co's case'that the lady accepted the offer by using the smoke balls. Similarly, in case a reward has been offered for giving information about missing person or a lost article, any person who gives the necessary information first, shall be entitled to the reward.

## 2.3.3 How is an Acceptance Made?

You know that an offer may be either express or implied. Similarly, the acceptance may also be either express or implied. When the acceptance is given by words spoken or written, it is called an 'express acceptance'. For example, A offers to sell his book to B for Rs. 20. B may accept this offer by stating so orally or by writing a letter to A. The acceptance may also be implied by conduct. For example, A offers a reward of Rs. 100 to anyone who traces his lost dog. B, who was aware of this offer, finds the dog, he is entitled to the reward as he accepted the offer by doing the required act. Take another example. A enters into DTC bus for going to Rajghat. This is an implied acceptance by A and he is bound to pay the fare.

## 2.3.4 Legal Rules for a Valid Acceptance

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

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

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

   Sometimes, a person may accept the offer "subject to a contract" or "subject to formal contract" or "subject to contract to be approved by the

solicitors''. In such cases no contract arises because a condition remains to be performed in the future. For example, A's bid was provisionally accepted at an auction sale. The acceptance was 'subject to confirmation'. Before confirniation, however, A withdrew his bid. It was held that because acceptance was not absolute, it was subject to confirmation, A can withdraw his bid before it is confirmed.

2) **Acceptance** must be in the prescribed manner : Where the offerer has prescribed a mode of acceptance, it must be accepted in that very manner. If the offer is not accepted in the prescribed manner it is up to the offerer to accept or reject such acceptance. But when the acceptance is not in the prescribed manner and the offerer wants to reject it, he must inform the acceptor within a reasonable time that he is not bound by acceptance since it is not in the prescribed manner. If he does not do so within a reasonable time, he will be bound by the acceptance. For example, A makes an offer to B and says ''send your acceptance by telegram''. B sends his acceptance by a letter. A can refuse this acceptance on the ground that it was not accepted in the prescribed manner. But, if A fails to inform B within a reasonable time he will be deemed to have accepted the acceptance by ordinary letter and it will result in the formation of a valid contract: If, however, no mode has been prescribed, it should be accepted in some usual and reasonable manner.

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

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

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

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

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

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

Check **Your** Progress B

1) Define Acceptance.

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.....

.....

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

.....

.....

.....

3) Fill in the blanks :

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

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

iii) Acceptance must be made in the ..... manner.

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

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

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

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

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

iii) Partial acceptance is invalid. .....

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

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

## 2.4 COMMUNICATION OF OFFER AND ACCEPTANCE

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

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

## 2.4.1 Communication of Offer

According to Section 4 of the Contract Act, the communication of an offer is complete when it comes to the knowledge of the person to whom it is made i.e., when the letter containing the offer reaches the offeree. For example, A of Delhi sends a letter by post to B of Bombay offering to sell his house for Rs. 10 lakh. The letter is posted on April 5, and this letter reaches B on April 7. The communication of the offer is complete on April 7.

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

## 2.4.2 Communication of Acceptance

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

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

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

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

## 2.4.3 Contracts over, Telephone

A contract by telephone is treated on the same principle as an oral agreement made between two parties when they are face to face with each other. Thus, when offers of acceptance are made on phone, the parties are in direct contact and no contract is concluded until the offerer actually receives or hears the acceptance i.e., the contract is made only when the acceptance, is clearly heard and understood by

the offerer. The acceptor must ensure that his acceptance is properly received by the offerer. Normally when the parties disconnect they usually utter suclr words as 'Bye', 'O.K.', etc. This indicates that the parties have heard what they wanted to communicate. But, if the conversation is interrupted before acceptance has been given, the contract is not concluded. For example, **A** made an offer to B over telephone. While B was conveying his acceptance, the line suddenly went dead and **A** could not hear anything. Thus, no contract was concluded. Then, B makes another attempt and this time he could convey his acceptance. The contract is said to be concluded on the second attempt.

## 2.5 REVOCATION OF OFFER AND ACCEPTANCE

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

### 2.5.1 Revocation of Offer

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

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

### 2.5.2 Revocation of Acceptance

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

Sometimes, an interesting situation may arise. The letter of acceptance and the telegram containing revocation of acceptance may be delivered to the offerer at the same time. In such a situation the formation of a contract is a matter s f chance. Which one is opened first by the offerer will decide the issue. Generally it is presumed that **a** man of ordinary prudence will first read the telegram. Hence, the revocation will be quite effective.

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

In brief you should remember that an offer can be revoked at any time before the

letter of acceptance' is posted and an acceptance can be revoked before it reaches the offerer.

### 2.5.3 Communication of Revocation

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

i) **As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who make it.**

ii) **As against the person to whom it is made, when it comes to his knowledge.**

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

## 2.6 LAPSE OF AN OFFER

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

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

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

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

3) **By failure to fulfil condition precedent to acceptance:** When there is a condition in the offer which must be fulfilled before the acceptance of the offer, the offer lapses if the acceptance is given without fulfilling that condition. For example, A offered to sell his scooter to B for Rs. 10,000 subject to the candition that B should pay Rs. 2,000 before a certain date. B accepted the offer but did not pay the money. In this case the acceptance has no validity and the offer stands terminated.

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

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

6) By counter offer by the offeree: Counter offer means making a fresh offer instead of accepting the original offer. A counter offer amounts to the rejection of the original offer. Hence, as soon as the counter offer is made, the original offer stand lapsed. If the person who makes a counter offer changes his mind and wishes to accept the original offer, he cannot do so. For example, A offered to sell his bicycle to B for Rs. 200. B said that he would buy it for Rs. 170. Here B's offer to buy for Rs. 170 is counter offer and terminates the original offer of A. If later on B wants to buy the cycle for Rs. 200, it will be a case of a fresh offer and not an acceptance of the original offer.

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

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

Check Your Progress C

1) When is communication of offer complete?

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

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.....

.....

3) When is communication of revocation complete?

.....

.....

.....

4) Fill in the blanks :

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

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

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

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

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

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

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

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

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

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

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

## 2.7 LET US SUM UP

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

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

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

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

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

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

An offer may be **revoked** up to the time the acceptor posts his letter of acceptance but not afterwards. An acceptance may be revoked at any tjme before the letter of acceptance reaches the. offerer, but not afterwards. The communication of revocation is complete (i) as against the person who makes it ,when it is put into a course of transmission to the person to whom it is made, and (ii) as against the person to whom it is made, when it comes to his knowledge.

An offer comes to an end (i) by lapse of stipulated or reasonable time, (ii) by the

death of insanity of the offerer or the offeree before acceptance, (iii) by the failure to fulfil a condition precedent to acceptance (iv) by rejection of offer by the offeree, (v) when it is not accepted in the prescribed manner or in some usual or reasonable manner, (vi) when a counter offer is made by the offeree, (vii) when the offerer revokes the offer-before it is accepted by the offeree, (viii) when it becomes illegal or itssubject-matter is destroyed before acceptance.

## 2.8 KEY WORDS

Acceptance : Giving consent to the offer.

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

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

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

General Offer : Offer made to the world at large.

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

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

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

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

Specific Offer : Offer made to a definite person.

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

## 2.9 ANSWERS TO CHECK YOUR PROGRESS

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

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

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

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

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

ii) when the letter of acceptance is posted.

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

iv) before the letter of acceptance reaches the offerer.

v) lapse.

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

## 2.10 TERMINAL QUESTIONS/EXERCISES

Questions

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

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

3) Comment on the following statements.

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

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

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

4) When does an offer come to an end?

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

6) Can the following be regarded as offers?

i) a catalogue of goods for sale

ii) an advertisement to sell goods by auction

iii) display of goods with price tags attached to them

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

v) an announcement or notice to pay a reward of Rs. 100 to anyone who finds and returns his lost dog.

7) Explain the following terms with examples

i) Cross Offer

ii) Counter Offer

iii) General Offer

iv) Implied Offer

v) Invitation to Offer

8) Answer the following giving suitable reasons.

i) Narender offers to sell his scooter to Mohan for Rs. 6,000. Mohan replies, "I will pay Rs. 5,500 for it." Narender refuses to sell at this price. Mohan then offers to pay Rs. 6,000 to Narender. But, Narender refuses to sell his scooter. Discuss the position of parties.

(Hint: Narender is not bound to sell his scooter. His original offer to sell for Rs. 6,000 came to an end when a counter offer was made.)

ii) Ram offered to pay Rs 10,000 to any person who would swim a hundred yards on Bombay's sea coast on the New Year's Day. A fisherman was accidently thrown overboard by the rough sea waves and he swam this distance to save his life. He claimed this award. Will he succeed?

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

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

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

iv) A proposes, by a letter sent by post; to sell his car to B at a certain price. B accepts the proposal by a letter sent by post. B sends a telegram next day revoking his acceptance and this telegram reaches A before the letter of acceptance. Is revocation of acceptance valid?

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

v) Vijay gave an advertisement in the newspapers that he would sell his household goods by auction on January 10, 1989 at his residence at New Delhi. Amitabh from Bombay, reached New Delhi on the appointed date and time, but Vijay had cancelled the auction sale. Advise Amitabh.

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

vi) Lalji offered to sell his plot to Sohan for Rs. 10 lakh. Sohan accepts the offer enclosing a cheque for Rs. 2 lakh. With a promise to pay the balance in two instalments. Is there any contract?

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

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

# UNIT 3 CAPACITY OF PARTIES

**Structure**



## 3.0 OBJECTIVES

After studying this unit you should be able to:

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

## 3.1 INTRODUCTION

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

## 3.2 WHO IS COMPETENT TO CONTRACT?

Section 11 of the Indian Contract Act clearly states as to who shall be competent to contract. It provides that ***every person is competent to contract (i) who is of the age of majority according to the law to which he is subject, (ii) who is of sound mind, and (iii) who is not disqualified from contracting by any law to which he is subject.*** Thus, a person to be competent to contract should not be

i) a minor, or

ii) of an unsound mind, or

iii) disqualified from contracting

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

## 3.3 POSITION OF A MINOR

### 3.3.1 Who Is 'a Minor?

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

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

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

### 3.3.2 Position of Agreements by a Minor

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

The position with regard to minor's contracts may be summed-up as follows:

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

2) Fraudulent representation by a minor: Will it make any change in case minor is guilty of deliberate misrepresentation about his age thereby inducing the other party to contract with him? No! it will make no change in the status of the agreement. The contract shall continue to remain void because if such a thing is permitted, unscrupulous people while dealing with a minor shall, as a first thing, ask him to sign a declaration that he is of the age of majority. It will thus defeat the whole objective of protecting his interests.

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

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

But, should it mean that those younger in age have liberty to cheat the seniors and retain the benefits. The Lahore High Court (prior to partition) in Khan Gul v. Lakha Singh held that where the contract is set aside the *status* quo ante

should be restored and the court may direct the minor, on equitable grounds, to restore the money or property to the other party. Thus, in such cases, if money could be traced, the court would, on equitable grounds, ask the minor for restitution. Sections 30 and 33 of the Specific Relief Act. 1963 provide that in case of a fraudulent misrepresentation af his age hy the minor, inducing the other party to enter into a contract, the court may award compensation to the other party.

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

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

5) **Minor as a partner: A** minor cannot be a partner in a partnership firm. However, a minor may, with the consent of all the partners for the time being, be admitted to the benefits of partnership (Section 30 of the Partnership Act, 1932). This means he can share the profits without incurring any personal liability for losses.

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

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

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

Exceptions

1) **Contract for the benefit of a minor:** A person incompetent to contract may accept a benefit and be a transferee, Although a sale or mortgage of property by a minor is void, a duly executed transfer by way of sale or mortgage in favour of a minor who has paid to valid consideration is not void. Such a transaction shall be enforceable by him or any other person on his behalf, A minor, therefore, in whose favour a deed of sale is executed is competent to sue for possession of the property conveyed thereby. It was held by a Full Bench of the Madras High Court that a mortgage executed in favour of a minor who has

advanced the mortgage money is enforceable by him or by any other person on his behalf (Raghva v. Srinivasa, 1917). Similarly, a minor can be the payee of a cheque or any other negotiable instrument and claim payment thereon. Also, where a minor sells goods to another major person, he shall be entitled to recover its price from him.

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

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

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

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

However, you should note that the payment for necessaries supplied to a minor can only be claimed out of the properties belonging to the minor. He cannot be held personally liable for the same, i.e., he cannot be asked to expend labour in exchange, nor can his income, if any, be attached. This rule is equally applicable to the necessary services rendered to him. Thus, the lending of money to a minor for the purpose of defending a suit on behalf of a minor in which his property is in jeopardy, or for defending him in prosecution, or for saving his property from sale in execution of a decree is deemed to be a service rendered to the minor. Other examples of necessary services rendered to a minor are: provision of education, medical and legal advice, provision of a house on rent to a minor for the purpose of living and continuing his studies.

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

**Check Your Progress A**

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

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

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

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

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

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

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

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

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

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

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

2) The .guardian of a minor (a) can (b) cannot bind the minor by a contract . entered into on his behalf for the purchase of immovable property. Which statement is correct?

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

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

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## 3.4 AGREEMENTS BY PERSONS OF UNSOUND MIND

### 3.4.1 Who is a Person of Sound Mind?

You know that a person while making a contract should be of a sound mind otherwise the contract will have no validity in the eyes of law. Who is a person of sound mind has been amply clarified by Section 12 of the Indian Contract Act which reads ***a person is said to be of sound mind for the purpose of making a contract, if at the time when he makes it, he is capable of understanding it and of forming a rational judgement as to its effect upon his interests.*** Thus soundness of mind of a person depends on two facts:

i) his capacity to understand the terms of the contract, and

ii) his ability to form a rational judgement as to its effect upon his interests. If a person is incapable of both, he suffers from unsoundness of mind. Idiots, lunatics and drunken persons are examples of those having an unsound mind

Section 12 further states that *a person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.*

**Examples**

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

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

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

### 3.4.2 Burden of Proof

The following rules may be noted in this regard:

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

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

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

### 3.4.3 Position of Agreements by Persons of Unsound Mind

1) **Lunatics: A** lunatic is a persan who is mentally deranged due to some mental strain or other personal experience. However, he has some intervals of sound mind. He is not liable for contracts entered into while he is of unsound mind. However, as regards contracts entered into during lucid intervals, he is bound. His position in this regard is identical with that of a minor.

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

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

**Exceptions**

**A** contract with a person of unsound mind is subject to the same exceptions as the contract with a minor is. Thus a person of unsound mind (i) may enforce a .

contract for his benefit, and (ii) his properties, if any, shall be attachable for realisation of money due against him for supply of necessaries to him or to any of his dependents.

## 3.5 PERSONS DISQUALIFIED BY LAW

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

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

An alien friend, (i.e., a foreigner) whose country is at peace with the Republic of India, has usually the full contractual capacity of a natural born Indian subject. But, he cannot acquire property in Indian ship or be employed as Master or any of other Chief Officer of such a ship.

In the case of contracts with an alien enemy (i.e., an alien whose country is at war with India) the position may be studied under two heads: (i) contracts during the war and (ii) contracts made before the war. During the subsistence of the war, an alien can neither contract with an Indian subject nor can be sued in an Indian Court except by licence from the Central Government. As regards contracts entered' into before the war breaks out, they are either dissolved of merely suspended. All contracts, which are against the public policy or are such that may benefit the enemy, stand dissolved. The contracts which are not against public policy are merely suspended for the duration of the war and revived after the war is over, provided they have not already become time-barred under the law of limitations.

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

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

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

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

**Company under the Companies Act or Statutory Corporation under special Act of Parliament:** A company or a corporation is an artificial person. It exists only in contemplation of law, its contractual capacity, is determined by its constitution. The contractual capacity of a statutory corporation is expressly defined by the statute creating it. The contractual capacity of a company registered under the Companies Act is determined by the objects clause of its memorandum of association. Any act done in excess of the powers given in the memorandum is ultra-vires and void.

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

Check Your Progress B

l) State whether each of the following statements is True 'or False.

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

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

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

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

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

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

.....

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3) What is idiocy?

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## 3.6 LET US SUM UP

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

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

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

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

## 3.7 KEY WORDS

Alien: A resident of a foreign country.

Convict: A person found guilty of an offence.

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

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

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

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

Void-ab-initio: Void from the beginning.

## 3.8 ANSWERS TO CHECK YOUR PROGRESS

**A)** 1) i) false ii) true iii) false iv) false v) true vi) ture vii) false viii) false ix) false x) trpe

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

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

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

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

## 3.9 TERMINAL, QUESTIONS/EXERCISES

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

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

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

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

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

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

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

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

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

ii) Hari sold some goods to Gaurav on credit not knowing that Gaurav was a minor. Hari did not receive the payment. Can he sue Gaurav on attaining majority?.
(Hint: No, a contract with a minor is void ab-initio)

iii) A, a minor sold some goods to B, a major. Can he recover the price?
(Hint: Yes, a minor can be a promisee.)

iv) Anthony, a major, executes a promissory note in favour of Roberts for the necessaries supplied by Roberts to Anthony during Anthony's minority. Is Anthony liable to Roberts on the promissory note?
*(Hint:* No, Anthony is not liable to pay)

**v)** Shailendra, on behalf of her minor daughter, entered into a contract with Girish whereby Girish promised to marry her. Later on, Girish refused to marry. Can she sue Girish for damages?
(*Hint:* Yes, she could maintain a suit for ddmages as it was for her benefit.)

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

# UNIT 4 FREE CONSENT

## Structure



## 4.0 OBJECTIVES

After studying this unit you should be able to:

- explain the meaning of consent
- describe the circumstances when consent is not free
- explain the meaning of coercion and undue influence, and their effect on the validity of a contract
- distinguish between 'coercion and undue influence'
- explain the meaning of misrepresentation and fraud, and describe their effect on the validity of a contract
- distinguish between misrepresentation and fraud
- describe various types of mistakes and their effect on the validity of a contract.

## 4.1 INTRODUCTION

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

## 4.2 MEANING OF CONSENT

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

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

## 4.3 CONCEPT OF FREE CONSENT

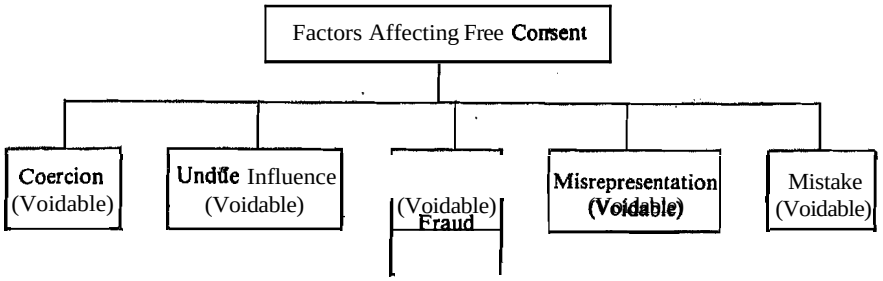
For a contract to be valid it is not enough that the parties have given their consent. The consent should also be free i.e., it has been given by the free will of the parties involving no pressure or use of force. Section 10 of the Contract Act specifically provides that ***All agreements are contracts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

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

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

and their effect on the validity of the contract.

**Figure 4.1.**




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

## 4.4 COERCION

### 4.4.1 What is Coercion?

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

1) **Committing any act forbidden by the Indian Penal Code** : When the consent of a person is obtained by committing any act which is forbidden by the Indian Penal Code, the consent is said to be obtained by coercion. Committing a murder, kidnapping, causing hurt, rape, defamation, theft etc. are some of the examples of the acts forbidden by the Indian Penal Code. For example, A beats B and compels him to sell his scooter for Rs. 2,000. In this case the consent of B is induced by coercion.

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

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

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

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

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

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

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

**Threat to File a Suit**

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

**Threat to Commit Suicide**

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

## 4.4.2 Effect of Coercion



The effect of coercion is explained in Sections 19 and 72 of the Act. Section 19

provides that when the consent of a party to an agreement is obtained by coercion, the control is voidable at the option of the party whose consent was not free (also called aggrieved party). In other words, it is upto the aggrieved party to decide whether to set aside the contract or perform it. If, however, the aggrieved party decides to avoid the contract, he cannot be compelled to perform his promise. But in that case, he has to restore any benefit received by him under the contract, to the other party from whom it had been received. For example, A threatens to kill B if he refuses to sell his scooter for Rs. 1,000 to A. B sells his scooter to A and receives the payments. Here B's consent was 'not free and if B decides to avoid the contract then he will have to return Rs. 1,000 which he had received from A.

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

### 4.4.3 Burden sf Proof

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

## 4.5 UNDUE INFLUENCE

### 4.5.1 What is Undue Influence?

The second factor which affects consent and makes it unfree, is undue influence. The term 'undue influence' means the improper or unfair use of one's superior power in order to obtain the consent of a person who is in a weaker position. Section 16 (i) of the Contract Act defines undue influence as ***'A contract is said to be induced by undue influence' where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.***

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

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

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

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

Examples

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

b) A was suffering from a number of ailments and B was treating him. B by exercising his influence over A as his medical attendent, induced A to agree to pay B an unreasonable sum for his professional services. In this case B has used his superior position to obtain an unfair advantage over A. Thus, you observe that undue influence compels a person in a weaker position to do something which he otherwise would not have done had he been left free to

do the things. Undue influence destroys the free mind of a person and compels him to do something which is against his will. Thus, undue influence is a kind of mental pressure and not a physical coercion.

### 4.5.2 Presumption of Domination of Will

You have learnt that undue influence is involved only when one party is in a position to dominate the will of the other. Now the question arises as to when can a person be said to be in a position to dominate the will of the other. Answer to this question is provided by Section 16 (2) of the Act. It states that a person is deemed to be in a position to dominate the will of another where :

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

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

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

### 4.5.3 Effect of Undue Influence

If the consent of a party is induced by undue influence, the contract is voidable at the option of the party whose consent has been so caused. Section 19 A of the Act states the effect of undue influence as when ***consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely, or, if the party who was entitled to avoid has received any benefit thereunder, upon such terms and conditions as the court may seem just.*** For example, A, a money-lender, advanced Rs. 100 to B, an agriculturist, and by undue influence, induced B to execute a bond for Rs. 200 with an interest at *6* percent per month. The court may set the bond aside, ordering B to repay Rs. 100 with such interest as may seem just.

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

### 4.5.4 Burden of Proof

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

i) **the other party was** in **a position to dominate his** will. It may be remembered that mere proof of nearness of relations is not sufficient for the court to assume that one person was in a position to dominate the will of the other, the dominating position of the stronger party has to be proved.

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

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

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

Unconscionable Transactions

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

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

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

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

The presumption of undue influence can be rebuted by showing that

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

ii) the price was adequate, and

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

Contracts with Pardanashin Woman

A pardariashin woman is one who observes complete seculsion i.e., who does not come in contact with people other than her family members. Law provides a special protection to pardanashin woman on the ground of their being ignorant so far as the worldly knowledge goes. A contract with a pardanashin woman is

presumed to have been induced by undue influence. The burden of proving that no undue influence was used lies on the other party. The other party will have to prove that (i) the terms of the contract were fully explained to her, (ii) she understood the implications, (iii) free independent advice was available to her, and (iv) she freely consented to the contract. Here you should note that this protection is available only to a woman who observes complete parda. Some degree of parda or seculsion is not sufficient to entitle her to get special protection.

## 4.6 DISTINCTION BETWEEN COERCION AND UNDUE INFLUENCE

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

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

**Check Your Progress A**

1) Define consent.

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2) When is consent said to be free?

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3) What is coercion ?

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

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5) What is an unconscionable transaction?

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

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

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

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

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

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

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

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

## 4.7 FRAUD

### 4.7.1 What is Fraud?

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

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

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

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

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

iv) *any other act fitted to deceive;*

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

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

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

company or its agent. But, if the false statement had been made by a director. of the company, A could avoid the contract.

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

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

   Sometimes it may so happen that when a representation was made it was true, but before the contract is entered into, it becomes untrue and this fact is known to the party. In such a situation, it must be corrected. If it is not corrected, it will amount to fraud. In this connection you should also note that if the person making representation honestly believes his statement to be true, he cannot be held liable for fraud, no matter how ill-advised, negligent or stupid he might have been. In order to constitute fraud, the false representation must have been made intentionally.

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

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

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

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

## 4.7.2 Does Silence Amount to Fraud?

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

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

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

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

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

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

## 4.7.3 Consequences of Fraud

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

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

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

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

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

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

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

2) If the party whose consent was not free thinks it proper to accept the contract, he may do so and insist upon its performance. The second para of Section 19 provides that a party whose consent was caused by fraud may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representation made had been true. For example, A fraudulently informs B that A's estate is free from encumbrances. B, believing the statement to the true, bought the estate. It was later discovered that the estate was subject to a mortgage. In this case, B may either avoid the contract or insist on its being carried out subject to the mortgage debt being redeemed.

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

# 4.8 MISREPRESENTATION

## 4.8.1 What is Misrepresentation ?

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

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

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

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

3) **Inducing mistake about subject-matter:** The subject matter of every agreement must clearly be understood by the concerned parties. If one of the parties, leads the other, even innocently, to commit a mistake regarding the nature or quality of the subject-matter, it is considered misrepresentation. Section 18(3) of the Act says when a party causes, however innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject-matter of the contract, this is misrepresentation. For example, A chartered a ship to B, which was described in the 'charter party' and was represented to him as being not more than 2,800 tonnage register. It turned out that She registered tonnage was 3,045 tons. A refused to accept the ship in fulfilment of the charter party, and it was held that he was entitled to avoid the charter party by reason of the erroneous statements as to tonnage **(The Oceanic Steam Navigation Co., V. Soonderdas Dhrumsy).**

## 4.8.2 Essentials of Misrepresentation

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

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

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

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

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

### 4.8.3 Effect of Misrepresentation

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

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

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

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

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

ii) If his consent is not induced by misrepresentation.

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

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

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

## 4.9 DISTINCTION BETWEEN FRAUD AND MISREPRESENTATION

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

| | Fraud | Misrepresentation |
|---|---|---|
| 1) | Wrong statement is made intentionally. | Wrong statement is made innocently. |
| 2) | The person making the wrong statement does not believe it to be true. | The person making the wrong statement believes it to be true. |
| 3) | There is an intention to deceive. | There is no intention to deceive. |

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|---|---|
| 4) Besides rescinding the contract, the aggrieved party can also claim damages. | The aggrieved party can rescind the contract but cannot claim damages. |
| 5) Except where the silence amounts to fraud, the contract is voidable even if the party defrauded had the means of discovering the truth with ordinary diligence. | The aggrieved party cannot avoid the contract if he had the means of discovering the truth with ordinary diligence. |

Check Your Progress B

1) Define 'Fraud'

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2) What is 'Misrepresentation' ?

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3) What are the consequences of fraud ?

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

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

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

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

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

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

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

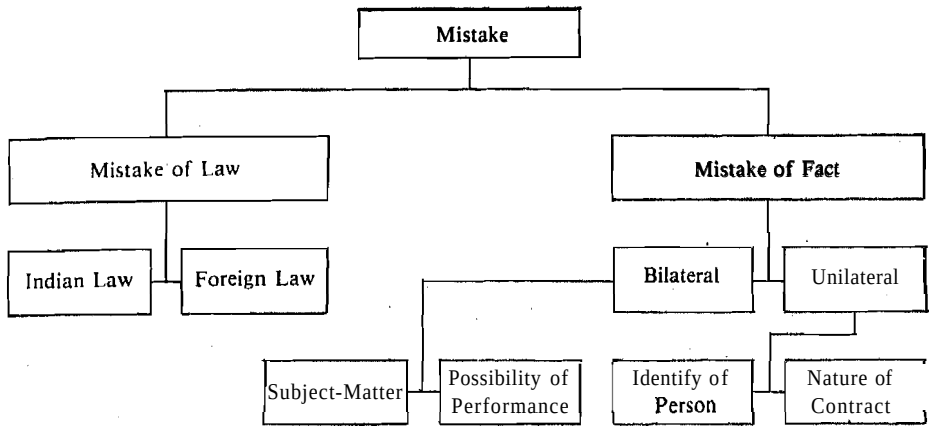
## 4.10 MISTAKE

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

Mistake may be defined as the erroneous belief concerning something. Whenever an agreement is made under a mistake, there is no consent, and the agreement is nor valid. Broadly speaking, Mistake may be of two types: (1) Mistake of Law and (2) Mistake of fact. Mistake of law can be further classified into (a) mistake of Indian law, and (b) mistake of foreign law. Similarly, mistake of fact can be (a) bilateral mistake or (b) unilateral mistake. Look at figure 4.2, for detailed classification of mistakes.

**Figure 4.2**

**Types of Mistakes**




## 4.10.1 Mistake of Law

As stated earlier, mistake of law may be (a) mistake of Indian Law, or (b) mistake of foreign law.

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

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

## 4.10.2 Mistake of Fact

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

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

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

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

iii) **Mistake must relate to as essential fact:** The mistake must relate to a matter of fact which is essential to the agreement. In other words, only such mistake of fact that goes to the root of the agreement, renders the agreement void. For example, A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void, because the mistake relates to something i.e., the horse, which is essential to the contract.

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

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

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

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

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

iv) **Mistake as** to **the quantity of the subject-matter:** Where both the seller and the buyer make a mistake regarding the quantity of the subject-matter, the agreement is void. In the case of **Henked** v. **Pape, P** inquired about the price of rifles from H suggesting that he might buy fifty rifles. On receiving the quotation, P telegraphed "send three rifles". But. because of the mistake of the telegraph authorities, the message transmitted was "send the rifles" H despatched fifty rifles. P accepted three rifles and returned the remaining forty seven rifles. It was held that there was no contract. However, P was liable to pay for three rifles on the basis of an implied contract.

v) **Mistake as to the quality of the subject-matter:** If the subject-matter is something essentially different from what the parties thought it to be, the agreement is void. For example, **A** contracis to sell a particular horse to B. **A and** B believe it to be ,a race horse. But, it turns to be a cart horse. The agreement is void.

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

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

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

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

**Unilateral Mistake**

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

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

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

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

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

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

. Mis[illegible]s to **the nature of the contract:** A contract is void when one of the parties [illegible]t any fault of his own, makes a mistake as to the very nature of the contract. Thus, when a person is induced to sign a written document

containing a contract fundamentally different in nature from what he thinks he is signing, the contract shall be void.

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

### 4.10.3 Effect of Mistake

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

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

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

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

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

**Cheek** Your Progress' C

1) What is Mistake ?

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2) What do you understand by mistake of fact ?

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3) What is a unilateral mistake ?

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

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

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

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

iv) Ignorance of law is no excuse.

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

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

## 4.11 LET US SUM UP

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

Coercion is the committing or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining or threatening to detain any property to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. In this case the contract is voidable.

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

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

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

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

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

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

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

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

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

## 4.12 KEY WORDS

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

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

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

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

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

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

**Purdanashin** Women : 4 woman who by custom of the counfry or usage of the particular community she belongs, is obligate to observe complete seclusion.

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

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

## 4.13 ANSWERS TO CHECK YOUR PROGRESS

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

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

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

## 4.14 TERMINALS QUESTIONS/EXERCISES

1) Define Consent. When Consent is said to be free?

2) What is the effect of coercion on the validity of the contract?

3) Does a threat to commit suicide amounts to coercion?

4) When is a person deemed to be in a position to dominate the will of' another?

*5)* Define fraud and point out its effects on the validity of the contract.

*6)* "Mere silence as to facts is not fraud". Explain with examples.

7) Distinguish between :
   i) Coercion and undue influence
   ii) Fraud and Misrepresentation

8) What is the position of a contract made with a pardanashin woman?

9) Define mistake and explain various types of mistakes.

10) Explain and illustrate the effect of a 'mistake of fact' on contracts:

11) On whom 'the burden of proof lie in case of undue influence? State the cases in which undue influence is presumed.

12) Answer the following problems giving reasons for your answer:

   i) **A** threatens to shoot B if'he does not sell his scooter to him **(A)** for Rs. 1,000 B signs the necessary documents for the sale of scooter. Later on, B wants to avoid the contract. Will he succeed? If so, why?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## SOME USEFUL BOOKS FOR THIS BLOCK

Gulshan, S. S. and G. K. Kapoor, **1989.** Business *Law*, Wiley Eastern Limited: New Delhi (Chapters 1-5)

Kapoor, N. D., **1988.** Mercantile *Law,* Sultan Chand & Sons: New Delhi (Chapters 1-5)

Kuchhal, M. C., 1989. Mercantile *Law,* Vikas Publishing Private Limited: New Delhi (Chapters 1-5)

Maheshwari, R. P. and **S.** N. Maheshwari, **1989.** Business *Law,* National Publishing House: New Delhi (Chapters 1-5)

Shukla, M. **C.,** 1987. *A* Manual of Mercantile Law, S. Chand & Co., New Delhi (Chapter 1).

# UNIT.5 CONSIDERATION AND LEGALITY OF OBJECT

**Structure**



## 5.0 OBJECTIVES

After studying this unit, you should be able to:

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

## 5.1 INTRODUCTION

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

## 5.2 WHAT IS CONSIDERATION?

In Mercantile law, the term 'consideration' is used in the sense of ***quid pro quo*** which in turn means 'something in return'. This 'something' may be some benefit. right, interest or profit that may accrue to one party or it may be some forbearance, detriment, loss or responsibility upon the other party. This explanation of consideration was given in a very popular English case of **Currie v. Misa.** Another simple and good description of 'consideration' is available in Sir Pollock's definition. In his book 'Pollock on Contracts', he says, "consideration is the price for which the promise of the other is bought, and the promise thus given for value is enforceable". Section 2(d) of the Indian Contract Act defines consideration as ***when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise.***

Examples

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

2 X promises his debtor Y not to file a suit against him for one year on Y's agreeing to pay him Rs. 100 more. Here the abstinence of X is the consideration for Y's promise to pay.

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

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

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

## 5.3 LEGAL RULES FOR VALID CONSIDERATION

If you analyse the definition of consideration as per Section 2(d), you may notice certain essential features which are necessary for consideration to be valid and acceptable legally. These features are also n o w n as the legal rules for consideration. Let us now study such rules in detail.

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

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

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

The case of Chinnayya v. Ramayya is a good illustration on the point. In this case, A by a deed of gift transferred certain property to her daughter, with a direction that the daughter should pay an annuity to A's brother, as had been done by A. On the same day the daughter executed a writing in favour of the brother, agreeing to pay the annuity. Afterwards, she declined to fulfil her promise saying that no consideration had moved from her uncle ('A's brother') The Court, however, held that the words 'the promisee or any other person' in Section 2(d) clearly show that the consideration need not necessarily move from the promisee, it may move from any other person. Hence. A's brother was entitled to maintain the suit.

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

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

Examples

1. A, a minor, was given the benefit of certain services by the plaintiff. The plaintiff rendered those services, not voluntarily but at the desire of A. These services were continued even after majority at the request of A who subsequently promised to pay an annuity to the plaintiff. It was held that the past consideration was a good consideration. (Sindhc v. Abraham)

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

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

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

Future **Consideration:** When the consideration is to move at a future date, it is called future or executory consideration. It takes the form of a promise to be perfbrmed in the future. For example, A promises B to deliver him 100 bags of wheat at a future date. B promises to pay for it on delivery.

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

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

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

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

## 5.4 STRANGER TO A CONTRACT AND STRANGER TO CONSIDERATION

You have learnt that in India, consideration is permitted to be supplied by any person and it need not necessarily be supplied by the promisee himself. Thus, the concept of 'stranger to consideration' is a valid and acceptable concept. However, a stranger to the consideration must be distinguished from a stranger to a contract. A stranger to a contract means a person who is not a party to the contract. Such a person cannot even in India, bring a valid suit. For example, **A** who is indebted to B, sells his property to C and C promises to pay off the debt to B. In case C fails to pay, B has no right to sue C being stranger to the contract.

Exceptions

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

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

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

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

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

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

## 5.5 ADEQUACY OF CONSIDERATION

In fact, adequacy of consideration is always the lookout of the promisor. Courts do not see whether every person making the promise has recovered full return for the promise. Thus, if 'A' promises to sell a house worth Rs. 8,00,000 for Rs. 80,000 only, the inadequacy of the price in itself shall riot render the transaction void. But where a party pleads coercion or undue influence or fraud, inadequacy of consideration will also be a piece of evidence to be looked into. Far example, B agrees to sell a horse worth Rs. 1,000 for Rs. 10. B denies that his consent to the agreement was freely given..The inadequacy of consideration is a fact which the Court should take into account in considering whether or not **B's** consent was freely given. ***Section*** 25 ***(Explanation 2) of Indian Contract Act also states that an agreement to which the consent of the party is freely given is not void merely because the consideration is inadequate; but the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was freely given.***

Check Your Progress A

1 What is consideration?

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2 What is quid-pro-quo?

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3 At whose desire should consideration move?

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.....

4 Is past consideration valid?

.....

.....

5 Can consideration move from a stranger?

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.....

6 Fill in the blanks:

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

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

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

7 State whether following statements are True or False.

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

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

iii) Past consideration is no consideration.

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

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

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

vii) A stranger to consideration can sue.

## 5.6 LEGALITY OF AGREEMENTS WITHOUT CONSIDERATION

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

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

a) expressed in writing,

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

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

d) is between parties standing in a near relation to each other. For example, an elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. The agreement was put to writing and was registered. Held, the agreement was valid. (Venkataswamy v. Rangaswamy)

You should note that for an agreement to be valid under this clause, the agreement must be the result of natural love and affection. Nearness of relation by itself does not necessarily import natural love and affection. Thus, where a Hindu husband by a registered document, after referring to quarrels and disagreements between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable Rajlakhi Devi v. Bhootnath.

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

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

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

Examples

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

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

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

i) the promise is put into writing

ii) signed by the debtor or his agent, and

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

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

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

5 Agency: For creation of an agency, no consideration is required. You should note that, however, if no consideration has passed to the agent, he is only a gratuitous agent and is not bound to do the work entrusted to him, althbugh if he begins the work he must do it to, the satisfaction of his principal (Section 185).

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



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

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

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

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

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

5 If it relates to creation of an agency.

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

## 5.7 LEGALITY OF OBJECT AND CONSIDERATION

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

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

**Examples**

i) A loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act is illegal and cannot be recovered back **(Srinivas v. Raja Ram Mohnn).**

ii) **A** promises to drop prosecution which he has instituted against B for robbery, and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful **(Illustration (h)** to **Section 23).**

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

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

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

5 **If the Court regards it as immoral or opposed to public policy:** An agreement whose obiect or consideration is immoral or is opposed to the public policy, is

void. For example, A let a cab on hire to B, a prostitute, knowing that it would be used for immoral purposes. The agreement is void (**Pearce v.** Brooks).

**Partial Illegality**

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

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

**Check Your** Progress B

1 State whether the following statements are True or False.

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

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

iii) A promise to compensate a voluntary act done in the past id valid,

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

v) An agreement to commit fraud is voidable.

2 A agrees for illicit cohabitation with B. B agrees to pay a fixed monthly allowance in consideration of her services.

i) State whether the agreement is valid or not. Give reasons.

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ii) Is the agreement yalid if the payment is in respect of past cohabitation with a married woman with or without the knowledge of her husband?

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

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## 5.8 AGREEMENTS OPPOSED TO PUBLIC POLICY

It is very difficult to define the term 'public policy' with any degree of precision because 'public policy', by its very nature, is highly uncertain and fluctuating. It keeps on varying with the habits and fashions of the day, with the growth of commerce and usage of trade. In England, **Lord** Halsbury **in** case **of** Janson **v.**

Drieftein Consolidated Mines Etd, observed "that categories of public policy are closed, and that no court can invent a new head of public policy." Section 23 of the Indian Contract Act, however, leaves it open to court to hold any contract as unlawful on the ground of being opposed to public policy.

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

Heads of Public Policy

The commonly accepted grounds of public policy include:

1 **Trading** with Enemy : All contracts made with an alien (foreigner) enemy, unless made with the permission of the Government, are illegal on the ground of public policy.

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

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

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

Examples

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

2 Similarly, where A promises to pay a sum to B in order to induce him to retire so as to provide room for A's appointment to the public office held by B, the agreement is void (Saminatha v. Muthusarni).

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

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

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

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

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

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

8 Agreements in restraint of legal **proceedings**: Section 28 specifies two kinds of agreements as void: (i) an agreement by which a party is restricted absolutely from enforcing his legal rights arising under a contract by the usual legal proceedings in the ordinary tribunals, and (ii) an agreement which limits the time within which the contractual rights may be enforced. It is discussed in more detail in Unit 6.

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

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

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

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

Check Your Progress C

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

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

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## 5.9 LET US SUM UP

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

Section 25 which declares a contract without consideration as no contract also recognises certain exceptions whereunder in spite of there being no consideration contract shall be valid and enforceable. Section 185 further adds to the list of these exceptions. Thus, the contracts without consideration are valid in the following cases:

i) agreements which are the result of natural love and affection between parties standing in a near relationship, if the agreement is written and registered,

ii) a promise to compensate for something voluntarily,

iii) a promise to pay a time-barred debt

iv) completed gifts (i.e., gifts offered and accepted) are valid, but a promise to gift cannot be enforced, and

v) contracts of agency.

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

What agreements shall be construed against public policy is not defined anywhere in the Act. On analysis of judicial pronouncements, such agreements may be said to include: (1) trading with enemy, (2) agreements for stifling prosecution, (3) champerty and maintenance contracts, (4) agreements for sale of public offices and titles, (5) agreements in restraint of parental rights, (6) marriage brokerage or brocage contracts, (7) agreements interfering with course of justice, (8) agreements to create monopolies, (9) agreement in restraint of trade. (10) agreement in restraint of marriage, (11) agreement in restraint of personal liberty, and (12) agreement in restraint of legal proceedings.

## 5.10 KEY WORDS

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

Maintenance and Champerty : These two expressions are normally used together in law. 'Maintenance' means the promotion of litigation in which a person has no

interest of his own. 'Champerty*, on the other hand, is a bargain whereby one party., is to assist another in recovering property and in turn is to share in the proceeds of the action.

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

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

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

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

## 5.11 ANSWERS TO CHECK YOUR PROGRESS

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

2 'Quid-pro-quo' is a latin expression meaning!something in return'

3 The promisor

4 Yes

5 Yes

6 i) must, the promisor
ii) adequate, value
iii) void-ab-initio-(nudum pactum)

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

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

2 i) No. Consideration is unlawful (Sec. 23)
ii) Consideration is unlawful

3. No. Section 23, unlawful object. Involves injury to the person or property of another. Similar decision was given in Gherulal Parekh v. Mahadeo.

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

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

## 5.12 TERMINAL QUESTIONS

1 Define 'Consideration'. Discuss various types of considerationis.

2 Do you agree with the view 'No Consideration, No Contract?

3 In what cases a contract without consideration is not valid.

4 Discuss the rule that a stranger to a contract cannot sue on the contract. Are there any exceptions to this rule?

5 'A stranger to contract cannot sue, but a stranger to consideration can sue'. Do you agree?

6 "Insufficiency of consideration is immaterial, but a valid contract must be supported by lawful and real consideration." Comment.

7 Under what circumstances is the object or consideration of a contract deemed unlawful? Illustrate with examples.

8 Discuss the doctrine of public policy. Give examples of agreements that are considered opposed to public policy.

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

# UNIT 6 VOID AGREEMENTS AND CONTINGENT CONTRACTS

## Structure



## 6.0 OBJECTIVES

After studying this unit, you should be able to:

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

## 6.1 INTRODUCTION

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

## 6.2 VOID AGREEMENTS

Section 2(g) of the Indian Contract Act defined a void agreement as, "an agreement not enforceable by law". Some agreements are void-ab-initio which means that they are unenforceable right from the time they are made. For example, you learnt that an agreement with a minor or a person of unsound mind is void-ab-initio. Such an agreement does not become a contract at all. There may, however, be some agreement which, when made, are enforceable (i.e., they are contracts) but later, due to development of certain circumstances or change in circumstances, the contracts becomes unenforceable. When they become unenforceable they are called 'void contracts'. For example, A agrees to sell B a ship load of sugar on its way from Cuba to India. Due to heavy storm, the sea water enters the ship and the whole sugar gets

wet. This makes the contract void as A cannot compel B to accept wet sugar in place of sugar saying it is the same sugar, only its form having changed. So also B cannot insist A to deliver him the agreed sugar or else pay damages. Then, there are certain agreements which have been expressly declared void under certain provisions of the contract Act or any other law.

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

1 Agreements by or with persons incompetent to contract (sections 10 & 11).

2 Agreements entered into through a mutual mistake of fact between the parties (section 20).

3 Agreement, the object or consideration of which is unlawful (section 23).

4 Agreement, the consideration or object of which is partly unlawful (section 24).

5 Agreement made without consideration (section 25).

6 Agreements in restraint of marriage (section 26).

7 Agreements in restraint of trade (section 27).

8 Agreements in restraint of legal proceedings (section 29).

9 Wagering agreement (section 30).

10 Impossible agreement (section 56).

11 An agreement to enter into an agreement in the future.

In Units 3 to 5 you have already read about agreements in items I to 5 listed above. We shall, now study the rest of the 'void agreements' i.e., items 6 to 12.

## 6.2.1 Agreements in Restraint of Marriage

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

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

## 6.2.2 Agreements in Restraint of Trade

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

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

Examples

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

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

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

Exceptions

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

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

1 **Sale** of Goodwill: The seller of goodwill of a business may agree with the buyer thereof not to carry on a similar business within specified local limits. Such a restraint shall be valid, if limits are reasonable (section 27). Please note that the reasonableness of restrictions will depend upon many factors, such as the area in which the goodwill is effectively enjoyed, the price paid for it and above all, the nature of the business. For example, a seller of immitation jewellery in England, sold his business to B and promised that for a period of two years he would not deal (a) in immitation jewellery in England (b) in real jewellery in certain foreign countries. The first promise alone was held lawful. The second promise is void and the restraint was unreasonable in point of space and nature of business **(Goldsoll** V. **Goldman).**

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

a) A partner shall not carry on any business other than that of the firm while he is a partner [section 11(2) of the Indian Partnership Act, 1932].

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

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

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

Exceptions

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

1 **Trade** Combinations: Business combinations with the idea of regulating business and not restraining it have been held to be desirable in public interest. Restraints imposed by such associations are, therefore, not to be declared void on grounds of restraint of trade. In the case of **Haribhai v. Sharef Ali,** four ginning factories entered into an agreement fixing uniform rate for ginning cotton and pooling

their earnings to be divided between them in certain proportions. The Bombay High Court held the agreement to be valid and enforceable. Bur the Courts would not allow a restraint to be imposed disguised as trade regulations. Thus, an agreement between certain persons to carry on business with the members of their caste only **(Vaithelinga v. Saminada),** and an agreement to restrict the business of sugar mill within a zone allotted to it, have been held void **(Carew & Co. Ltd. v. North Bengal Sugar Mills).**

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

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

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

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

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

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

3 **Service Agreements:** An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else or, directly or indirectly, take part in or promote or aid any business in direct competition with that of his employer is valid **(Charles Worth v. Macdonnld).** For example, A agreed to become assistant for three years to B who was a doctor practising at Zanzibar. It was agreed that during the term of the agreement A was not to practise on his own account in Zanzibar. After one year, A started his own practice. Held, the agreement was valid and A could be restrained by an injunction from doing so,

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

**Check Your Progress A**

I Are the following agreements valid?

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

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

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

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

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

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

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## 6.2.3 Agreements in Restraint of Legal Proceedings

Section 28 of the Indian Contract Act regards the following two restraints of legal proceedings as void.

1. **Restriction on Legal Proceedings:** An agreement by which a party is restricted absolutely from enforcing his legal rights under, or in respect of, any contract by the usual legal proceedings in the ordinary tribunals. For example, a contract contains a stipulation that no action should be brought upon it in case of breach, Such a stipulation would be void because it would restrict both parties from enforcing their rights under the contract in the ordinary tribunals. But, a contract whereby it is provided that all disputes arising between the parties should be referred to the arbitration, whose decision shall be accepted as final and binding on both parties of the contract, is not invalid. The courts have power, in spite of such a stipulation, to set aside the decision of the arbitrator on grounds of misconduct on the part of the arbitrator.

   A contract may contain a double stipulation that any dispute between the parties should be settled by arbitration, and neither party should enforce his rights under it in a court of law. Such stipulation would be valid as regards its first branch. (i.e., all disputes between the parties should be referred to arbitration, because that stipulation itself would not have the effect of ousting the jurisdiction of the courts. But the latter branch of the stipulation (i.e, neither party should enforce his rights under it in a court of law) would be void because by that the jurisdiction of the court would be necessarily excluded. Further, it should be noted that the restriction imposed upon the right to sue should be absolute in the sense that the parties are precluded from pursuing their legal remedies in the ordinary tribunals. Thus, where there are two courts, both

of which have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other, does not contravene the provisions of section 28 **(Milton & Co. v. Ojha Automobile Co.).**

2 **Limitation of Time:** Another type of agreement rendered void by section 28 is where an attempt is made by the parties to restrict the time within which an action may be brought so as to make it shorter than that prescribed by the law of limitation. For example, according to the Indian Limitation Act, an action for breach of contract may be brought within three years from the date of breach. If a clause in an agreement provides that no action should be brought after two years, the clause is void.

A clause in a policy of life insurance declaring that "no suit to recover under this policy shall be brought after one year from the death of the assured" was held void. However, cases of the above sort are distinguished from those which provide for surrender or forfeiture of rights if no action is brought within the stipulated time. A clause in a policy of life insurance provided "if a claim be made and rejected and an action or suit be not commenced within three months after such rejection..., all benefits under the policy shall be forfeited." This clause was held valid.

## 6.2.4 Uncertain Agreements

An agreement is called an uncertain agreement when the meaning of that agreement is not certain or capable of being made certain. Such agreements are declared void under section 29.

**Examples**

1 A agrees to sell to B "one hundred tons of oil". The agreement is void for uncertainty since there is no clearity in the agreement what kind of oil was intended.

2 A agrees to sell B "my white horse for Rs. 5,000 or Rs. 10,000". There being nothing to show which of the two prices was to be given, the agreement is void.

In the case of **Guthying v. Lynn,** a horse was bought for a certain price coupled with a promise to give £5 more if the horse proved lucky. The agreement was held void for uncertainty. The Court had no machinery to determine what luck the horse had brought to the buyer.

Cases relating to uncertain agreements have generally arisen in connection with the sale of goods where uncertainty is related to the price. For example, where goods are sold, the price being payable subject to 'hire-purchase' terms **(Scammell v. Custen)** or at such price as should be agreed upon between the parties **(May & Butcher v. The Kind),** the agreement in each case was held void for uncertainty as to price. However, you should note that where the price is left to be fixed by a third party, there is no uncertainty and the agreement will be enforceabe. For example, where A agrees to sell to B one thousand kilograms of rice at a price to be fixed by C, there is no uncertainty as the price is capable of being made certain. The agreement, therefore, is not rendered void. Similarly, if the agreement is totally silent as to price, it will be valid, as in that case, section **2** of the Sale of Goods Act will apply and the reasonable price shall be payable.

**Certain other illustrations where agreements have been declared void for uncertainty:**

1 An agreement to grant a lease when no date of commencement is expressly or impliedly fixed **(Giribala Dasi v. Kalidas Bhanga).** But when the commencement of a lease, is dependent upon a contingency, which has occurred, the agreement is not void **(Sitlani v. Viroosing).**

2 An agreement to pay a certain amount, after deductions as would be agreed upon between parties **(Kalpana Devara v. Krishna Mitter).**

3 **A** contract to negotiate **(Courtney and Fairbaion Ltd. v. Tolani Bors. (Hotels) Ltd.)**

4 A defendant passtd a document to the Apra Savings Bank whereby he promised

to pay to the manager of the bank the sum of Rs. 10 on or before a certain date and a similar sum monthly every succeeding month. It was held that the instrument could not be regarded as a promissory note as it was impossible from its language to say for what period it was to continue and what amount was to be paid under it (Carter v. The Agra Savings Bank).

Certain illustrations where agreements have been held not to be uncertain:

1 A, who is a dealer in coconut oil only, agrees to sell to B "one hundred tons of oil". The nature of A's trade indicates the meaning of the words, and A has entered into a contract for the sale of one hundred tons of coconut oil.

2 A agrees to sell B "all the grain in my granary at Ramnagar". There is no uncertainty here to make the agreement void.

3 A agrees to sell B one hundred tons of coconut oil at a price to be fixed by C, As the price is capable of being made certain, there is no uncertainty here to make the agreement void.

### 6.2.5 Wagering Agreements

The Indian Contract Act does not define a wager. A wagering agreement, according to Sir William Anson, *is* a ***promise to give money or money's worth upon the determination or ascertainment of an uncertain event.*** Cockburn C.J. defined it as "a contract by A to pay money to B on the happening of a given event in consideration of B's promise to pay money to A on the event of no happening." Thus, a wagering agreement is an agreement under which money or money's worth is payable, by one person to another on the happening or non-happening of a future uncertain event. For example, A and B bet as to whether it would rain on a particular day or not—A promising to pay Rs. 100 to B if it rained, and B promising an equal amount to A, if it did not. This agreement is a wager.

Essentials of a Wagering Agreement: From the above description of a wagering agreement, following essentials may be noted.

1 Uncertain event; The first thing essential to wager is that the performance of the bargain must depend upon the determination of an uncertain event. An event may be uncertain either because it is yet to take place or it might have already happened but the parties are not aware of its result.

2 Mutual chances of gain or loss: The second essential feature is that upon the determination of the contemplated event each party should stand to win or lose. If either of the parties may win but cannot lose, it is not a wagering agreement.

3 Neither party to have control over the event: Neither party should have control over the happening of the event one way or the other. If one of the parties has the event in his own hands, the transaction lacks an essential ingredient of a wager.

4 No other interest in the event: Further, neither party should have interest in the happening of the event other than the sum or stake he will win or lose.

5 Promise to pay money or money's worth: Lastly, to constitute wager, the promise should be to pay money or money's worth only.

Effects of Wagering Agreement: An agreement by way of wager is void. Section 30 provides: ***agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made.*** Thus, in India, unless the wager amounts to a lottery (it is a crime according to section 294-A of the Indian Penal Code), it is not illegal but simply void. For example, A borrows Rs. 500 from B to pay to C, to whom A has lost a bet. Agreement between A and B is valid. It should be noted that in Maharashtra and Gujarat they have been declared illegal.

Lotteries: Lottery is an arrangement for the distribution by chance amopg persons purchasing tickets. The dominant motive of the participants need not be gambling. Where, however, a wagering transaction amounts to a lottery, it is illegal and comes under section 294-A of the Indian Penal Code. This section reads as follows:

*Whoever keeps an)' office or place for the purpose of drawing any lottery not authorised by Government, shall be punished with imprisonment of either description for a term which may extend to six months, or with fine or with both.*

*And whoever published any proposal to pay any sum or to deliver any goods, or to do or forbear doing any-thing for the benefit of any person, on any event or contingency relative or applicable to the drawing of any ticker, lot number of figure in any such lottery, shall be punished with fine wtiich may extend to one thousand rupees.*

In the case of Universal Mutual Aid and Poor Houses Association v. Thoppa Naidu, monthly subscriptions were collected to raise a donation fund to carry out charitable objects. A substantial portion of the interest accruing on the fund so raised was utilised in granting loans free of interest and cash bonuses to certain subscribers, the names and amounts to be determined by means of drawings. The court held that the business carried on by the company was a lottery and, therefore, illegal though there was a charitable or philanthropic purpose annexed to the lott'ery. The company was, therefore, ordered to be wound up.

A cycle and gramophone dealer started a chit with 100 subscribers, each subscribing Rs. 3 per month, for a period of 20 months. There was to be a monthly draw in which the subscriber whose number or name drawn was given a cycle or a gramophone at his option and relieved from further liability to pay subscriptions. In the 21st month each of the subscribers who did not draw at any of the previous drawings were given a cycle or gramophone, it was held that the transaction amounted to a lottery and was, therefore, illegal (Public Prosecutor v. M. Naidu).

Does the permission from the Government to hold lottery make it legal? In the case of Sir Dorabji Tata v. Edward F. Lance, where the Government of India had sanctioned a lottery called the War Loan Lottery, the plaintiff sued on a contract to purchase a ticket bearing a particular number, and for an injunction restraining the Secretary of the Turf Club from proceeding with the drawing. The defence was that, it being a wagering contract, the suit was not maintainable. The court held that the permission granted by the Government will not have the effect of overriding section 30 of the Indian Contract Act and making such a lottery legal. Its only effect was that the person responsible for running the lottery would not be punishable undc: the Indian Penal Code.

Is purchasing a lottery ticket an offence? It is not an offence to buy a lottery ticket. Section 294-A of the Indian Penal Code is aimed at promoters of lotteries (Barclay v. Pearson). In one of the recent judgments, Supreme Court held that sale of a lottery ticket confers on the purchaser thereof two rights; (a) a right to participate in the draw, and (b) a right to claim a prize contingent upon his being successful in the draw (H. Anraj v. Government of Tamil Nadu). Thus this decision of the Supreme Court, by recognising the right of the purchaser of a lottery ticket has reversed' the earlier outlook on the subject. It may well be said that where a lottery is authorised by the Government, it shall not be illegal as was decided in the case of Sir Dorabji Tata v. Edward F. Lance. Consequently, collateral transactions shall also be enforceable. Thus, where A lends Rs. 2,000 to B for purchase of lottery tickets, A shall be able to recover the same.

Exceptions to Wagering Agreements (Transactions Held 'Not Wagers?: The following transactions have been held not to be wagers:

1 Transactions for the sale and purchase of stocks and shares or for the sale and delivery of goods, with a clear intention to give and take delivery of shares or. goods, as the case may be. You should note that, where the intehtion is only to settle in price differences, the transaction is a wager and hence void.

2 Prize competitions which are games of skill, e.g., picture puzzles, athletic competitions, etc. Thus, an agreement to enter 'into a wrestling contest in which the winner was to be rewarded by the entire sale proceeds of tickets, was held not to be a wagering contract (Babasaheb v. Rajaram). A crossword puzzle in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the editor of newspapers is a lottery and therefore, a wagering transaction. According to Prize Competition Act, 1955

prize competitions in games of skill are not wagers provided the prize money does not exceed Rs. 1,000.

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

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

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

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

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

## 6.2.6 Agreements to do Impossible Acts

Section 56 of the Indian Contract Act declares that an agreement to do an act impossible in itself is void. Thus, where A agrees with B to discover treasure by magic, the agreement is void. We may say that parties who purport to agree to the doing of something obviously impossible must be deemed not to be serious or not to understand what they are doing. Moreover, law cannot regard a promise to do something obviously impossible as of any value and such a promise is, therefore, no consideration.

An agreement to do an act impossible in itself should be contrasted from a contract which becomes impossible of performance. Subsequent impossibility renders a contract void when the act becomes impossible. Details on subsequent impossibility and its effect shall be discussed in Unit 7.

## 6.2.7 Restitution

Restitution means "return" or "restoration". When an agreement or a contract becomes void, the person who has received any benefit or advantage under such agreement or contract must restore it or compensate for it to the person from whom he has received it (section 65).

**Examples**

1 A pays B Rs. 1,000 in consideration of B's promising to marry C, who is A's daughter, C is dead at the time of the promise. The agreement is void. B must repay Rs. 1,000 to A.

2 A contracts with B to deliver to him 250 quintals of rice before the first of May. A delivers 130 quintals only before that day and none after. B retains 130 quintals after the first of May. B is bound to pay A for 130 quintals.

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

4 In the above example, if A receives an advance of Rs. 1,000 and is unable to sing due to illness, A must return the advance. B cannot sue A for the loss he has suffered due to A's illness.

It must be noted that the law of restitution is applicable only to those contracts which become void later on by some event which the promiser could not prevent or because of supervening impossibility. The principle of restitution does not apply to the contracts which are void-ab-initio with the exception where the minor has entered into agreement by misrepresenting his age.

# 6.3 CONTINGENT CONTRACTS

## 6.3.1 What is a Contingent Contract?

A contingent contract is a contract to do or not to do something if some event, collateral to such contract, does or does not happen (section 31). For example, A contracts to pay B Rs. 10,000 if B's house is burnt. This is a contingent contract.

The following are the essential features of a contingent contract.

1 The performance of a contingent contract is made dependent upon the happening or non-happening of dome event.

2 The event on which the performance is made to depend, is an event collateral to the contract i.e., it does not form part of the reciprocal promises which constitute the contract. For example, where A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract arid not contingent, because the event on which B's obligation is made to depend is a part of the promise itself and not a collateral event. Similarly, where A promises to pay B Rs. 10,000 if he marries C, it is not a contingent'contract.

3 The contingent event should not be the mere will of the promisor. For instance, if A promises to pay B Rs. 1,000 if he so chooses, it is not a contingent contract. However, where the event is within the promisor's will but not merely his will, it may be a contingent contract. For example, if A promises to pay B Rs. 1,000 if A left Delhi for Bombay, it is a contingent contract, because going to Bombay is an event no doubt within A's will, but is not merely his will.

## 6.3.2 Rules Regarding Enforcement of Contingent Contracts

The rules regarding contingent contracts are summarised hereunder (sections 32 to 36):

1 Contracts contingent upon the happening of a future uncertain event cannot be enforced by law unless and until that event has happened. And if, the event becomes impossible, such contract becomes void (section 32).

Examples

i) A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced by law unless and until C dies in A's life-time.

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

2 Contracts contingent upon the non-happening of a certain future event can be enforced when the happening of that event becomes impossible, and not before (section 33). For example, A agrees to pay B a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3 If a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything, which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies. (section 34). For example, A agrees to pay B a sum of money if B marries C. But C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and that C may afterwards marry B.

4 Contracts contingent upon the happening of an uncertain specified event within a fixed time become void if, at the expiration of the rime fixed, such event has not happened or if, before the time fixed, such event becomes impsssible (section 35) For example, A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

5 Contracts contingent upon the non-happening of a specified event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or before the time fixed expired, if it becomes certain that such event will not happen' (section 35). For example, A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return-within the year, or is burnt within the year.

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

**Examples**

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

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

### 6.3.3 Difference Between a Contingent Contract and a Wagering Agreement

1 A wagering agreement consists of reciprocal promises while a contingent contract may not consist of reciprocal promises.

2 A wagering agreement is of a contingent nature while a contingent contract may not be of a wagering nature.

3 A wagering agreement is void while a contingent contract is valid.

4 In a wagering agreement parties have no other interest in the subject matter except for winning or losing of wagering amount while it is not so in contingent contracts.

5 In a wagering agreement the future event is the sole determining factor while in a contingent contract future event is only collateral.

**Check Your Progress** B

1. Are the following contracts valid and enforceable by law?

a) A contracts to pay B Rs. 10,000 if B's house is burnt.

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b) A contracts with B to buy B's horse if A survives C.

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c) A ,agrees to pay B Rs. 10,000, if he makes two parallel lines meet.

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2 M lost a sum of Rs. 8,500 to L & Co. on bets on horse races and on his failure to pay was reported to the organising club. M subsequently executed in favour of L & Co. a hundi for Rs. 8,500 in consideration of their withdrawing his name from the club and thereby preventing his being posted as a defaulter. When L & Co. demanded payment, M pleaded that the consideration was unlawful. Decide.

## 6.4 LET US SUM UP

Void agreements are those agreements which are not enforceable by law. These are agreements in restraint of marriage, agreements in restraint of trade, agreements in restraint of legal proceeding, agreements which ate uncertain in their meaning and wagering agreements. In all the aforesaid cases, law declares such agreements to be of no legal effect except in certain exceptional circumstances..

A wagering agreement is an agreement to pay money or money's worth on the happening or non-happening of a specified uncertain event. Wagering agreements are void in India. However in Maharashtra and Gujarat they are illegal.

Contingent contracts are a class of conditional contracts. It is a contract to do or not to do something if some event, collateral to such contract, does or does not happen.

The chief characteristic of Contingent Contracts is that their performance depends upon happening or non-happening of certain event in future and such event must be uncertain and collateral to the contract.

## 6.5 KEY WORDS

**Against Public** Policy : Against the general interest of the public.

**Collateral** Transaction: A transaction which is helping or subsidiary to the main transaction.

Exclusive Dealing Agreements: An agreement to deal exclusiyely in the products of a single manufacturer or an agreement to sell the whole produce to a single dealer.

Insurable Interest: A person is so situated with regard to the thing insured that he would have benefit by its existence and loss from its destruction.

Prima Facie: Latin expression which means 'on the face of it'.

Tribunals: Courts and other judical machinery.

Void-ab-initio: Latin expression which means unenforceable from the beginning.

## 6.6 ANSWERS TO CHECK YOUR PROGRESS

A 1 a) Yes b) Yes c) No, restraint of trade.

2 The first part of the agreement is valid being reasonably necessary for the protection of the purchaser's interest. But the second part by which he was prohibited from competing with the company in any business which the company might carry on was unreasonable. and thus void (Nordenfelt v. Maxim Nordenfelt Gun Co.).

3 No, the agreement being in restraint of trade is void (Madhab Chander v. Raj Coomar).

4 A shall not succeed. Any restraint of trade operative after the termination of employment is bad in law (Oakes & Co. v. Jackson).

B 1 a) Yes. It is a contingent contract

b) Yes. Again it is a contingent contract but can be enforced only if A survives C.

c) No. Agreement is void (Section 36 and Section 56).

2 M shall be liable to pay the consideration in the form of L & Co's promise to withdraw. M's name from the club in order to prevent M being posted as a defaulter was legal. A wagering contract being only void does not affect collateral transactions.
(Leicester & Co. v. S.P. Millick)

## 6.7 TERMINAL QUESTIONS

1 "An agreement in restraint of trade is void". Examine this statement mentioning exceptions, if any.

2 Discuss the law regarding wagering agreements under the Indian Contract Act.

3 A promises to marry B only and none else and in the event of breach agrees to pay Rs. 50,000. A marries C, can B claim Rs. 50,000?

4 What are contingent contracts? State the rules regarding enforcement of such contracts. Give illustrations.

**Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the university. These are for your practice only.**

# UNIT 7 PERFORMANCE & DISCHARGE

**Structure**



## 7.0 OBJECTIVES

After studying this unit you should be able to:

- Understand the meaning of performance
- explain the types or perrormance
- state the requisites of a valid tender
- answer the question as to who should perform
- explain the rules regarding performance of joint promises
- enumerate the rules relating to time, place and manner of performance
- list the various modes of discharge of a contract.

## 7.1 INTRODUCTION

You have learnt the rules regarding the formation of a contract. After the formation of the contract the logical thing for parties is to perform their respective promises. When the parties to the contract perform the respective obligations, the contract comes to an end. In this unit you will learn about the meaning of performance, types of performance, performance of joint promises, the time, place and manner of performance.

You will also learn about the rules regarding performance of 'reciprocal promises, assignment of contracts and appropriation of payments. Besides these, different modes of discharge of contract shall also be explained.

## 7.2 MEANING OF PERFORMANCE

You have learnt that every valid contract creates legal obligation on both the contracting parties and this obligation continues fill the contract has been actually performed or otherwise discharged. Performances of the contract is one of the various modes of discharge of the contract and this is the most natural, desired and usual mode of discharging an obligation.

The term 'performance' means that the parties to the contract have fulfilled or carried out their respective obligations arising out of the contract. For example, A contracts to sell his book to B for Rs. 50. A delivers the book and B makes the payment, the contract is discharged by performance.

Section 37 of the Indian Contract Act lays down the obligations of the parties regarding performance. It provides that, ***the parties to a contract must either perform, or offer to perform, their respecrive promises, unless such performance is dispensed with or excused under the provision of this Act, or any other law.***

### 7.2.1 Types of Performance

From Section 37 you can infer that the performance may be either actual or attempted. Let us study them in detail.

1 Actual performance': When a party to a contract has done, what he had undertaken to do and there remains nothing to be done by him the promise is said to have been actually performed and the liability of such a party comes to an end. For example A who is indebted to B for Rs. 1,000, promises to repay the amount after two months. A repays the amount on the due date. This is actual performance..

2 Attempted Performance: Sometimes, when the performance becomes due, the promisor offers to perform his obligation but the promisee refuses to accept the performance. This is known as 'attempted performance' or 'tender*. For example, A. promises to deliver certain goods to B. A takes the goods to the appointed place during business hours but B refuses to take the delivery of goods. Thus, A has done what he was required to do under the contract, It is,an attempted performance. In case of an attempted performance, the promisor shall not be held liable for non-performance as an attempted performance or tender is as good as performing the contract. Section 38 of the Contract Act provides. ***where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non performance, nor does he thereby lose his rights under the contract.***

### 7.2.2 Kinds of Tender

Tender or attempted performance can be of two types (i)ender of goods and services and (ii) tender of money.

i) Tender of goods and services: A contract to deliver goods or render some service is completely discharged when the goods are tendered for acceptance according to the terms of the contract. If the goods or services are refused, they need not be offered again and the promisor is discharged from his liability. At the same time, he may file a suit against the promisee for non-acceptance.

ii) Tender of money: Where the debtor (promisor) makes a valid tender i.e., offers to pay the amount to the creditor and the creditor refuses to accept the same, the debtor is not discharged from his liability to pay the amount. In' other words, a tender of money does not'amount to discharge of the debt. The debtor continues to be liable for the payment of debt. But, the debtor will not be liable for interest from the date of a valid tender i.e., no interest shall become payable from the date of the, rejection of a valid tender of money.

### 7.2.3 Essentials of a Valid Tender

In the foregoing paragraphs you have seen that a tender of performance discharges a party from further liability, However, it is necessary that the tender must be valid. For a tender to be valid, the following conditions must be satisfied;

i) **It must be** unconditional: An unconditional tender is one which is in accordance with the terms of the contract. Thus, a conditional offer of performance is not a good tender and the other party is entitled to reject it. For example, A, a debtor, offered to pay B, his creditor, the amount due to him if B sells certain goods to him. It is a conditional tender and. therefore, invalid.

ii) It must be **made** at *a* proper time **and place:** Generally, the time and place of performance are agreed upon, by the parties and the tendcr must be made accordingly. Thus, a tender of goods after the business hours or of goods or money before the due date is not a valid tender. For example, if the promisor wants to deliver the goods at 1 a.m., this is not a valid tender unless it was so agreed.

iii) In case of **tender** of **goods,** it must give a reasonable **opportunity to** the promisee **of** ascertaining **that the** goods **offered** are the same **as the promisor** is bound to deliver. Thus, a tcnder of goods at such time when the other party cannot inspect the goods, is not a valid tender.

iv) It must be for *the* whole obligation: *A* piecerncal tender of goods or to pay the amount in instalments is not a valid tender. For example. A promises to deliver 100 bags of rice on a certain day. If on the agreed day and place A offers to deliver 80 bags only. This is not a valid tcnder and A is not d'scharged from his obligation. However, a minor deviation from the terms of the contract may not render the tender invalid.

v) **It must** be **made** to **the promisee** or his duly **authorised** agent: Thus, a tender to a stranger is not valid. In case there are joint promisees, it is not necessary for the promisor to offer performance to each one of them. A tender may be made to any one of the joint promisees. Thus, a tender made to one of several joint promisees has the same legal effects as a tender to all of' them.

vi) In **case of** payment of money, tender **must** be of the **exact** amount due and it must be in the legal tendcr. It should not be in any other form such as foreign currency or cheque. A payment by cheque is a valid tender provided the person to whom it is made is ready and willing to accept it.

### 7.2.4 Effect of Refusal to Perform Promise Wholly

When a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract. But, if the promisee has signified by words or conduct, his acquiescence in the continuation of the contract, he cannot terminate, it. Far example, A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights every week during the next two months, and B engages to pay her at the rate of Rs. 100 for each night. On the sixth night A wilfully absents herself from the . 'theatre. In such a situation, B is at liberty to put an end to the contract, If however, with the consent of B, A sings on the seventh night, B has signified his acquiescence in the continuation of the contract and, therefore, he cannot now put an end to it. Of course, B is entitled to compensation for damage sustained by him through A's failure to sing on the sixth night.

## 7.3 WHO CAN DEMAND PERFORMANCE?

1 **Promisee:** Normally, the promisee is the only person who can demand performance of the promise under a contract. A third party cannot demand performance of the contract even if it was made for his benefit. For example, A promises B to pay Rs. 500 to C. The person who can demand performance is B and not C.

2 *Legal* Representative: In the case of death of the promisee, his legal representative can demand performance, unless a contrary intention appears from the contract or the contract is of a personal nature. For example, A agrees to marry B. However, before marriage takes place. B dies. Since it is a contract of personal nature the legal representative of B cannot demand performance of the promise from A.

3 **Third** Party: In some exceptional cases, the third party can also demand performance of the contract even though he is not a party to the contract. Such cases have been discussed in Unit 5 under the heading 'stranger to a contract'.

4 Joint Promisees: When a person has made a promise to two or more personsjointly, then, unless a contrary intention appears from the contract, the performance of the promise may be demanded either (i) by all the promiseesjointly; or (ii) in case of death of any of joint promisees, by the representatives of such deceased personjointly with the surviving promisees, or (iii) in case of death of all joint promisees, by representatives of all of them jointly. Thus, the right of joint promisees is only joint and any of them cannot demand performance unless it was so agreed. For example, A for a consideration of Rs. 5,000 lent to him by Band C, promises Band C jointly to repay them Rs. 5,000 plus interest on a specified day. B dies. The right to claim performance rests with B's representative jointly with C during his life time, and after C's death it would lie with the representatives of B and C jointly.

## 7.4 WHO MUST PERFORM?

You have learnt who can demand performance. Let us now understand who is to perform the contract. Normally, the contract should be performed by the promisor himself However, in certain cases, it can also be performed by his agents or legal representatives. It all depends upon the intention of the parties. Normally a contract can be performed by the following persons.

1 Promisor himself: If from the nature of the contract it appears that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This usually applies to contracts involving personal skill, taste or art work. For example, A promises to paint a picture for B. As this promise involves personal skill of A, it must be performed by A.

2 Promisor or Agent: Where the contract does not involve personal skill of the promisor, the contract could be performed by the promisor himself or by any competent person employed by him for the purpose, For example, **A** promises to pay to B a sum of money, **A** may perform this promise either by paying the money personally to B or by causing it to be paid to B by his authorised agent.

3 **Legal** Representatives: The contracts which do not involve any personal skill or taste, may be performed by his legal representative after the death of the promisor. For example, A promises to deliver goods to B on a certain day on payment of Rs. 2,000. **A** dies before the said day. A's legal representatives are liable to deliver the goods to B and B is bound to pay Rs. 2,000 to A's representatives. If, however, the contract involves some personal skill or taste, it comes to an end with the death of the promisor.

4. **Third** Person: In some cases, a contract may be performed by a third person provided the promisee accepts the arrangement. According to Section 41, once the promisee accepts the performance from a third person, he cannot compel the promisor to perform the contract again.

5. Performance of Joint Promises: According to section 42, when two or more persons have made a joint promise, the joint promisors must fulfil the promise jointly during their life time. And if any one of them dies, then his legal representatives and survivors must jointly fulfil the promise. For example, A, B and **C** jointly promise to pay Rs. 3,000 to D. A dies. B and C alongwith A's legal representative are jointly and severally liable to pay the amount to D. This rule is called 'devolution of joint liabilities'. It is however, subject to the condition that no other intention appears from the contract. In other words, if a contrary intention appears from the contract then the rule given above shall not apply.

In case the joint promisors do not perform their promise jointly, then Section 43 comes into operation. It provides 'When two or more persons make a joint promise, the promisee may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise. Thus, the

liability of joint promisors is joint and several and any of the joint promisors can be compelled to perform. For example, A, B and C jointly promised to pay Rs. 3,000 to D. In this case D may compel either A, or B or C to pay the entire amount of Rs. 3,000.

Section 43 further provides that unless a contrary intention appears from the contract, each joint promisor may compel every other joint promisor to contribute equally to the performance of the promise. If any joint promisor makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. For example, A, B and C jointly promise to pay D Rs. 3,000. C is compelled to pay the whole amount, A is insolvent but his assets are sufficient to pay one half of his debts. C is entitled to receive Rs. 500 from A's estate and Rs. 1,250 from B.

In the above example if nothing could be recovered from A's estate, then C is entitled to recover Rs. 1,500 from B i.e., the loss of A shall be shared by B and C equally. It should be noted that when a promisee releases one of the joint promisors it does not discharge the other joint promisor or promisors. This means that the remaining joint promisors continue to be liable to pay the amount. The released joint promisor remains liable to contribute to the other joint promisors (section 44).

For example, A, B and C jointly promise to pay Rs. 3,000 to D. D releases A from liability, this release of A does not discharge B and C from their liability. If D recovers the entire amount from C, he can claim contribution from A and B.

## 7.5 TIME AND PLACE FOR PERFORMANCE?

It is for the parties to a contract to decide the time and place for the performance of the contract. The rules regarding the time and place of performance are given in sections 46 to 50 of the Contract Act. These are as follows:

1 Performance of a promise within a reasonable time: According to section 46 where the time for performance is not specified in the contract, and the promisor himself has to perform the promise without being asked for by the promisee, the contract must be performed within a reasonable time. The question 'what is a reasonable time' is, in each particular case, a question of fact. Thus, it is clear from this provision that if time for performance is not stated, the contract is not bad for want of certainty.

2 Performance of promise where time is specified: Sometimes, the time for performance is specified in the contract and the promisor has undertaken to perform it without any application or request by the promisee. In such cases, the promisor must perform his promise on that particular day during the usual hours of business and at a place where the promise ought to be performed (section 47). For example, A promises to deliver goods at B's warehouse on January 1, 1990. On that day A brings the goods to B's warehouse, but after the usual hours of closing, and they are not received. A's performance is not valid.

3 Performance of promise on an application by the Promisee: It may also happen that the day for the performance of the promise is specified in the contract but the promisor has not undertaken to perform it without application or demand by the promisee. In such cases, the promisee must apply for performance at a proper place and within the usual hours of business. (Section 48)

4 Performance of promise where no place is specified and also no application is to be made by promisee: When a promise is to be performed without application or demand by the promisee, and no place is specified for performance, then it is the duty of the promisor to apply or ask the promisee to fix a reasonable place for the performance of the promise and to perform it at such place (Section 49). For example, A undertakes to deliver 1,000 kilos of jute to B on a fixed day. A must apply to B to fix a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5 Performance of promise in the manner and time prescribed or sanctioned by promisee: Sometimes the promisee himself prescribes the manner and the time

of performance. In such cases, the promise must be performed in the manner and at the time prescribed by the promisee. The promisor shall be discharged from his liability if he performs the promise in the manner and time prescribed by the promisee (Section 50).

**Examples**

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

(ii) A desires B, who owes him Rs. 100, to send him a note for Rs. 100 by post. The debt is discharged as soon as B puts into the post a letter containing note duly addressed to A.

## 7.6 TIME AS THE ESSENCE OF THE CONTRACT

The term 'time as the essence of the contract' means that the time is an essential factor and the concerned parties must perform their respective promises within the specified time. Now the question arises that if one of the parties fail to perform his promise in time then can the other party rescind the contract? This can be answered by finding out whether time was or was not the essence of the contract.

The mere fact that time is specified for the performance of a contract is not by itself sufficient to prove that time is the essence of the contract. For this we have to ascertain the real intention of the parties. Time is generally considered to be the essence of the contract in the following cases.

a) Where the parties have expressly agreed to treat it as the essence of the contract;

b) Where the delay operates as an injury to the party; and

c) Where the nature and necessity of the contract requires it to be performed within the specified time.

In mercantile contracts, unless a different intention appears from the terms of the contract, time fixed for the delivery of the goods is considered to be the essence of the contract but not the time for the payment of the price. This is so because the prices of goods keep on fluctuating so rapidly that if punctuality is not observed it may result in heavy losses. But in case of the sale of an immovable property, the time is presumed to be not the essence of the contract.

According to Section 55 para 1 ***where time is the essence of the contract and a party fails to perform his/her promise in time the contract becomes voidable at the option of the other party*** i.e., if the promisee wants he can rescind the contract. But in contracts where time is not the essence of the contract, if a party fails to perform the contract in time, then the other party cannot rescind the contract but it has the right to claim damages for delay in performance.

**Check Your Progress A**

1 What do you understand by performance of a contract?

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2 What is Tender?

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3 Who can demand performance of the contract?,

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4 When is time the essence of the contract?

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5 State whether the following statements are True or False.

i) A contract involving the exercise of personal skill can be performed by the agent or representative of the promisor.

ii) In case of payment of a debt, refusal to accept the payment by the creditor does not discharge the debtor.

iii) An offer to perform a promise is, in part, a valid tender.

iv) If any one of the joint promisors makes default in making the payment, the other joint promisors must share the loss arising from such default equally.

v) The promisee may compel any one of the joint promisors to perform the promise.

vi) A. release of one promisor does not discharge the other joint promisors.

vii) in a contract where time is the essence of the contract, if the promisor fails to perform in time, the contract becomes void.

viii) If the promisee accepts the performance from a third person, then he cannot compel the promisor to perform the promise again.

ix) Where time for performance is specified, but promisor is required to perform only on being asked by the promisee it is the duty of the promisee to apply for performance.

## 7.7 PERFORMANCE OF RECIPROCAL PROMISES

You have learnt that parties to an agreement make mutual promises to do or to abstain from doing something, they are known as 'reciprocal promises'. Section 2(f) of the Contract Act defines a reciprocal promise as *promises which form the consideration or part of the consideration for each other.* In such cases there is an obligation on each party to perform his own promise and to accept performance of the others' promises.

### 7.7.1 Types of Reciprocal Promises

Reciprocal promises have been classified by Lord Mansfield in Jones V. Barkley case in the following three categories

a) **Mutual and independent:** When each party must perform his part of the promise independently without waiting for the performance or readiness to performance by the othei party, the promises are called mutual and independent.

b) **Conditional and dependent:** When the performance of one party depends on the prior performance of the other party, the promises are called conditional and dependent.

c) **Mutual and concurrent:** When the parties have to perform their promises simultaneously, they are said to be mutual and concurrent.

### 7.7.2 Rules for the Performance of Reciprocal Promises

After having learnt the meaning and types of reciprocal promises, let us now discuss the rules regarding the performance of reciprocal promises.

1 Mutual and Concurrent: Section 51 lays down the rule by saying that when reciprocal promises are to be performed simultaneously, a promisor need not perform his part unless the promisee is ready and willing to perform his part. For example, A and B agree that A shall deliver goods to B to be paid for by B on delivery. In this case, A need not deliver the goods unless B is ready and willing to pay for the goods on delivery; and B need not pay for the goods unless A is ready and willing to deliver them on payment.

2 Mutual and Dependent: In such cases, the performance of promise by one party depends on the prior performance of the promise by the other party. If the party who is liable to perform first, fails to perform it, then he cannot claim performance from the other party. Not only that, the party at fault becomes liable to pay compensation to the other party for any loss which the other party may sustain by the non-performance of the contract (section 54). For example, A contracts with B to execute certain building work for a fixed price. B is to supply the scaffolding and timber necessary for the work. B refuses to furnish any scaffolding or timber. So, the work cannot be executed. A need not execute the work and B will be bound to make compensation to A for any loss caused to him by the non-performance of the contract.

3 Mutual and Independent: You will notice that as it is clear from the name itself, such promises are to be performed by each party independently without waiting for the other party to perform his promise. If a party fails to keep his promise, the other party cannot excuse himself from performance on the ground of non-performance by the defaulting party. In such a situation, the aggrieved party can claim damages from the defaulting party,

### 7.7.3 Order of Performance sf Reciprocal Promises

Sometimes a problem arises, with regard to the order in which reciprocal promises are to be performed. In this connection section 52 of Contract Act provides that where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they must be peformed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires. FOP example, A and B contract that A shall build a house for B at a fined price. A's promise to build the house must be performed before B's promise to pay for it.

### 7.7.4 Effects of Preventing the Performance of Reciprocal Promises

Sometimes it may so happen that one party to a reciprocal promise prevents the other from performing his promise, In such a situation, the contract becomes voidable at the option of the party so prevented, and he is also entitled to claim compensation from the other party for any loss suffered due to non-performance of the contract. For example, A and B contracted that B shall execute certain work for A for Rs. 1,000. B was ready and willing to execute the work accordingly. But, A prevents him from doing so. The contract is voidable at the option of B and if he decides to rescind it, he is entitled to recover from A compensation for any loss which he has incurred due to its non-performance.

## 7.8 ASSIGNMENT OF CONTRACTS

Assignment of contract means transfer of rights and liabilities arising out of a Contract to a third party, An assignment to be complete and effective must be effected by an instrument in writing. Actually there are no specific provisions in the contract Act dealing with assignment it is a term used in the Transfer of Property Act.

You have already learnt that contracts involving personal skill or taste or ability must be performed by the promisor himself. In other words such contracts cannot be assigned. But where the contract is not of a personal nature, it can be assigned subject to certain conditions.

Now let us see how the contract can be assigned? Contracts can be assigned in two ways: (a) By the act of parties and (b) by operation of law.

a) Assignment by act of parties: This means that the parties themselves make the assignment. The rules in this regard are as under:

i) The liabilities or obligations under a contract cannot be assigned. It means that the promisor cannot compel the promisee to accept some other person as the promisor in his place. For example, A owes B Rs. 500 and A is also to recover Rs. 500 from P. A cannot compel B to recover the money from P. But, the promisor may transfer his liability to a third person with the consent of the promisee and the transferee. In the example given above, A can transfer his liability to P with the consent of B and P. This is technically known as 'novation'.

ii) If the contract does not expressly or impliedly provides that the contract shall be performed by the promisor only, the parties can decide that the performance be done by another competent person. But, even then the promisor remains liable to the promisee for proper performance.

iii) The rights and benefits under a contract, which is not of a personal nature, can be assigned. For example, **A** owes B Rs. 1,000. B may assign his right to ***C.*** But in such a situation the assignee takes assignment subject to all equities between the original parties. In the above example if A has already paid a portion of the debt to B, he will be liable to pay to C a correspondingly less amount.

iv) An actionable claim can always be assigned, But this must be done by an instrument in writing. It is also necessary that a notice of assignment has been given to the debtor. An actionable claim is a claim to any debt (except a secured debt) or to any beneficial interest in movable property. Examples of actionable claims are book debts, money debts, right of action arising out of a contract etc.

b) Assignment by operation of Law: Contracts which are not of a personal nature get assigned due to operation of law. Assignment by operation of law takes place in cases of death or insolvency of any party to the contract. Upon the death of a party to the contract his rights and obligations automatically pass on to his heirs or legal representatives. In case of insolvency, all the rights and obligations pass on to the official Receiver or Assignee.

## 7.9 APPROPRIATION OF PAYMENT

The term 'appropriation of payment' means the application of payment. When a debtor owes several distinct debts to one creditor and makes a payment to the creditor which is insufficient to discharge all the debts, a problem may arise as to which particular debt, should the payment be applied. In some cases the debtor may himself expressly point out to which particular debt the payment be applied, while in others the circumstances may indicate the debt to which the payment is to be applied. But the difficulty arises when neither there is an express indicating nor can it be implied from circumstances. In India, the rules regarding appropriation of payments are given in sections 59 to 61. These rules are as following.

1 Where there is an express or implied intimation by the debtor (Section 59): A debtor has the right to instruct his creditor to which particular debt the payment is to be applied. If the creditor accepts the payment, he is duty bound to follow the instructions. If the debtor expressly informs the creditor while making payment that the payment be applied to a particular debt, the creditor must do so. But if there is no express intimation by the debt then the intention should be seen from the circumstances of the case. Let us now explain this rule by the following two examples:

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

ii) **A** owes B, among other debts, the sum of Rs. 567. B writes to **A** and

demands payment of the surn. A sends Rs. 567. This payment is to be applied to the discharge of the debt of which B had demanded payment.

You should note that if the creditor does not want to apply the payment as per the express or implied instructions of the debtor, he must refuse to accept the payment. In no case the creditor can alter the appropriation after accepting the payment.

2 **Where there** is no express **or implied** intimation: If, while making the **payment,** the debtor does not **intimate** and there arc no circumstances indicating to which **debt** the **payment** is to be applied, then the creditor **has the** option to apply the payment to any lawful debt due from the debtor. The amount, in such a case, can be applied even too a debt which has become time-barred. However, it cannot be applied to a disputed debt. But, once an appropriation has been made by the creditor and the debtor is informed, rhe creditor cannot change his option later on.

3 Where neither party appropriates: Where neither the debror nor the creditor makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether or not they are time-barred. If the debts are of equal standing, the payment shall be applied in discliarge of each proportionarely. It should be noted that where moneys are received by the creditor without any definite appropriation on either side, the money so received must first be applied in payment of interest and then in payment of principal.

Check Your **Progress** B

I What are reciprocal promises'?

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2 Classify **reciprocal** promises.

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3 What do you mean by assignment of contracts?

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4 State whether the following statements are True or False:,

i) Promises forming consideration for each other are known as reciprocal promises

ii) Promises which are to be performed simultaneously are termed as mutual and independent.

iii) Where the performance by one party depends on the prior performance of the other party, they are mutual and dependent promises.

iv) Contractual obligations involving personal skill or ability cannot be assigned.

v) Assignment by operation of law takes place in cases of death or insolvency.

vi) A debtor while making the payment expressly informs the creditor that the payment should be applied to a particular debt, the creditor is not bound to do so.

vii) Where the debtor does not intimate and there are no circumstances

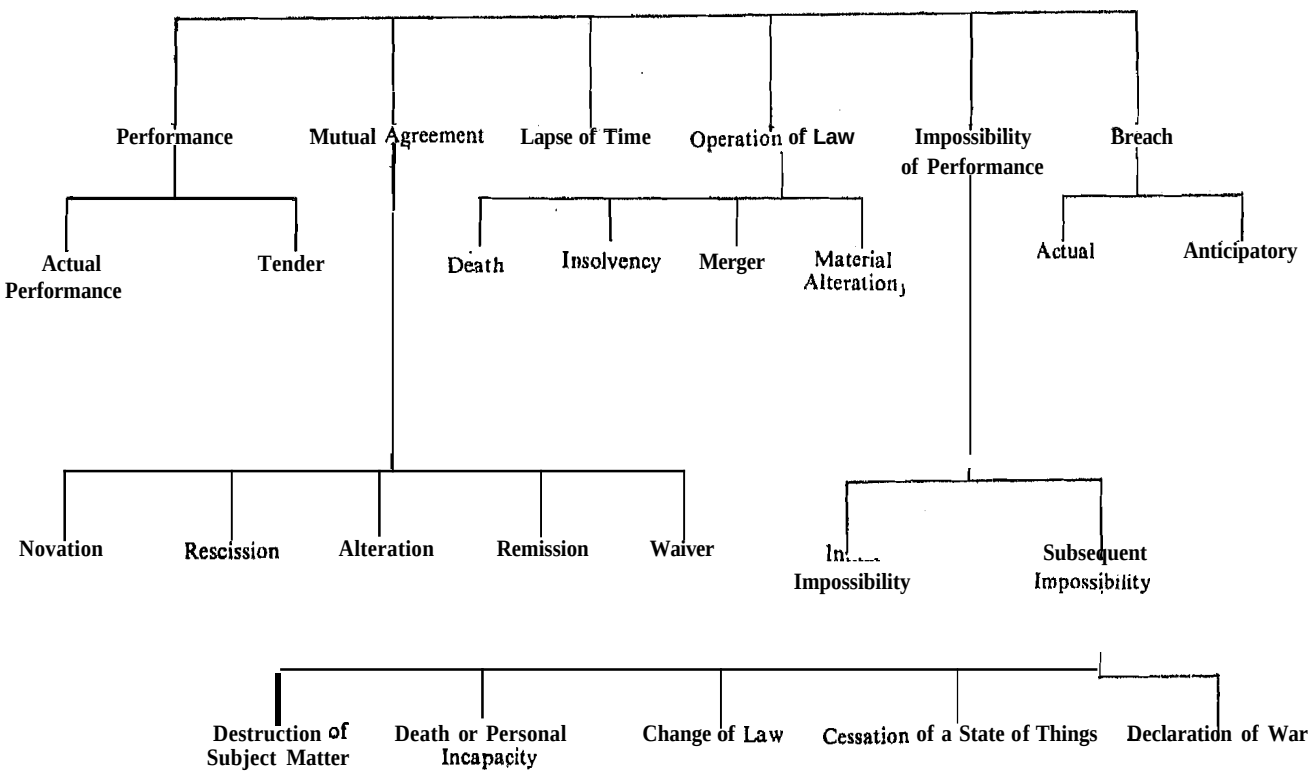
indicating debt to which the payment is to be applied, the creditor may apply it at his discretion to any lawful debt due.

viii) While making payment if the debtor does not specify the debt to which the payment is to be applied. Creditor can apply the payment even to a time-barred debt.

## 7.10 MODES OF DISCHARGE OF A CONTRACT

You have learnt that a valid contract creates certain obligations for the contracting parties and the parties become liable to fulfil their respective promises.

**Figure 7.1 Modes of Discharge of a Contract**




When such promises are performed, the contract is said to be discharged. The term 'discharge of a contract' means that the parties to it are no more liable under the contract. The most obvious or desirable method of discharge of a contract is to perform it. We have discussed the various rules regarding the performance in the foregoing pages. Let us now have some idea about the other modes of discharge of a contract.

A contract may be discharged in any one of the following ways:

1 By performance
2 By mutual agreement
3 By lapse of time
4 By operation of law
5 By impossibility of performance
6 By breach.

Look at Figure 7.1 for various modes of discharge of a contract. Now we shall study these modes one by one.

### 7.10.1 Discharge by Performance

The most obvious or natural mode of discharge of a contract is by performance. The performance may be either actual or an attempted one. You have learnt about the performance in section **7.2** of this unit.

### 7.10.2 Discharge by Mutual Agreement

Just as a contract is created by means of an agreement, it can be terminated or discharged by mutual agreement. If the parties to a contract agree to make a fresh contract in place of the original contract, the original contract is discharged. A contract can be discharged by mutual agreement in any of the following ways.

a) Novation: The term 'novation' means the substitution of a new contract for the existing one. This arrangement may be either between the same parties or between different parties. The consideration for the new contract is the discharge of the original contract. Since novation implies a new contract, all the parties to the existing contract must agree to it.

Examples

i) A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor instead of A. The old debt of A to B is discharged, and a new debt from C to B has been contracted. This is novation involving change of parties.

ii) A owes B Rs. 10,000. A enters into an agreement with B and gives B a mortgage of his estate for Rs. 5,000 in place of the debt of Rs. 10.000. This arrangement constitutes a new contract and terminates the old.

b) Rescission : Rescission means cancellation of the contract. If by mutual agreement the contracting parties agree to rescind the contract, the contract is discharged. A contract can be rescinded before the performance becomes due. Non-performance of a contract by both the parties for a long period, without complaint, amounts to implied rescission. Rescission is different from novation in the sense that in case of novation a new contract is substituted for the original contract whereas in rescission the original contract is cancelled and no new contract is made.

c) Alteration: It means a change in one or more of the terms of a contract with consent of all the parties. Alteration has the effect of terminating the original contract. In an alteration there is a change in the terms of a contract but no change of parties to it. In novation there may be change of parties.

d) Remission: It means the acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made. According to section **63,** every promisee may (a) remit or dispense with it, wholly or in' part, or (b) extend the time of performance, or (c) accept any other satisfaction instead of performance. A owes B Rs. 5,000. A pays to B Rs. 3,000 who accepts it in full satisfaction of the debt. The whole debt is discharged.

e) Waiver: Waiver means abandonment or intentional relinquishment of a right under the contract. When a party waives his rights under it,, the other party is released from his obligation. For example, A promises to paint a picture for B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

### 7.10.3 Discharge by Lapse of Time

The rights and obligations under a contract can be enforced only within **a** specified period called the 'period of limitation'. The Limitation Act has prescribed the period of limitation for various contracts. For example, period of limitation for exercising right to recover an immovable property is twelve years and right to recover a debt is three years. After the expiry of this limitation period, the contractual rights cannot be enforced. In other words, if a debt is not recovered within three years of its

payment becoming due, the debt becomes time barred and is discharged by lapse of time.

### 7.10.4 Discharge by Operation of Law

A contract may be discharged by operation of law in the following cases.

i) **Death of the Promisor:** Contracts involving the personal skill or ability of the promisor come to an end with the death of the promisor.

ii) **Insolvency:** When a person is declared insolvent by an Insolvency Court, he is discharged from his obligation existing at that time. So, if a promisor is declared insolvent, he is discharged from his liability.

iii) **Merger:** When an inferior right accounting to a party in a contract merges into the superior rights accruing to the same party, the earlier contract is discharged. For example, **A** took a land on lease from B. Subsequently, A purchases that very land. Now **A** becomes the owner of the land and the earlier contract of lease stands terminated.

iv) **Material alteration:** In a written contract if any party makes some material alteration in the terms of the contract without the approval of the other party, the contract stands terminated. A material alteration is one which varies the rights, liabilities or the position of the parties as such, You should note that immaterial alterations, such as correcting the clerical errors or the spelling of a name has no effect on the validity of the contract.

### 7.10.5 Discharge by Impossibility of Performance

You learnt in Unit 1 that for a contract to be valid it must be capable of being performed. But sometimes, due to some reasons which are beyond the control of the parties, the performance of a contract becomes impossible. In such cases, the contract is discharged on the ground of impossibility of performance. Section 56 of Contract Act provides that an agreement to do an act impossible in itself is void. This rule is based on the principle that law does not recognise the impossible and what is impossible does not create any obligations.

Impossibility may be of two types : (i) initial and (ii) subsequent.

**Initial impossibility:** It means impossibility at the time of making the contract. Whether the fact of impossibility is known or unknown to the parties, the agreement is void ab-initio. For example A agrees with B to discover a treasure by magic. The agreement is void due to initial impossibility.

If, however, the promisor alone knows about the initial impossibility while making the contract, he shall have to compensate the promisee for any loss which the promisee may suffer on account of non-performance. This rule is given in Para 3 of section 56. For example, **A** contracts to marry B, being already married to C. Being forbidden by the law of which he is subject to practise polygamy, **A** must compensate B for the loss caused to her by the non-performance of the contract on account of impossibility.

You should note that where initial impossibility is unknown to both the parties, the contract will become void because of mutual mistake of fact. For example, Aagrees to sell his horse to B for Rs. 1000. Unknown to both the parties, the horse was dead at the time of making the agreement. This agreement is void.

**Subsequent or Supervening Impossibility:** Impossibility which arises subsequent to the making of the contract is called supervening impossibility. If the contract was capable of performance at the time of making it, but subsequently because of some event (over which neither party has any control) the performance becomes impossible or unlawful, the contract becomes void and the parties are discharged' from their obligations.

You will notice that supervening impossibility is different from initial impossibility. In case of initial impossibility the agreement is void ab-initio while in case of supervening impossibility the contract **becomes** void.

The doctrine of supervening impossibility is contained in Para 2 of Sec. 56 which provides; A ***contract to do an act which after the contract is made, becomes***

*impossible, or by reasons of some event which rhe promisor could nor prevent, unlawful becomes void when the act becomes impossible or unlawful.*

The contract will become void on the ground of supervening impossibility only if the following conditions are satisfied.

a) The act should have become impossible.

b) The impossibility should be by reason of some event which the promisor could not prevent.

c) The impossibility should not be self-induced by the promisor.

The performance of a contract may become subsequently impossible due to any of the following reasons.

1 Destruction of Subject-Matter: If the subject-matter of a contract is destroyed after the formation of the contract, without the fault of either party, the contract becomes void.

Examples

i) A musical hall was agreed to be let out on certain dates, but before those dates the hall was destroyed by fire. The contract was held to have become void on the ground of impossibility of performance (Taylor v. Caldwell).

ii) A person agreed to deliver a part of a specific crop of potatoes. The potatoes were destroyed by a pest through no fault of the party. The contract was held to be discharged (Howell v. Coupland).

2 Death or personal incapacity: When the peformance of a contract depends upon the personal skill or ability of a party, the contract stands discharged on the death or incapability of that person. For example, A agreed to perform at a concert on a specified day. A fell seriously ill and so could not perform on the said day. It was held that the contract is discharged on the ground of impossibility (Robinson v. Davison).

3 Change of Law: A contract which was lawful at the time of making it but becomes unlawful by reasons of subsequent change in law, the performance becomes impossible and the contract is discharged.

Examples

i) A agreed to transport certain goods belonging to B from one place to another. Subsequently, A's trucks were requisitioned by the Government under a statutory power. It was held that A was discharged from his obligation (Noor Bux v. Kalyan).

ii) A agreed to sell his land to B. Subsequently, the land was acquired by the Government. Now A cannot perform his promise, the contract was held to become void on the ground of impossibility (Shyam Sunder v. Durga).

4 Cessation of a state of things: If a contract is entered into on the basis of the continued existence or occurrence of a particular state of things, the contract is discharged if the state of things ceases to exist or changes. It should be noted carefully that the contract is discharged only when the happening of the event was the basis of the contract,

Examples

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

ii) A took a room on hire in a hotel for viewing the coronation procession of King Edward VII. Because of King's illness the procession was cancelled. It was held that A was not liable to pay the room rent because the very purpose of hiring the room was defeated (Knell v. Henry). This type of supervening impossibility is also called 'frustration of contract'.

5 Declaration of War: If a war is declared subsequent to the formation of the contract, all pending contracts are either suspended or declared as void. If the war is of a short duration, such contracts may be revived after the end of the

war. For example, A contracts to take in cargo for B at a foreign port. A's Government afterwards declares war against the country in which the port is situated. The contract becomes void when the war is declared.

Exceptions **i.e.,** cases not covered by **supervening impossibility:** The above rule is not applicable in some cases. When a person has promised do something, he must fulfil his promise unless the performance becomes absolutely impossible. *Impossibility of* ***performance is, as a rule,*** *not an execuse from performance.* Some of the cases which do not come within the principle of supervening impossibility are as follows:

a) Difficulty of Performance: The contract is not discharged simply because the performance has become more difficult, more expensive or less profitable than stipulated at the time of its formation.

**Examples**

i) A agreed to supply coal within certain period. Due to government's restrictions on the transport of coal from collieries, he failed to supply in time. But since coal was available in the open market from where A could have obtained it, A will not be discharged on the ground of impossibility.

ii) A promised to send certain goods from Bombay to Antwerp in September. In August, war broke out and shipping space was not available except at very high rates. It was held that the increase of freight rates did not exccuse performance.

b) Commercial Impossibility : Performance cannot be excused on the ground of commercial impossibility. If the raw material is available at a very high rate or wages have gone up and the performance becomes less profitable than anticipated, the contract does not become void. Commercial impossibility does not discharge the parties. For example, A agreed to supply certain goods to B. As a result of an increase in the cost of raw material and wage bill, it is now no longer profitable for A to supply the goods-at the agreed rate, A cannot be excused for non-performance,

c) Default of a Third Party: If the contract cannot be performed because of the default of a third person on whose work the promisor relied, the promisor is not discharged. For example, A entered into a contract with B for the supply of certain cotton goods to be manufactured by C, a manufacturer of these goods. C did not manufacture those goods. A is not discharged from his obligation and is liable to B for damages.

d) Strikes, Lockouts and Civil Disturbances: A strike by the workers or a lockout by the employer or riots etc. will not excuse the parties from performing the contract unless there is a clause in the contract to that effect.. For example, a contract was entered into between two merchants for the sale of certain goods which were to be imported from Algeria. The goods could not be imported because of riots and civil disturbances in that country. It was held that this was no excuse for non-performance of the contract.

c) Partial Impossibility: If the contract is made for several purposes, the failure of one or more of them does not discharge the contract. 'For example, A agreed to let a boat to H to (i) view the naval review at the coronation of King, and (ii) to cruise round the fleet. Due to the illness of the King, the naval review was cancelled, but the fleet was assembled and the boat could have been used to cruise round the fleet. It was held that the contract was not discharged.

Effects of Supervening Impossibility

a) Contract becomes void: When the performance of a contract becomes subsequently impossible or unlawful; the contract'becomes void (section 56 para **2).**

b) Compensation **for Non-performance:** When the promisor alone knows that the performance is impossible or unlawful, he must compensate the promisee for any loss which he might have suffered on account of non-performance (section 56 para **3).**

c) **Benefit** to be Restored: When a contract becomes void, any person who has

received any advantage under such contract is bound to restore it, or to make compensation for it, to the person from whom he received it (section 65). For example, A contracts to sing for B at a concert for Rs. 1,000, which is paid in advance, A is too ill to sing. A must refund the advance of Rs. 1,000 to B.

### 7.10.6 Discharge by Breach

You have learnt that when a contract is made, the parties to it are expected to perform it, unless they are excused. *If any party refuses or fails to perform his part of the contract, a breach of contract occurs and* the contract is discharged. In case of breach the aggrieved party is relieved from performing his obligation and gets a right to proceed against the party at fault. A breach of contract may arise in two ways: (i) actual breach and (ii) anticipatory breach.

Actual Breach: Actual breach of contract may take place either on the due date of performance or during the course of performance. For example, A agreed to deliver 100 bags of rice to B at a certain price on 10th July. If A refuses or fails to deliver the goods on time, there occurs an actual breach. If the promisor has performed part of the contract and then refuses or fails to deliver the remaining goods, it is also actual breach of contract.

Anticipatory Breach: Anticipatory breach occurs when the party declares his intention of not performing the contract before the performance is due. This intention may be declared expressly or impliedly. For example, A agrees to supply certain goods to B on 10th July. Before this date A informs B that he shall not supply the goods. If, instead of, expressly informing B about his intention of not performing the contract, A does something which makes it impossible for him to perform, this will also amount to anticipatory breach. If in the example given above, A sells all the goods before the said date to P at a higher price, this action of A clearly indicates his intention.

Thus a breach of contract operates a discharge of contract. In case of breach, the aggrieved party gets the right to claim compensation or damages from the defaulter The various remedies available to the aggrieved party shall be discussed in unit 8.

Check Your Progress C

1 What is 'Novation'?

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2 Does death of the promisor discharges the contract in all cases?

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3 State the doctrine of supervening impossibility?

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4 When is the contract discharged by operation of law?

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5 State whether the following statements are True or False:

i) If a new contract is substituted in place of an existing contract, it is called alteration.

ii) Insolvency of the promisor discharges the contract.

iii) Impossibility of performance is not an excuse for non-performance of a contract.

iv) Difficulty in performing the contract makes it void.

v) If a contract could not be performed because of a default by a third person on whose work the promisor relied, the coneract becomes void.

vi) An agreement to do an act impossible in itself is void.

vii) Anticipatory breach of contract takes place before the performance is due.

## 7.11 LET *US* SUM UP

The most natural way of terminating the contract is to perform it. The performance may be either actual or attempted (also known as Tender). When a party offers to perform his promise in accordance with the contract, and the other party refuses to accept it, the contract is discharged. Attempted performance or tender is equivalent to actual performance. The party who offered to perform is discharged from his obligation. The tender to be valid must be unconditional, made at the proper time, place and manner, made to the promisee or his authorised agent, and must be for the whole obligation.

Performance can be demanded by the promisee only. In case of his death his representatives can demand performance. In case of contracts of a personal nature, they should be performed by the promisor. In other cases, it may be performed by his agent, and in case of his death by his legal representatives.

When two or more persons make a joint promise, then unless a contrary intention appears from the contract, all of them must perform jointly. If any one of the joint promisors dies, his legal representative shall be liable to perform alongwith otherjoint promisors.

The contract should be performed at the time specified and at the place agreed upon. If no time is specified the promisor must perform the promise within **a** reasonable time. In case no time and place is fixed for the performance, the promisee must ask the promisor to fix the day and time for performance. In commercial agreements, time is the essence of the contract.

Promises which form the consideration or part of the consideration for each other are termed as reciprocal promises. Reciprocal promises may be (a) mutual and independent, (b) conditional and dependent, and (c) mutual and concurrent. Reciprocal promises must be performed in the order specified in the contract.

Assignment of a contract means transfer of rights and obligations under a contract to third party. It may be done by the act of the party or by operation of law. Rights and benefits under a contract can be duly assigned. But, a promisor cannot assign his liabilities. Contracts of a personal nature cannot be assigned.

Appropriation means applying the payment to a particular debt. If, while making the payment, the debtor specifies the debt to which it should be applied, then the creditor must appropriate the payment to that debt only. In case the debtor does not specify the debt to which it should be applied, the amount can be appropriated by the creditor in the manner he deems it fit.

A contract may be discharged by mutual agreement which may take the form of Novation, Alteration, Rescission, Waiver or Merger. **A** contract stands discharged if it is not performed within the period of limitation and no action is taken by the promisee. It can be discharged by operation of law also, This includes discharge by death, insolvency, merger, material alteration.

When the performance of a contract becomes impossible or unlawful after the formation of the contract, the contract becomes void on the ground of supervening impossibility. Supervening impossibility may arise due to the destruction of the subject matter, death or personal incapacity of the promisor, change of law, outbreak of war, non-existence of a state of things. The contract is discharged in these cases. However, the contract will not be discharged in case of a) difficulty of performance, b) commercial impossibility, c) default by a third party, d) strikes, lockouts and civil disturbances.

A contract is also discharged by breach of contract. When either party fails or refuses to perform his promise, a breach of contract takes place. Breach may be either actual or anticipatory. Actual breach takes place at the time when performance is due or during the course of peiformance. Anticipatory breach means when a party declares his intention of not performing his promise before the due date of performance.

## 7.12 KEY WORDS

Appropriation: Applying the payment to a particular debt is called appropriation.

**Assignment:** When a party transfers his rights and interest in the contract to another person, he is said to assign the contract.

Breach: When a contracting party refuses to perform his obligation, there is a breach of contract.

Contribution: When a joint promisor has performed the whole of the promise, he may claim the share from other joint promisors. This is known as contribution.

Joint promisors: When a promise is made by two or more persons, they are known as joint promisors.

Novation: When a new contract is substituted for an existing one either between the same parties or new parties, it is termed novation.

Period of Limitation: A time laid down in the Law of Limitation for performing various contracts. If it is not performed during this period, the performance becomes time barred.

Reciprocal promise: A promise made in consideration of other party's promise is reciprocal promise.

Remission: Acceptance of lesser performance than what was contracted for is known as remission.

Rescission: When one or all the terms of a contract are cancelled, it is termed as rescission.

Tender: An offer to perform a promise.

## 7.13 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) False, ii) True, iii) False, iv) True, v) True, vi) True, vii) False, viii) True, ix) True.

B 4 i) True, ii) False, iii) True, iv) True, v) True, vi) False, vii) True, viii) True.

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

## 7.14 TERMINAL QUESTIONS

1 What do you mean by performance of a contract?

2 What is meant by tender? What are the essentials of a valid tender?

3 Who should perform the contract? Is performance of a contract by a third party valid?

4 Explain the legal rules relating to time and place of performance of a contract.

5 "Time is the essence of the contract". Comment.

6 Discuss the law relating to assignment of contracts.

7 Define the term 'Reciprocal Promise'. State the rules far the performance of reciprocal promises.

8 State the various modes of discharge of a contract.

9 Explain with examples the doctrine of supervening impossibility.

10 Explain the meaning of 'Novation'. How novation is different from rescission'?

11 State the rules regarding appropriation of payment.

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit youranswers to theuniversity. These are for your practice only.

# UNIT 8 REMEDIES FOR BREACH AND QUASI CONTRACTS

**Structure**



## 8.0 OBJECTIVES

After studying this unit, you should be able to:

- explain as to what amounts to a breach of contract
- list the remedies in case of breach of contract
- describe the circumstances under which the various remedies shall be available
- define quasi contracts and describe various types of quasi contracts.

## 8.1 INTRODUCTION

In Unit 7 you learnt about the performance of a contract by the parties and consequent termination of the contract. What happens, if the parties refuse or fail to perform the agreed obligation? Such a failure or refusal results in what is called as breach of contract. In this unit you will learn about the meaning of breach of contract, kinds of breach of contracts and the remedies available to the other party in case of a breach of contract. You will also learn about the nature and effects of certain transactions called quasi contracts which are not contracts in the strict sense of the term, but generate obligations similar to those created by contracts.

## 8.2 MEANING OF BREACH OF CONTRACT

As you know, the term 'agreement' is defined under section 2(e) as 'reciprocal promises'. Thus, both the parties are subjected to an obligation to do or not to do something. In case any of the parties fails to carry out his agreed obligation or by his act makes it impossible to perform his obligations under the contract, he is said to have committed the breach of that contract. Breach of contract may arise in two ways: (i) anticipatory breach, and (ii) actual breach. Let us now study these two in detail,

### 8.2.1 Anticipatory Breach of Contract

Anticipatory breach of contract occurs when a party repudiates the contract before the time fixed for its performance or when a party by his own act disables himselfabsolutely from performing the contract.

Examples

1 A contracts to marry B. Before the agreed date of marriage, he marries C. In this case, A has committed anticipatory breach of contract.

2 A contracts to supply B with certain articles on 1st of August. On July 20, he informs B that he will not be able to supply the goods. A has committed anticipatory breach of contract.

Section 39 deals with anticipatory breach of contract. It provides *when a party to a contract has* ***refused to perform, or*** *disabled himself from performing his promise* ***in its entirety, the promisee*** *may put* ***an end to the contract, unless he has*** *signified, by words* ***or.*** *by conduct, his acquienscence (willingness)* ***in its*** *continuance.* For example, A who is 2 singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months. B agrees to pay her 100 rupees for each performance. On the sixth night A wilfully absents herself from the theatre. B is at liberty to put an end to the contract. In this example, if B permits A to sing on the seventh night, B has signified his willingness in the continuance of the contract. He cannot now put an end to it but is entitled to compensation for the damage sustained by hirn through A's failure to sing on the sixth night.

Reading through the provisions of Section 39 and the aforesaid example, you would have noted that in the event of an anticipatory breach i.e., where a party to a contract refuses to perform his part of the contract before the actual date of performance, the promisee shall have two options: (i) rescind the contract and sue for damages for breach of contract without waiting until the due date for performance, or (ii) may not rescind the contract but treat the contract as operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. You should note that in case the promisee decides not to rescind the contract, the contract shall remain alive for the benefit of both the parties. But if during the intervening period i.e., the date of breach and the due date of the performance, any event happens that intervene (e.g., supervening impossibility) for the benefit of the promisor, the promisee shall lose his right to sue for damages. For example, A agreed to load a cargo of wheat on B's ship by a particular date, When the ship arrived, A refused to load the cargo, but B did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired the war broke out, rendering the performance of the contract illegal. The contract has come to an end by frustration and B cannot sue A for damages (Avery v. **Bowden).**

In case' of anticipatory breach of contract, the aggrieved party may claim damages either at the time when such a breach is committed or wait till the time when the performance becomes due and claim damages if promise still remains unperformed. However, the amount of damages claimable **shall vary in the two cases.** This difference can be clarified with the help of an example, X agrees to sell to Y a certain quantity of wheat at Rs. 300 per quintal to be delivered on August 3. On July 2. X gives notice expressing his unwillingness to sell wheat, and the price of wheat on the date is Rs. 400 per quintal. If Mr. Y repudiates the contract forthwith (which he is entitled to do at his option), he would be able to recover damages @ Rs. 100 per quintal which is the difference between market price and the contract price on July 2. If, instead of taking the action forthwith, he keeps the contract alive till August 3, and in the mean time, the price increases to Rs. 500 per quintal. Y would be able to recover damages @ Rs. 200 per quintal.

### 8.2.2 Actual Breach of Contract

Actual breach of contract may take place in any of the two ways: (i) breach at the time when the performance of contract is due, or (ii) breach of contract during the pcrformance of the contract. Now let us study about these two separately in detail.

Actual **breach of** Contract at the time when performance is due. If a party to contract refuses or fails to perform his part of the contract at the time fixed for

performance of that contract, he will be liable for its breach. For Example, A agreed to sell his car to B on July 2. On July 2 A refused to sell his car to B. On A's refusal to sell the car, there is an actual breach of contract. Now the question is whether it should be accepted or whether the promisee can refuse such performance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be the essence of the contract or not.

In this respect, Section 55, lays down, *When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable at the option of the* ***promisee, if the intention of the parties was that time should be the essence of the contract.***

If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time. But the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.

If, in case of a contract voidable on account of the promisor's failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so. For example, A, a singer, contracts with B, the manager of a theatre to sing at his theatre two nights in every week during the next two months, and B agrees to pay her 100 rupees for each night's performance. On the sixth night A wilfully absents herself from the theatre and B, in consequence, rescinds the contracts. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract by A.

According to the aforesaid provisions, if performance beyond the stipulated time is accepted, the promisee must give notice of his intention to claim compensation. If he Fails to give such notice, he will be deemed to have waived that right.

**Actual breach of contract during the performance of the contract**

Actual breach of contract also occurs when during the performance of the contract one party fails or refuses to perform his obligation under the contract. For example, A contracted with a Railway Company to supply it certain quantity of railway chairs at a certain price. The delivery was to be made in instalments. After a few instalments has been supplied, the Railway Company asked A to deliver no more. Held, A could sue for breach of contract **(Cort v. Ambergate etc'Rly Co.).**

## 8.3 REMEDIES FOR BREACH OF CONTRACT

When a contract is broken by a party, there are several courses of action (remedies) which the other party may pursue. These remedies include:

1 Rescission of the contract

2 Suit for damage

3 Suit for specific performance

4 Suit for injunction

5 Suit upon quantum meruit

### 8.3.1 Rescission 'of the Contract

As you have read section 39 of the Act provides that when a party to a contract has refused to perform, or disabled himself from performing his promise in. its entirety, the promisee may put an end to the contract. This is called right of rescission. It means setting aside of the contract. In such a case aggrieved party is discharged from all the obligations under the contract. For example, A promises to supply the furniture for B's new office on a certain day. B promises to pay for the

furniture on its receipt. **A** does not supply the furniture on the agreed date. B is discharged from the liability of paying the price and can rescind the contract.

It should be noted that section 75 of the Indian Contract Act also confers upon a person rightfully rescinding the contract to make a claim for compensation of any loss or damage sustained through the non-fulfilment of the contract. Thus, in the above example B shall not only be entitled to rescind the contract but also to claim compensation for the damage which he has sustained because of the non-supply of furniture by **A** on the specified date,

## 8.3.2 Suit for Damages

In the event of breach of contract; the aggrieved party besides rescinding the contract can claim for damages. Damages are monetary compensation allowed for loss suffered by the aggrieved party due to the breach of contract. The object of the court in awarding damages for breach is that the aggrieved party may be put in the financial position which would have existed had there been no breach of contract. The law does not punish a party because he has broken a contract but if, by reason of his wrongful act, the other party has suffered any pecuniary (monetary) loss, the court will compel the party in breach to compensate the loss by paying damages to the other party.

In India, the rules relating to damages are based on the judgement in English case of **Hadley v. Baxendale.** The facts of this case were: H's mill was stopped due to the breakdown of a shaft. He delivered the shaft to B, a common carrier, to be taken to a manufacturer to copy it and make a new one. H had not made it known to B that delay would result in a loss of profits. By some neglect on the part of B, the delivery of the shaft was delayed in transit beyond a reasonable time. Held, B was not liable for loss of profits during the period of delay as the circumstances communicated to B did not show that a delay in the delivery of shaft would entail loss of profits to the mill. The following rule of law was laid down in this case: ***'Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.'***

Section 73, of the Indian Contract Act which deals with compensation for loss or damage caused by breach of contract is based on the judgement in the above case. It states that the aggrieved party may claim the damages as follows:

a) Such damages which naturally arose in the usual course of things from such breach. This relates to ordinary damages arising in the usual course of things.

b) Such damages which the parties knew, when they made the contract, to be likely to result from the breach. This relates to special damages.

c) The aforesaid compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach, and

d) Such compensation for damages arising from breach of quasi contract shall be same as in any other contract,

**Rules Relating to Different Types of Damages: We** may now consider in detail the types of damages and rules relating to them.

1 **Ordinary Damages:** Ordinary damages are those which naturally arise in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price on the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer and further loss if the market falls, nor is he liable to have the damages reduced if the market rises. For example **A** contracts to deliver 100 bags of rice at Rs. 100 per bag on a future date. On the due dates he refuses to deliver. The market price on that day is Rs. 110 per bag. The measure of damages is the difference between the market price on the date of the breach and the contracted price i.e., Rs. 110—100 = Rs. 10.

You should note that section 73 specifically provides for compensation for any loss or damage which arise naturally in the usual course of things from the breach and as such compensation cannot be claimed for any remote indirect loss or damage by reason of the breach. For example, A Railway passanger's wife caught cold and tell ill due to her being asked to get down at a place other than the Railway Station and she had to walk a long distance in drizzling night to reach home. In a suit by the plaintiff against the railway company, it was held that damages for the personal inconvenience of the plaintiff alone would be granted, but not for sickness of the plaintiff's wife because it was very remote consequence **(Hobbs v. London and S).**

2 **Special Damages:** Damages other than those arising directly from the breach may be recovered if such damages may reasonably be supposed to have beep in contemplation of both the parties as the probable result of the breach of a contract. Such damages are known as 'special damages'. Thus, when there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisee to not only the ordinary damages but also special damages that may result therefrom. For example, A, who is a builder, agrees to erect and finish a house by 1 January in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that it falls down before 1 January and has to be rebuilt by B. As a consequence, B loses the rent which he was to have received from C, and is obliged to make compensation to C for the breach of his contract. A must make compensation to B for the cost of rebuilding the house, for the rent lost, and for the compensation made to C. Here, you should note that the communication of the special circumstances is a pre-requisite to the claim for special damages. The case of **Hadley v. Baxendale** which laid down the rules regarding 'special damages' in England is the most celebrated illustration on the point. The facts of this case have already been discussed.

3 **Exemplary/Punitive/Vindictive Damages:** Exemplary (also called punitive or vindictive damages), are intended to show the court's strong disapproval of the conduct of the defendant in committing the wrong. They are not proportionate to the actual pecuniary loss sustained by the aggrieved party but are inflicted by way of punishment. These are normally awarded in case of (i) a breach of promise to marry, or (ii) wrongful dishonour of a cheque by a banker. The measure of damages in case of breach of promise to marry is dependent upon the severity of the shock to the sentiments and goodwill of the promisee. In case of wrongful dishonour of a cheque, the rule is—smaller the amount of the cheque, larger will be the amount of damages awarded and vice versa.

4 **Nominal Damages:** Nominai damages are awarded in case of breach of contract where there is only a technical violation of the legal right, but no substantial loss is caused therby. The damages granted in such cases are called nominal because they are very small, say, a rupee. It may be noted that the aggrieved party cannot claim these damages as a matter of right. It is always at the discretion of the court whether or not to award nominal damages.

5 **Damages for Deterioration Caused by Delay:** In the case of deterioration caused to goods by delay, damages can be recovered from carrier even without notice. The word 'deterioration' implies not only physical damages to the goods but also loss of special opportunity for sale. In the case of **Wilson v. Lancashire and Yorkshire Railway Co.** the plaintiff had bought velvet for making caps for sale during the spring. But, due to delay in transit, he was unable to utilise it for making caps for sale during the season. It was held that the fall in value of the cloth arrived after the season amounted to a deterioration for which the plaintiff was entitled to recover damages without notice.

6 **Damages for Inconvenience and Discomfort:** When a party has suffered physical discomfort and inconvenience as a result of breach of contract, that party can move a suit for claiming compensation. However, according to the general rule, the motive or the manner of breach do not affect the measure of damages.

**Examples**

1) A was wrongfully dismissed in a harsh and humilating manner by *G* from his employment. Held, a) A could recover a sum representing his wages for the period of notice and the commission which he would have earned during that period, b) He could not recover anything for his injured feelings or for the loss sustained from the fact that his dismissal made it more difficult for him to obtain employment **(Addis** v. **Gramaphone Co. Ltd.).**

2) H, with his wife and children took a ticket for a midnight train, to be transported to'a particular place where he lived. They were, however, transported to a wrong place and they had to walk several miles on a drizzling night. H was awarded compensation for inconvenience but nothing for the medical expenses of his wife who caught cold, as this consequence was too remote. **(Hobbs** v. **London & S.W. Pail & Co.).**

7 **Liquidated Damages and Penalty:** Some time, in order to avoid delay in the assessment and payment of damages, at the time of formation of contract, the parties to a contract mutually agree to stipulate or specify sum, which will become payable by the party guilty of breach. If the specified sum represents a fair and genuine pre-estimate of the damages likely to result due to breach, then it is called **liquidated damages.** On the other hand, if the sum fixed at the time of formation of contract is disproportionate to the damages likely to occur, the sum is deemed to be a **penalty.** The amount is so provided to ensure performance of the contract.

Under English law, liquidated damages are enforceable but penalty cannot be claimed. In India, however, there is no such distinction recognised between penalty and liquidated damages. The courts in India allow only 'reasonable compensation' (section 74).

8 **Stipulations for interest:** The largest number of cases decided under section 74 relate to stipulation in a contract providing for payment of interest:

i) **Payment of interest in case of default: A** stipulation for payment of interest in case of default is not in the nature of a penalty, if the interest is reasonable. If the court. finds that the rate of interest is exorbitant and is penal in character in may grant some relief.

ii) **Payment of interest at higher rate:** Such a stipulation occurring in a contract may be of a two fold character:
   a) It may either provide for payment of interest at an increased rate from the date of the contract on failure of the debtor to pay on the due date the interest or principal or an instalment of principal; or
   b) It may provide for payment at a higher. rate from the date of default only.

***A stipulation for increased interest from the date of the bond, and not from the date of default*** is always in the nature of a penalty, and relief may be granted to the party. The court may award only reasonable compensation **(Rameshwar** Pd. **Singh v. Rai Sham Kishen).** Thus, where a loan is advanced at 15% p.a. with a stipulation that in case of default in payment of any instalment, interest shall be raised to 20% p.a. Such a stipulation is a penalty and court may award reasonable compensation only.

***A stipulation for increased interest from the date of default may be stipulation by way of penalty.*** When it is so, relief is granted against it. Whether such a stipulation is penal or not depends on the terms of the contract and the circumstances of each case. For example, A gives B a bond for repayment of Rs. 10,000 with interest @ 12% at the end of six months, with a stipulation that in case of default, interest shall be payable @ 75% from the rate of default. This is a stipulation by way of penalty and B is only entitled to recover from A such compensation as the court considers reasonable.

iii) **Payment of Compound Interest on Default: A** stipulation in a bond for payment of compound interest on failure to pay simple interest at the same

rate as was payable upon the principal is not a penalty. But a stipulation in a bond for the payment of compound interest at a rate higher than that of simple interest is a penalty and the party may be relieved against.

9 Forfeiture of 'Earnest Money' or 'Security Deposit': The amount deposited as security for performance of a contract and the same is supposed to be adjusted against the price on completion of the contract, it is called earnest money. Is a clause in a contract providing for forfeiture of earnest money in the event of failure to perform in the nature of penalty? In a number of judicial decisions, it has been held that such a clause shall be in the nature of a penalty and only reasonable compensation could be claimed. **(Mohd. Sultan** v. **Naina Mohd, M/s** Variety Body Builders **v.** Union of **India,** Fnteh **Chand v. Balkishan Dass).**

### 8.3.3 Suit for Specific Performance

In certain cases of breach of contract, damages may not be considered as an adequate remedy. The aggrieved party may not be interested in monetary compensation. The court may, in such cases, direct the defaulting party to carry out the promise according to the terms of the contract. This is called 'Specific Performance' of the contract.

Specific performance of a contract may, at the discretion of the Court, be enforced where the contract involves the sale of a particular house or some rare article or any other thing for which monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market. For example, A agreed to sell an old painting to B for Rs. 10,000. Subsequently, A refused to sell the painting. Here, B may file a suit against **A** for the specific performance of the contract.

Specific performance is not granted under the following situations :

**a)** When monetary compensation is an adequate relief;

b) When the contract is of a personal nature, e.g., a contract to many, a contract to paint a picture, etc. In such contracts injunction is granted in place of specific performance.

c) Where it is not possible for the court to supervise the performance of the contract, e.g., a building construction contract.

**d)** When the contract is made by a company beyond its powers as laid down in its memorandum of association.

e) When the contract is inequitable to either party.

f) Where one of the parties is a minor.

### 8.3.4 Suit for Injunction

Where a party is in breach of a negative term of a contract **(i.e.,** where he does something which he promised not to do) the court may by issuing an order, prohibit him from doing so. Such an order issued by court is called an 'injunction'.

**Examples**

**1** G agreed to buy the whole of the electric energy required for his house from a certain company. He was, therefore, restrained by an injunction from buying electricity from any other person. (Metropolitan Electric **Supply Company** v. **Ginder).**

**2.** W agreed to sing at L's theatre, and during a contract period to sing nowhere else. Afterwards, W made contract with Z to sing at another theatre and refused to perform the contract with L. *Held,* W could be restrained by injunction from singing for **Z.** (Lumely **v. Wagner).**

### 8.3.5 Suit upon Quantum Meruit

The phrase 'Quantum **Meruit'** means 'as much as is merited (earned)'. The normal rule of law is that unless a party has performed his promise in its entirety, he cannot

claim performance from the other. To this rule, however, there are certain exceptions on the basis of quantum meruit. When a person has done some work under a contract and the other party repudiates the contract, or some event happens which makes the further performance of the contract impossible, then the party who has already performed the work can claim payment for the work he has already done. **This right of claiming the payment for work already done, before the repudiation of the contract or its further performance becoming impossible is called the right to quantum meruit.** For example, **X,** a writer, was engaged by M who is the editor of a magazine to write a series of twelve articles to be published in the magazine. After X had delivered six articles, the publication of the magazine was discontinued. X is entitled to receive payment for the six articles already written. You will study more about quantum meruit later in this unit.

**Check Your Progress A**

1 What is a breach of contract?

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2 What is an anticipatory breach of contract.?

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3 State whether the following statements are True or False.

i) Special damages are available as a matter of statutory right.

ii) Special damages cannot be claimed unless extraordinary circumstances resulting in a special loss were communicated to the promisor.

iii) Exemplary damages are available only in case of defamation, like wrongful dishonour of a cheque by a bank.

iv) In India, although liquidated damages are allowed, penalty provision in a contract is void.

v) The promisee has a right to refuse to accept monetary compensation and insist on specific performance of a contract by the promisor.

4. Fill in the blanks:

i) The rule on special damages was for the first time laid down in the case of.....

ii) The measure of ordinary damages is the difference between.....price and the.....price.

iii) Specific performance of a contract will not be granted where the contract is of a.....

iv) Quantum Meruit means.... .....

v) Actual breach of a contract may take place (a) at the time when performance is due, or (b).....

## 8.4 QUASI CONTRACTS

There are many situations in which a person may be required to conform to an obligation, although he has neither broken any contract nor committed any tort. For example, A has forgotton certain articles in B's house. Now B is bound to restore .

them to A. Such obligations are generally described as 'quasi contractual obligations'.

Quasi contracts are based on the principle of equity and justice. It simply states that nobody shall enrich himself unjustly at the expense of another. In fact, a quasi contract is not a contract at all. It is an obligation which the law creates in the absence of any agreement, when the acts of the party or others have placed in the possession of one person, money or its equivalent under such circumstances that in equity and good conscience, he ought not to retain it, and which in justice and fairness belongs to another. He then is placed under an obligation to restore or repay for such a benefit.

### 8.4.1 Definitions of Quasi Contracts

There is no statutory definition of a quasi contract available either under the English Law or under the Indian Contract Act. Pollock describes quasi contracts as "contracts 'in law' but not 'in fact', being the subject matter of a fictitious extension of the sphere of the contract to cover obligations which do not in reality fall within it". Sir William Anson, a noted English author points out that "circumstances must occur under any system of law in which it becomes necessary to hold one person to be accountable to another, without any agreement on the part of the former to be so accountable, on the ground that otherwise he would be retaining money or some other benefit which has come into his hands to which the law regards the other person as better entitled, or on the ground that without such accountability, the other would unjustly suffer loss. The 'Law of Quasi Contract' exists to provide remedies in circumstances of this kind."

Quasi contracts are also called ***implied contracts,*** They are implied because they create such obligations which resemble those created by contracts. The essentials for the formation of a contract are absent but as outcome resembles those created by a contract they are called quasi contracts. Under English Law, they are also termed as ***Constructive Contracts*** or ***Contracts in Law,*** etc. Indian Contract Act terms quasi contracts as ***certain relations resembling those created by conti-acts*** and are found under sections 68 to 72.

### 8.4.2 Difference Between Quasi Contracts and Contracts

In case of contracts, it is the consent of the party which produce the obligations. But in quasi contracts there is no question of consent, it is the law alone or natural equity which produces obligations. As noted earlier, a quasi contract is based on the ground that a person shall not be allowed to unjustly enrich himself at the expense of another. There is, however, similarity between quasi contract and contracts in case of claims for damages. In case of breach of a quasi contract section 73 of the Indian Contract Act provides for the same remedies (claim for damages) as provided in case of breach of a contract. It reads: ***When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person has contracted to discharge it and has broken his contract.***

### 8.4.3 Types of Quasi Contracts

You have studied what is a quasi contract and how it differs from a contract. Now, let us look into various kinds of quasi contracts recognised under the Indian Contract Act. Sections ***68*** to 72 deal with five types of quasi contractual obligations.

Supply of Necessaries

According to section 68, if a person incapable of contracting (which would include a minor, idiot and lunatic) or anyone whom he is legally bound to support, is supplied by another with 'necessaries' suited to his condition in life such person is entitled to recover the value thereof from the property of such incapable person. You should note that the aforesaid claim for necessaries is based upon' quasi contractual obligations because a contract with a person incompetent to contract is void-ab-initio. The following two points must, however, be noted in this regard:

a) The amount is recoverable only from the property (if any) of the incapable person and not from him personally.

true owner could not be found. After some time, A tendered to B the lawful expenses incurred by him for finding the true owner and asked him to return the diamond to him (A). B refused to do so. ***Held*** B must return the diamond to A as A was entitled to retain it against the whole world, except the true owner **(Hollins v.** Fowler).

2 The finder has lien in respect of any sum which may be due to him on account of expenditure incurred by him in respect of the goods (section 168).

3 Where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it (section 168). This right was re-endorsed in the case of **Harbhajan v. Harcharan.**

4 The finder may sell the goods in the following circumstances :
   a) Where the thing found is in danger of perishing.
   b) Where the owner cannot, with reasonable diligence, be found out.
   c) Where the owner has been found but he refuses to pay the lawful charges of the finder.
   d) Where the lawful charges of the finder, in respect of the thing found amount to 2/3rd or more of the value of the thing found.

**Liability of Person to whom Money is Paid or Thing Delivered by Mistake or Coercion**

A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it (section **72).**

**Example**

I **A** and B jointly owe Rs. 100 to C. A alone pays the amount to C. Not knowing this fact, B pays Rs. 100 again to C. Now, C is bound to repay the amount to B .

2 A railway company refuses to deliver certain goods to the consignee, except upon the payment of illegal charges. The consigner pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

You should note that section **72** is based upon the principle of equitable restitution. A person is under a mistake that money is due when, in fact, it is not due. Such a person when he pays under mistake must be repaid. Money paid under mistake is recoverable whether the mistake be of fact or of law. In the case of **Sales Tax Officer v. Kanhaiya Lal.** The Supreme Court held that section **72** of the Indian Contract Act is wide enough to cover not only a mistake of fact but also a mistake of law. In this case, the levy of sales tax on forward transactions was held to be ***ultra vires*** by the Allahabad High Court. The respondent, therefore, claimed a refund of the tax paid under mistake of law under section **72.** It was held that the respondent was entitled to the refund.

With reference to the word 'coercion' used in this section, it may be noted that the word is to be interpreted in its popular sense to mean oppression, extortion or such other means **{Seth Kanhaiya Lal v. National Bank of India).**

## 8.5 QUANTUM MERUIT

As discussed earlier, the phrase 'quantum meruit' means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other **(Cutter v. Powell).** But, in certain cases, when a person has done some work under a contract, arid the other party repudiates the contract or some event happens which makes the further performance of the contract impossible then the party who has performed the work can claim remuneration for the work he has already done. The right to claim on 'quantum meruit' does not arise out of the contract as the right to damages does. It is'a claim on the quasi contractual obligations which the law implies in the circumstances (Patel Engg. Co. **Ltd. v. Indian Oil Corporation Ltd.).** The action of 'Quantum Meruit' is allowed in Indian Courts under section 70 of the Contract Act.

The claim of 'Quantum Meruit' arises in the following cases:

1 When a contract is discovered to be unenforceable: When an agreement is discovered to be void or becomes void, any person who has received any advantage under such agreement or'contract is bound to restore it, or to make compensation for it to the person from whom he received it. For example, A, a singer, contracts with B, the Manager of a theatrr to sing at his theatre for two nights every week during the next two months. and B agrees to pay her Rs. 1,000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B must pay A for the five nights on which she had sung.

2 When one party abandons or refuses to perform the contact: Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract. For example, C, an owner of a magazine engaged P to write a book to be published by instalments in his magazine. After a few instalments were published, the publication of the magazine was stopped. Held, P could claim payment on quantum meruit for the part already published. (Blanche v. Colburn). In another case S, a building contract or, agreed to construct a house for H for $565. He did work to the extent of $333 and then abandoned the contract. Afterwards, H gets the work completed another person. Then S cannot recover anything for the work done because he was entitled to the payment only on the completion of the work (Sumpter v. Hedges).

3 When a Contract is divisible: When a contract is divisible and the party not in default has enjoyed 'benefit of the part performance, the party in default may sue on a quantum meruit. But if the contract is not divisible, the party in default cannot claim compensation on this basis.

4 When an indivisible contract is completely performed but badly: When an indivisible contract for a lump sum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work. For example, A agreed to decorate B's flat for a lump sum of Rs. 10,000. A did the work but B complained of faulty workmanship. It costs B Rs. 2,000 to remedy the defect. A shall be entitled to recover from B Rs. 8,000 (Rs. 10,000—Rs. 2,000) (Hoeing v. Isaac).

Check Your Progress B

1 Distinguish between a contract and a quasi contract.

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2 What do you understand by Quantum Meruit?

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3 Fill in the blanks:

i) The alternative expression for 'Quasi Contracts' is. .....

ii) The property of a minor may be attached for. .....supplied to him.

4 State whether the followings statements are True or False:

i) Minor's properties may be attached for necessaries supplied to his dependant.

ii) A person cannot recover from another an amount paid under a mistake of law.

iii) One cannot claim performance from another unless one has carried out his part of the promise in full.

iv) Finding is keeping.

v) A finder Is the next best owner to the real owner.

## 8.6 LET US SUM UP

When one of the parties fails or refuses to perform his part of the promise, he is said to have committed a breach of contract. In such a case the other party, called the aggrieved party, has certain remedies. These remedies include: (1) right of rescission (that is right not to perform), **(2)** right to claim damages (including ordinary damages, special damages, exemplary or vindictive damages, nominal damages, liquidated damages and penalty), (3) suit for specific performance, (4) suit for injunction (stay order), and (5) suit on ***Quantum*** Meruit basis.

There are certain obligations/rights which are not contractual but they resemble contractual obligations/rights. Law, therefore, on principle of equity, treats them as contracts. Such situations are more commonly known as quasi contracts. Various types of quasi contracts are dealt with under sections 68 to **72** of the Indian Contract Act. These include: (I) claim for necessaries supplied to a person incapable of contracting or on his account, **(2)** reimbursement of person paying money due by another in payment of which he is interested, **(3)** obligation of person enjoying benefit of non-gratuitous act, (4) responsibility of finder of goods, and (5) liability of person to whom money is paid or thing delivered by mistake or under coercion.

## 8.7 KEY WORDS

**Anticipatory Breach:** Breach of a contract before its performance is due.

**Damages**: Monetary compensation granted to a party by the court in the event of a breach of a contract by the other party.

**Exemplary Damage:** Damages awarded to create an example.

**Frustration:** **A** term used in English **Law** for the term 'supervening impossibility' in Indian Law.

**Injunction**: An order of the court prohibiting a person to do a particular act commonly known as 'Stay Order'.

**Penalty:** The amount of compensation payable in case of breach and stated in the contract.

**Punitive**: In the nature of punishment.

**Quasi Contracts:** In the nature of contracts or similar to contracts.

**Quantum Meruit**: Quantity merited or 'as much as earned'.

**Rescission**: Right not to perform a contractual obligation.

## 8.8 ANSWERS TO CHECK YOUR PROGRESS

A 3 i) False ii) True iii) False iv) False v) False

4 i) Hadley v. Baxendale ii) Market, contracted iii) personal nature iv) as much as earned v) during the performance of a contract.

B 3 i) Certain relations resembling those created by contracts.
ii) Section 68 of the Indian Contract Act.

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

## 8.9 TERMINAL QUESTIONS

1 What do you understand by anticipatory breach of contract'? State the legal position of the parties in such a case.

2 What are the rules under the lndian Contract Act for estimating the loss or damage arising from a breach of contract'?

3 What is 'Breach of Contract? What remedies are available to an aggrieved party on the breach of a contract?

4 "Compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach of contract". Discuss.

5 Explain the terms 'Penalty' and 'Liquidated Damages' clearly indicating the difference between the two.

6 What are the quasi contracts? Enumerate the type of such contracts dealt within the Indian Contract Act.

7 Write a short note on 'Quantum Meruit'.

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

### Some Useful Books

Gulshan, S.S. and G.K. Kapoor. 1989 ***Business Law*** Wilay Eastern Limited, New Delhi (Chapters 6-10)

Kapoor, N.D. 1988. *Mercantile* Law, Sultan Chand & Sons, New Delhi (Chapters 6-12)

Kuchhal, M.C. 1989. ***Mercantile Law,*** Vikas Publishing House Private Limited, New Delhi (Chapter 6-12)

Maheshwari, R.P. and Maheshwari, S.N. 1989. ***Business*** Law, National Publishing House, New Delhi (Chapters 5-12)

Shukla, M.C. 1987. ***A Manual*** of *Mercantile Law, S.* Chand & Co., New Delhi (Chapter 1)

# UNIT 9 INDEMNITY AND GUARANTEE

**Structure**



## 9.0 OBJECTIVES

After studying this unit, you should be able to:

- define a contract of indemnity
- describe the rights of indemnity holder
- define a contract of guarantee
- distinguish. between a contract of indemnity and a contract of guarantee
- expalin the extent of surety's liability
- describe the rights of surety
- explain when a surety is discharged.

## 9.1 INTRODUCTION

You have so far studied the principles applicable to contracts in general. Let us now take up a particular species of contract viz., Contracts of Indemnity and Contracts of Guarantee. Since these are specific types of contract, the general principles of contracts are fully applicable to such contracts. In this unit you will learn the meaning of contract of indemnity, right of indemnity-holder, and commencement of indemnifier's liability. You will also study the meaning of contract of guarantee, the difference between contract of indemnity and guarantee, types of guarantees. rights of a surety, and discharge of surety from liability.

## 9.2 MEANING OF CONTRACT OF INDEMNITY

The term 'indemnity' simply means to make good the loss or to compensate the party who has suffered some loss. The term 'contract of indemnity' is defined in Section 124 of the Indian Contract Act as follows, **"A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the: conduct of any other person, is called a contract of indemnity."** The person who promises to compensate for the loss is called the "indemnifier" and the person to whom this promise is made: or whose loss is to be made good *is* known as

"indemnity-holder" or "indemnified". For example, A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of money. This is a contract of indemnity, here A is the indemnifier and B is the indemnified.

The above definition restricts the scope of contracts of indemnity as it covers only the losses caused by the conduct of the promisor himself or by the conduct of any other person. If a strict view is taken of this definition, it will exclude the losses caused by accidents. In that case insurance contracts should not fall within the purview of contracts of indemnity. But the fact is that all contracts of insurance (except life insurance) are also contracts of indemnity. The intention of law makers had never been to exclude insurance contracts from the purview of contracts of indemnity. That is why we follow the English definition which states **"a promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor".** This definition includes a promise to make good the loss arising from any cause whatsoever e.g. fire, perils of sea, accidents etc. When a person expressly promises to compensate the other from loss, it is termed as express indemnity. The contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case. Even Section 69 of the Contract Act (discussed in Unit 8) implies a duty to indemnity in case a person who is interested in the payment of money which another is bound by law to pay, has paid the amount. Similarly, in an auction sale there is an implied contract of indemnity between the auctioneer and the person who asks him to sell goods. For example, A, an auctioneer, sold certain goods on the instructions of B. Later on, it is discovered that the goods belonged to C and not B. So, C recovered damages from A for selling the goods belonging to him. Here A is entitled to recover the compensation from B. In this case there was an implied promise to compensate the auctioneer for any loss which he may suffer on account of the defective title of B.

As you know that contract of indemnity is a special type of contract, therefore, to enforce such contracts it is necessary that all the essentials of a valid contract (discussed in Unit 1) must be present. In case any one of the essential is missing, the contract cannot be enforced. Thus if the object or consideration of an indemnity agreement is unlawful, it cannot be enforced. For example, A asks B to beat C, promising to indemnify him against the consequences this cannot be enforced. Suppose B beats C and is fined Rs. 500, B cannot claim this amount from A, because the object of the agreement is unlawful.

## 9.3 RIGHTS OF INDEMNITY HOLDER

In pursuance of Section 125 of the Act the indemnity-holder may recover from the indemnifier (promisor), the following amounts, provided the acts within the scope of his authority :

1) He is entitled to recover all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applied.

2) He is entitled to recover from the indemnifier all costs which he had paid in bringing or defending any suit in respect of contracts of indemnity. In bringing or defending the suit the indemnity-holder must not contravene the orders of the indemnifier and he must act in the same way as a prudent man would have acted under similar circumstances in his own case.

3) He is entitled to recover from the indemnifier, all the amount which he had paid under the terms of the compromise of such suit. However, it is essential that the compromise must not be contrary to the orders of the indemnifier and in compromising the suit, he must act as a prudent man. This right is also available to the indemnity-holder when he paid any amount under any compromise entered by him and authorised by the indemnifier.

## 9.4 COMMENCEMENT OF INDEMNIFIER'S LIABILITY

An important question in this connection is when does the indemnifier become liable to pay, or, when is the indemnity-holder entitled to recover his indemnity? The

indemnity-holder is entitled to above-mentioned rights as soon as his liability has become certain although lie has himself paid nothing. Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay. Thus, if the indemnity-holder has incurred an absolute liability, he is entitled to ask the indemnifier to save him from that liability and pay it off. In simple words, the liability of indemnifier commences as soon as the liability of the indemnity-holder becomes absolute.

Check Your Progress A

1) Define a contract of indemnity.

.....

.....

.....

2) A contract of indemnity is a contingent contract. Do you agree'?

.....

3) The definition of contract of indemnity as given in the Contract Act includes implied promises to indemnify. Is it true?

.....

4) A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of money. C obtains judgment against B for the amount. Without paying any portion of the decree amount, B sues A for it's recovery, will he succeed?

.....

5) State whether the following can be enforced :
Where a person asks another to beat a third person, promising to indemnify him against the consequences.

.....

## 9.5 MEANING OF CONTRACT OF GUARANTEE

The object of contract of guarantee is to enable a person to obtnin an employment, a loan or goods on credit.

According to Section 126 of the Indian Contract ***Act,*** 'A ***contract of*** *guarantee'* ***is a contract to perform the promise, or*** *discharge the* ***liability, of a third*** *person in case* ***of his default. The person who gives the*** *guarantee* ***is*** *called the* ***'surety'; the person in respect of whose*** *default* ***the guarantee*** *is given* ***is*** *called 'the principal debtor';* ***and*** *the* ***person to whom the guarantee is given is called*** *'the creditor'.* ***A guarantee may be either*** *oral or* ***written.*** For example, if A and his friend B enter a trader's shop, and A asks the trader, "supply the articles required by B, and if lie does not pay you. I will." It is a contract of guarantee. The primary liability to pay is that of B but if he fails to pay, A becomes liable to pay. On the other hand, if A says to the trader, "let him (B) have the goods, I will see you are paid", the contract is one of indemnity and not a contract of guarantee.

From the above-mentioned definition of guarantee you will notice that in a contract of guarantke, there are three parties known as creditor, principal debtor and surety. A contract of guarantee is formed when all the three agree. Let us take an example, A and B enter in a shop, and A orders to deliver certain goods to B on credit, The shopkeeper says "I can give goods on credit provided A gives the guarantee for the payment". A promises to guarantee the payment. In this example, B is the principal debtor, A is the surety and the shopkeeper is the creditor and the contract is a contract of guarantee.

A contract of guarantee is an agreement and as such all the essentials of a valid contract must be present. For instance, the contracting parties should be competent to contract. Suppose in the above-mentioned example B is a minor i.e., incompetent

to contract. In such a situation A would be regarded as the principal debtor and he will become personally liable to pay. Thus, the incapacity of the principal debtor does not affect the validity of a contract of guarantee. The requirement is that the creditor and the surety must be competent to contract.

Now you may ask that if a contract of guarantec should have all the essentials of a contract then what is the consideration between surety and the principal debtor. It is not necessary that there should be direct consideration between the surety and the creditor i.e., the surety need not be benefited. It is sufficient (for the purposes of consideration) that something is being done or some promise is made for the benefit of principal debtor. It is presumed that the consideration received by principal debtor is the sufficient consideration for the surety. You would appreciate it if you go through the provision of Section 127, which says: ***Any thing done, or any promise made for. the benefit of the principal debtor, may be a sufficient considerntion to the surety for giving the guarantee.***

On examining the definition of contract of guarantee, you would find that as there are three parties, ther . are three contracts as well. One contract is between the creditor and the principal debtor, out of which the guaranteed debt arises. Second contract is between the surety and the principal debtor which implies that the principal debtor shall indemnify the surety, if the principal debtor fails to pay and the surety is asked to pay. The third contract is between the surety and the creditor by which surety undertakes (guarantees) to pay the principal debtor's liabilities (debt) if the principal debtor fails to pay.

For a valid contract of guarantee, it is essential that there must be an existing debt or a promise whose performance is guaranteed. In case there is no such debt or promise, there can be no. valid guarantee. In fact, a contract of guarantee pre-supposes the existence of a liability enforceable by law. For example, A gives the guarantec to B for the payment of a time-barred debt due from C. This is not a valid contract of guarantee because the primary liability between B and C is not enforceable by law. In case A pays the amount, he cannot recover it from C.

An interesting aspect of the contract of guarantee is that though it is not a contract of ***uberritnae fidei*** (a contract of absolute good faith) and therefore, it is not necessary for the principal debtor or the creditor to disclose all the material facts to the surety before he enters into a contract. However. the facts which are likely to affect the surety's decision must be truly represented to him. Section 142 of the Act provides that ***any guarantee which has been obtained by means of misrepresentation made by the creditor., or with his knowledge and assent, concerning a material part of the transaction, is invalid.***

You should also note that not only there should be no misrepresentation but it is also essential that the guarantee must not be obtained by concealing some facts. Section 143 provides that any **guarantee which the creditor has obtained by means of keeping silence to material circumstances is invalid.** For example, A employs B as clerk to collect money for him. B fails to account for some of his receipts, and A, in consequence, calls upon him (B) to furnish security for his duly accounting.-C gives the guarantee for B's duly accounting. A did not inform C about B's previous conduct. B, afterwards, makes default. Here the guarantee given by C is invalid because it was obtained by concealment of facts by A.

From this discussion, let us summarise the essential features of a contract of guarantee as follows :

i) Existence of a debt, for which some person other than the surety should be primarily liable.

ii) Consideration, but it is not necessary that the surety should be benefited.

iii) All the essentials of a valid contract should be present.

iv) Creditor and surety must be competent i.e., principal debtor need not be competent to contract.

v) Surety's liability is dependent on principal debtor's default.

vi) Guarantee must not be obtained by misrepresentation.

vii) Guarantee must not be obtained by concealment of material facts.

## 9.6 DISTINCTION BETWEEN CONTRACT OF INDEMNITY AND CONTRACT OF GUARANTEE

Following are the main points of difference between a contract of indemnity and a contract of guarantee.

i) In a contract of indemnity there are only two parties i.e., indemnifier and the indemnified while in a contract of guarantee there are three parties principal debtor, creditor and the surety.

ii) In a contract of indemnity there is only one contract, whereas in a contract of guarante , there are three contracts.

iii) In a contract of indemnity the indemnifier undertakes to save the indemnified from any loss caused to him by the conduct of indemniiier himself or the conduct of any other person, while in a contract of guarantee, the surety undertakes for the payment of debts of principal debtor, if the principal debtor fails to pay it.

iv) In a contract of indemnity, the liability of indemnifier is primary and independent, while in a contract of guarantee the liability of surety is secondary i.e., it arises only on the default of principal debtor. The primary liability is that of the principal debtor.

v) In a contract of indemnity, indemnifier's liability arises only on the happening of a contingency, while in a contract of guarantee there is an existing duty or debt, the performance of which is guaranteed by the surety.

vi) In a contract of indemnity, indemnifier acts independently without any request of the debtor or the third party, while in a contract of guarantee the surety guarantees at the request of principal debtor.

vii) In a contract of guarantee, if the principal debtor fails to pay and the surety discharge his debt, the surety can proceed against the principal debtor in his own right, while in a contract of indemnity, the indemnifier cannot sue the third party in his own name unless there is an assignment in indemnifier's favour. If there is no such assignment, the indemnifier must bring the suit in the name of indemiiificd.

## 9.7 EXTENT OF SURETY'S LIABILITY

In the absence of a contract to the contrary, the liability of surety is co-extensive with that of the liability of the principal debtor. It means that the surety is liable to the same extent to which the principal debtor is liable. For example. A guarantees to B the payment of a bill of exchange by C, the acceptor. On the due date the bill is dishonoured by C. A is liable, not only for the amount of the bill, but also for any interest and charges which may have become due on it.

You have noted that the liability of the surety is equal to that of the principal debtor. But if at the time of giving the guarantee, the surety has given the guarantee for a fixed amount,, in that case the liability of the surety can, in no case, be more than the fixed amount. For example, A lends Rs. 5,000 to B and C gives the guarantee for Rs. 3,000 only. If B makes a default, C shall be liable only for Rs. 3,000.

It is true that the liability of surety is co-extentive with that of the principal debtor, but it does not mean that if due to some reason the principal debtor cannot be held liable then the surety will also not be liable. This is so because the contract between the, surety and the creditor is an independent contract and not a collateral one. For example, when the principal debtor is a minor, the surety is liable. Not only this, if by any act the liability of the principal debtor is reduced or terminated, the surety continues to be liable. If the creditor fails to sue the principal debtor and the debt becomes time barred, the surety continues to be liable.

Though the primary responsibility to pay the debtor or perform the promise is that of the principal debtor, in the absence of a contract to the contrary, the liability of the surety arises immediately when a default is made by the principal debtor. The surety cannot ask the creditor to give a notice of default. The surety cannot even ask the creditor to first exhaust all the remedies open to him against the principal debtor, before taking action against the surety. Thus, the creditor is not bound to proceed first against the principal debtor before suing the surety.

In a contract, if there is a condition precedent for the surety's liability, the surety would only be liable when that condition is fulfilled first. Section 144 of the Act provides for such situations, ***that where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.*** For example, your friend **A** requires a loan of Rs. 10,000 from'the bank. You and two of your friends ***C*** and D, agree to guarantee the repayment of loan. C does not sign the necessary. documents. You and your friend D are also not liable on this guarantee because it is a condition precedent to your guarantee that the repayment of loan shall be guaranteed by all the three.

In case of a continuing guarantee the surety shall be liable for all such transactions which have taken place upto the time of termination of guarantee. You will learn more about it in subsequent paragraphs.

## 9.8 KINDS OF GUARANTEE

Contracts of guarantees may be classified into two types: Specific guarantee and. continuing guarantee. When a guarantee is given in respect of a single debt or specific transaction and is to come to an end when the guaranteed debt is paid or the promise is duly performed, it is called a specific or simple guarantee. However, a guarantee which extends to a series of transactions, is called a continuing guarantee (Section 129). The surety's liability in this case would continue till all the transactions are completed or till the guarantor revokes the guarantee as to the future transactions **A** fidelity guarantee is a continuing guarantee as it continues for a period of time

**Examples**

a) S is a bookseller who supplies a set of books to P, under the contract that if P does not pay for the books, his friend K would make the payment. This is a contract of specific guarantee and K's liability would come to an end, the moment the price of the books is paid to S.

b) On M's recommendation S, a wealthy landlord, employs P as his estate manager. It was the duty of P to collect rent every month from the tenants of S and remit the same to S before the 15th of each month. M, guarantee this arrangement and promises to make good any default made by P. This is a contract of continuing guarantee,

In order to understand continuing guarantee, the following points should be noted :

i) The most important feature of a continuing guarantee is that it applies to a series of separable, distinct transactions. Therefore, when a guarantee is given for an entire consideration, it cannot be termed as a continuing guarantee. For example, K gave his house to S on a lease for ten years on a specified lease rent. P guaranteed that S would fulfil his obligations. After seven years S stopped paying the lease rent. K sued him for the payment of rent. P then gave a notice revoking his guarantee for the remaining three years. P would not be able to revoke the guarantee because the lease for ten years is an entire indivisible'consideration and cannot be classified as a series of transactions. This contract, therefore, cannot'be classified as a contract of continuing guarantee.

ii) In deciding whether particular contract of guarantee is a Specific guarantee or a continuing one, you will have to see the intention of the parties as expressed by the terms of the contract and the prevailing circumstances. For example, A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C, C pays for them. Afterwards, B delivers four sacks to C for which C does not pay for. Here A cannot be held liable because it is clear from the terms of the contract that A intended'to guarantee only for the payment of price of the first five sacks of flour.

iii) **A** continuing guarantee may be given for a part of the entire debt or for the entire debt subject to a limit. Let us understand this with the help of an example. S gave guarantee for the loans takenfrom time to time by P from ***C***. P owes rupees ten thousand to C. S may have given his guarantee in the following two forms.

a) I guarantee the payment of the debt of rupees five thousand by P to C. This is a case of guarantee only for a part of the entire debt.

b) I guarantee the payment of any debts of P due to C subject to a limit of rupees five thousand. This is a guarantee for the payment of entire debt subject to a specified limit. You will be wondering as to the distinction between the two forms because in both the cases, S appears to be liable for just five thousand rupees. The distinction becomes clear in the event of insolvency of P, the principal debtor. Let us suppose that P has been declared insolvent and his estate can only repay forty paise in a rupee.

In the first case when the guarantee is only for a part of the entire debt, C can recover rupees five thousand from S (the guaranteed amount) and Rs. 2,000 from P's estate (forty percent of the balance of rupees five thousand). C will, therefore, get Rs. 7,000 in all. After paying five thousand to C, S can claim rupees 2,000 from P's estate. However, when the guarantee is for the entire amount subject to a specified limit, C will recover rupees five thousand from S (upto the guaranteed limit) and Rs. 4,000 from P (forty per cent of the entire debt of Rs. 10,000). S would not be able to claim anything from P's estate till the entire amount of rupees ten thousand has been paid to C.

## 9.9. REVOCATION OF CONTINUING GUARANTEE

A continuing guarantee may be revoked in any of the following ways:

1) By **Notice of Revocation:** In respect of future transaction the surety may at any time revoke his guarantee by giving a notice to creditor. In such a case, the surety remains liable for the transactions which have already taken place. For example, A guarantees to B to the extent of Ks. 10,000, that C shall pay for all the goods bought by him during the next three months. B sells goods worth Rs. 6,000 to C. A gives a notice of revocation, C is liable for Rs. 6,000. If any goods are sold to C after the notice of revocation, A shall not be, liable for that.

**2)** By **Death of** Surety: Unless there is contract to the contrary, the death **of** surety operates as a revocation of the continuing guarantee in respect to the transactions taking place after the death **af** surety.

3) In **the** Same Manner in **which the** Surety **is** Discharged: **A** continuing guarantee is also revoked under all the circumstances under which a surety is discharged from the liability, such as

i) Novation (Section 62)
ii) Variance in terms of Contract (Section **133)**
iii) Release or discharge of principal debtor (Section 134)
iv) When the creditor enters into an arrangement with the principal debtor (Section 135)
v) Creditor's act or omission impairing surety's eventual remedy (Section 139)
vi) Loss of Security (Section 141).

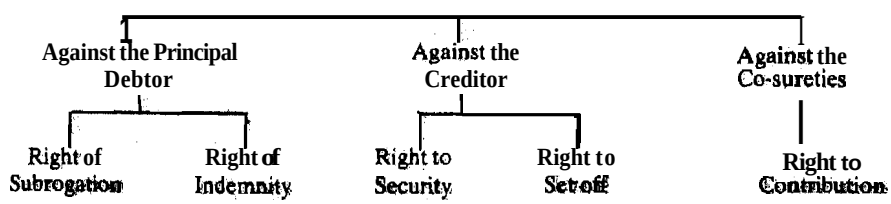
These grounds will be explained in 9.11 of this unit, under the heading 'discharge of surety'.

## 9.10 RIGHTS OF A SURETY

After making a payment and discharging the liability of the principal debtor, the surety gets various rights. These rights can be studied under three heads: (i) rights against the principal debtors. (ii) rights against the creditor, and (iii) rights against the co-sureties. These have been shown in Figure 9.1 and discussed below in detail.

**Figure 9.1**

**Rights of Surety**



### 9.10.1 Rights against the Principal Debtor

The surety has the follwing two rights against the principal debtor.

1) Right of subrogation: The surety acquires all the rights which the creditor had against the principal debtor. Section 140 lays down, *where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.* This right of the surety is called 'subrogation'. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of creditor

2) Right **of** Indemnity: Section 145 of the Act vests in the surety another right i.e, right of indemnity. In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee. The surety is not entitled to claim any sums which he has paid wrongfully.

Examples

i) B is indebted to C, and A is surety for the debt. C demands payment from A and, on his refusal, sues him for the amount, A defends the suit, having reasonable grounds for doing so, but he is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

ii) A guarantees to C, to the extent of Rs. 2,000, payment for rice to be supplied by C to B. C supplies to B rice for an amount which is less than Rs. 2,000 but obtains from A payment of the sum of Rs. 2,000 in respect of the rice supplied. A cannot recover from B more than the rice actually supplied.

### 9.10.2 Rights against the Creditor

**1)** Right to securities : When the surety has paid off the liabilities of principal debtor to the creditor, he becomes entitled to claim all the securities which were given by the principal debtor to the creditor. Surety has right to all securities whether received before or after the creation of the guarantee (Section 141). It is also immaterial whether the surety has knowledge of those securities or not. For example, on C's guarantee **A** lent Rs. 5,000 to B. This debt is also secured by an. assignment by deed as security for the debt, the lease of B's house. B defaults in paying the debt and C has to pay the debt. On paying off B's liabilities, C is entitled to receive the assignment deed in his favour.

**2)** Right to set off: When the creditor sues the surety for payment of principal debtor's liabilities, the surety can claim set off, or counter claim if any, which the principal debtor had against the ,creditor.

### 9.10.3 Rights against the Co-sureties

When the repayment of debt to the principal debtor is guaranteed by more than one person, they are called Co-sureties. The co-sureties are liable to contribute, as agreed, towards the payment of guaranteed debt. Section 138 provided that *where there are co-sureties, the release by the creditor of one of them does not discharge the others, nor does it free the surety so releasedfrom his responsibility to the other sureties.* Thus when the payment of a debt or performance of duty is guaranteed by co-sureties and the principal debtor has defaulted in fulfilling his obligation and thereupon the creditor compels only one or more of the co-sureties to perform the whole contract, the co-surety sureties performing the contract are entitled to claim contribution from the remaining co-sureties. According to Section 146, *in the absence of any contract to the contrary, the co-sureties are liable to contribute equally.* This principle will apply even when the liability of co-sureties is joint or several, and whether under the same or different contracts, and whether with or without the knowledge of each other. For example A, B, C and D are co-sureties for a debt of Rs. 2,000 lent by Z to R. R defaults in repaying the loan. A, B, C and D are liable to contribute Rs. 500 each.

According to Section 147 *wehre the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to the maximum of the amount guaranteed by each one. It is immaterial whether sureties are liable jointly or severally, under one*

*contract or under independent contracts and with or without the knowledge,* of ***each*** *ocher.* For example, *A,* B and C, as sureties for D, enter into three separate bonds, each in a different penalty, viz., A for Rs. 10,000, B for Rs. 20,000 and C for Rs. 40,000. D makes default to the extent of Rs. 30,000. A, B and ***C*** are liable to nay Rs. 10,000 each. Suppose thus default was to the extent of Rs. 40,000. Then A would be liable for Rs. 10,000 and B and ***C*** Rs. 15,000 each.

**Check Your Progress B**

1) Define a contract of guarantee.

.....

.....

.....

2) What is a continuing guarantee?

.....

.....

.....

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

i) An oral guarantee is not a guarantee at all. [ ]

ii) In a contract of guarantee, the surety (indemnifier) assumes a primary liability. [ ]

iii) A contract of guarantee is not a contract of 'uberrimae fidei'. [ ]

iv) The surety by paying the debt to the creditor cannot sue the debtor later. [ ]

v) A continuing guarantee can never be revoked. [ ]

4) Fill in the blanks:

i) If there is no debt, there can be ..... valid guarantee.

ii) Anything done or any promise made for the benefit of the principal debtor may be sufficient ..... to the surety for giving the guarantee.

iii) Guarantee obtained by misrepresentation is .....

iv) The liability of the surety is co-extensive with that of the ..... ..... unless it is otherwise provided by the contract.

5) Attempt the following cases, giving reasons for your answer:

i) A sells and delivers goods to B. ***C*** afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. Is there sufficient consideration for C's promise?

ii) A sells and delivers goods to B. ***C*** afterwards, without consideration, agrees to pay for them in default of B. State whether the agreement is valid.

iii) A guarantees to B the payment of a bill of exchange by C, the acceptor, The bill is dishonoured by C. State the position of A.

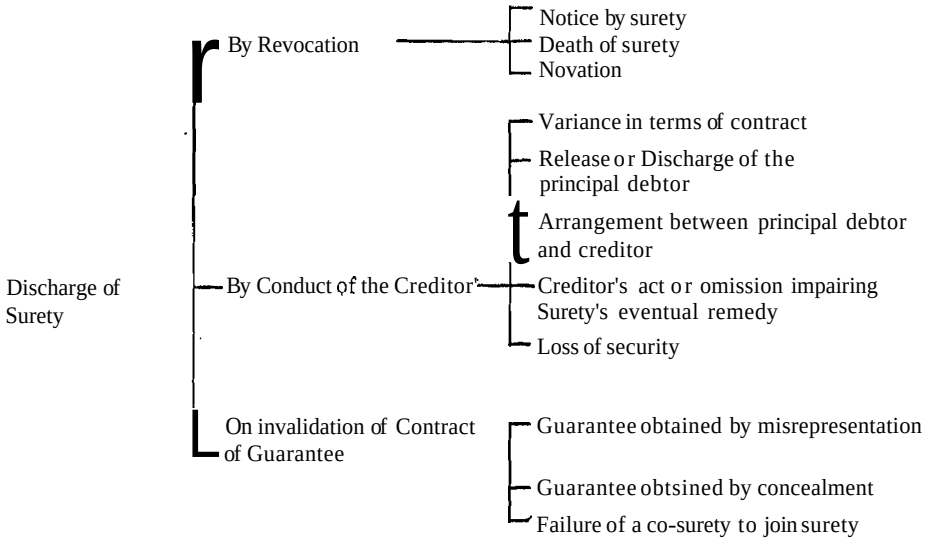
## 9.11 DISCHARGE OF SURETY FROM LIABILITY

Under any of the following circumstances a surety is discharged from his liability:

i) by revocation of the contract of guarantee,
ii) by the conduct of the creditor, or
iii) by the invalidation of the contract of guarantee

Look at Figure 9.2 for various modes of discharge of surety.

**Figure 9.2**
**Discharge of Surety**




## 9.11.1 By Revocation of the Contract of Guarantee

i). **Notice** by **surety:** You have learnt that a contract of guarantee may be specific or continuing. A specific guarantee cannot be revoked if the liability has already accrued. Thus, if A lends B a certain sum of the guarantee of C, then C cannot revoke the contract of guarantee. But, if A has not yet given the sum to B, even though the guarantee has been executed by C, C may revoke the contract by giving notice.

Where the guarantee is a continuing one and extends to a series of transactions, it may be revoked by the surety as to future transactions by giving notice to the creditor. The Act contemplates series of distinct and separate transactions to constitute a continuing guarantee which can be revoked by notice.

ii) **Death** of surety: In the absence of a contract to the contrary, a continuing guarantee is revoked by the death of the surety as to the fu'ture transactions, The estate of deceased surety is, however, liable for those transactions which had already taken place during the lifetime of the deceased. Surety's estate will not be liable for the transactions taking place after the death of surety even if the creditor had no knowledge of surety's death.

iii) Novation: A contract of guarantee is discharged by novation when a fresh contract being entered into, either between the same parties or between other parties, the consideration being the mutual discharge of the old contract. The original contract of guarantee comes to an end and so the surety stands discharged with regard to the old contract.

## 9.11.2 By Conduct of the Creditor

i) Variance in **terms** of the **contract:** A surety is discharged by such conduct of the creditor which has the effect of materially altering the terms of the contract of guarantee. For example, C contracts to lend B Rs. 2,000 on Ist January. A guaranteesrepayment, C pays the amount to B on 30th August, A is discharged from the liability as the contract has been varied. A surety is liable only for what he has positively undertaken in the guarantee; any alteration made without the surety's consent, in the terms of contract between the principal debtor and the creditor, will discharge the surety as to transactions subsequent to the variation (Section 133). For example, A becomes surety to C for B's conduct as a manager in C's bank. Afterwards B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts, B allows a customer to overdraw, and the bank loses a sum of money.

A is discharged from his suretyship due to the variance made in the terms without his consent.

ii) **Release or discharge of the principal debtor:** A surety is discharged if the creditor makes a contract with the principal debtor by which the principal debtor is released, or by any act or omission of the creditor, which results in the discharge of the principal debtor (Section 134). For example, A supplies goods to B on the guarantee of C. Afterwards B becomes unable to pay and contracts with A to assign some property to A in consideration of his releasing him from his demands on the goods supplied. Here, B is released from his debt, and C is also discharged from his suretyship. Or, to take another example, where A contracts with B for a fixed price to build a house for B within a specified time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber, A is discharged from performing the contract and C is discharged from his suretyship.

But, where the principal debtor is discharged of his debt by operation of law, say, on insolvency, this will not operate as a discharge of the surety. Also, where there are co-sureties, a release by the creditor of one of them does not discharge other co-sureties nor does it frees the surety so released from his responsibility to other sureties.

iii) **Arrangement between principal debtor and creditor:** Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promise to give him time to, or not to sue him, the surety will be discharged (Section 135).

However, when the contract to allow more time to the principal debtor is made between the creditor and a third party, and not with the principal debtor, the surety is not discharged (Section 136). For example, C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B, A is not discharged.

Similarly, mere forbearance by the creditor to sue the principal debtor or to enforce any other remedy against him, in the absence of any provision in the guarantee to the contrary, does not discharge the surety. For example, A owes Rs. 10,000 to K. The debt is guaranteed by M. The debt becomes payable but K does not sue A for six months after the debt has become payable. This will not discharge M.

iv) **By creditor's act or omission impairing surety's eventual remedy:** If the creditor does any act which is against the right of the surety, or omits to do any act which his duty to the surety requires, him to do and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged (Section 139). For example, B, a shipbuilder, contract to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages (the last instalment not to be paid before the completion of the ship). A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays the last instalment to B. A is discharged by this payment, Take another example, A puts M as apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see M makes up the cash. B omits to see as promised, and M embezzles. A is not liable to B on his guarantee.

v) **Loss of security:** If the creditor parts with or loses any security given to him at the time of the guarantee, without the consent of the surety, the surety is discharged from liability to the extent of the value of security (Section 141). For example, A, as surety for B, makes a bond jointly with B to C to secure a loan from C to B. Later on, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

### 9.11.3 By Invalidation of the Contract

A contract of guarantee, like any other contract, may be avoided if it becomes void or voidable at the option of the surety. A surety may be discharged from liability in the following cases:

i) **Guarantee obtained by misrepresentation:** When a misrepresentation is made by the creditor or with his knowledge or consent, relating to a material fact in the contract of guarantee, the contract is invalid (Section 142).

ii) **Guarantee obtained by concealment:** When a guarantee is obtained by the creditor by means of keeping silence regarding some material part of circumstances relating to the contracts, the contract is invalid. (Section 143).

iii) **Failure of co-surety to join a surety:** When a contract of guarantee provides that a creditor shall not act on it until another person has joined in it as a co-surety, the guarantee is not valid if that other person does not join.

### Check Your Progress C

1) What is subrogation?

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2) What do you mean by implied promise to indemnity surety under Section 145 of the Indian Contract Act?

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3) What is meant by novation?

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.....

4) State whether the following statements are True or False

i) The implied promise on the part of debtor to indemnify the surety enables the latter to recover from the principal debtor not only the sum he has rightfully paid under the guarantee but also sums he has paid wrongfully. [ ]

ii) The creditor may at his will release any of the co-sureties from his liability. [ ]

iii) Release of one co-surety automatically discharges the other co-sureties. [ ]

iv) Any alteration made without the surety's consent in the terms of contract between the principal debtor and the creditor, will discharge the surety as to transactions subsequent to the variation. [ ]

v) Omission of the creditor to sue the debtor within the period of limitation discharges a surety. [ ]

5) Attempt the following cases, giving reasons for your answer:

i) A bought B a motor car under a hire-purchase agreement by which he was to pay Rs. 10,000 per month. C guarantees these payments. A defaulted in the payment of his instalments, and it was agreed between A and B that A should give a cheque for Rs. 2,000 and pay the rest of arrears at the end of the month. State whether C is discharged.

ii) X guaranteed the honesty of a servant in C's firm. The servant was guilty of dishonesty in the course of his service, but C continued to employ him and did not inform X of what had occurred. The servant committed further acts of dishonesty. C sought the court for the recovery of loss from X. Is X liable?

iii) B appointed X as his agent to collect his rents and required him to execute a fidelity bond in which C was surety. Sometimes after the execution of bond, C died and X committed various acts of dishonesty. Is C's estate liable for the loss caused to B?

iv) A gives guarantee to C for goods to be supplied by C to B. C supplies the goods to B in due course. Afterwards, becomes financially embarrassed and contracts with all his creditors to assign to them all his property in consideration of them releasing him from their demands. The sale proceeds of the property are just sufficient to pay 75 paise in the rupee. C sues A for the balance, Decide.

v) X guarantees a debt due by Y to Z, the creditor, on Ist December 1986. Two years are over after the due date and Y has not paid debt and X does not take any action against the debtor Y. Is X discharged from his liability?

vi) A, B and C stand surety for D's duly accounting of cash to E. They stand surety for different amounts: A for Rs. 10,000. B for Rs. 20,000 and C for Rs. 40,000. D makes a default of Rs. 30,000. Discuss the respectiveliabilities of A, B and C.

## 9.112 LET US SUM UP

Contracts of indemnity and guarantee are specific contracts for which the Indian Contract Act has laid down detailed rules.

Contract of indemnity is defined as a contract by which one party promises to save the other party from loss caused to him by the conduct of promisor himself or any other person. Such contract can be express or implied, The person who promises to indemnify is callled indemnifier and the person to whom the promise is made is called Indemnity-holder.

The ,indemnity-holder, when sued, is entitled to recover from the promisor (indemnifier): (i) all damages which he may be compelled to pay (ii) all costs of suit which he may have to pay, and (iii) all sums which he may have paid under the terms of the compromise of any such suit. He can recover these sums as soon as his liability has become certain. He need not pay the amounts first and then recover from the indemnifier.

A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety, the person for whom the guarantee is given is called the Principal Debtor, and the person to whom the guarantee is given is called the Creditor.

A contract of guarantee can be specific or continuing. Specific guarantee relates to a single transaction while continuing guarantee extends to a series of transactions. A continuing guarantee can be revoked: (i) by notice to the creditor, (ii) by death of the surety and (iii) by variance in the terms of the contract between the principal debtor and the creditor.

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. His rights can be divided into three heads: (i) rights against the principal debtor, (ii) rights against the creditor, and (iii) rights against the co-sureties. He has the rights of subrogation and indemnity against principal debtor; right of recovering security and right of set off against the creditor; and right of contribution against the co-sureties.

The surety is discharged from liability: (i) by notice in cask. of continuing guarantee only, (ii) by surety's death (in case of continuing guarantee only), (iii) by novation, (iv) by variance in terms of the contract, (v) by release or discharge of the principal debtor, (vi) by arrangement between the creditor and the principal surety, eventual remedy, (vii) by loss of security by the creditor, and (ix) by invalidation of the contract of guarantee.

## 9.13 KEY WORDS

Indemnity: A promise to save the other party from loss caused to him by the conduct of the promisor himself or by the conduct of any person.

Indemnifier: The person who promises to indemnify.

**Indemnified/Indemnity-holder:** The person for whom the promise to indemnify is given.

**Guarantee:** A contract to perform the promise, or discharge the liability, of a third person in case of his default.

**Surety:** The person who gives the guarantee.

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

**Novation:** Fresh contract being entered into either between the same patties of bctwcen other parties, as a consequence of which the original contract of suretyship becomes discharged.

## 9.14 ANSWERS TO CHECK YOUR PROGRESS

**A)** 2) ***Yes,*** 3) No, 4) Yes, 5) No, because the object of the agreement is unlawful.

**8)** 3) i) False, ii) False, iii) True, iv) False, v) False.

4) i) no ii) consideration iii) invalid iv) principal debtor

5) i) ***Yes, See*** Section 127
ii) No. The agreement is void.
iii) **A** is liable not only for the amount of the bill but also for any interest and charges which may have become due on it — Section 128.

**C) 3)** i) False, ii) True, iii) False, iv) True v) False

5) i) C is discharged from the whole contract, because B had agreed to give time to A, and the contract was one contract and not a series of monthly contracts.

ii) X is not liable and C cannot recover his loss from X.

iii) This is a type of continuing guarantee. It is revoked by the death of surety as to future defalcations. In this case C's estate is liable for the loss up to the date of death.

iv) It is a comproise made without consulting the surety and hence, the surety is discharged.

**v)** A mere forbearance to sue does not discharge **even** if the debt becomes time-barred.

**vi) A,** B and C are liable to pay Rs. 10,000 each **(Section** 14).

## 9.15 TERMINAL QUESTIONS

1) Bring out the difference between a contract of indemnity and a contract of guarantee.

2) "Between co-sureties there is equality of the burden and the benefit". Elucidate.

3) Discuss clearly the nature of surety's liability. When is he discharged from his obligation?

4) Do you agree with the statement that 'The surety is a favoured debtor'? Give reasons for your answer.

5) State the rights of a surety against i) the principal debtor, ii) the creditor, and iii) co-sureties.

6) Narrate the essential features of a valid guarantee.

7) What do you understand by the right of subrogation . Explain with examples.

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

# UNIT 10 BAILMENT AND PLEDGE

Structure



## 10.0 OBJECTIVES

After studying this unit, you should be able to·

- define bailment and distinguish it from other types of contracts
- describe various kinds of bailmenrs
- explain rights and duties of bailor and bailee
- describe the rights and duties ot finder of goods
- define pledge
- explain rights and duties of pawnor and pawnee
- distinguish pledge from other types of contracts.

## 10.1 INTRODUCTION

Bailment and Pledge are examples of specific contracts. Indian Contract Act 1872 is not a comprehensive Act, dealing with all types of specific contracts. There are various other Acts which deal with specific contracts e.g., The Railways Act 1890, Carriers Act 1865 etc. The word bailment is derived from French word 'bailer' whish means "to deliver"

In law we use the term bailment in its technical sense which means change of possession of goods from one person to another . Pledge, on the other hand, is a kind of bailment for some special purpose cuch as where the goods ate transferred From one person to another as security for payment of debt or performance of a promise. Pledge is different from bailment. In this unit you will learn the meaning of bailment its kinds. rights and duties ol both bailor and bailee. You will also learn the meaning of pledge, its difference with bailment, and rights and duties of pawnor and pawnee.

## 10.2 MEANING OF BAILMENT

Section 148 of the Indian Contract Act reads: A ***bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.*** The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee". For example, you deliver some gold to a jeweller B to make bangles for your sister. In this case you are bailor and B is bailee and by delivering gold to B, a reletionship of bailment is created between you and the jeweller.

, Essentials of Valid Bailment

If you analyse the definition of bailment you will find that for creating a relationship of bailrnent the following features must be present:

i) Agreement
ii) Delivery of goods
iii) Purpose
iv) Return of the specific goods.

i) Agreement: For creating a bailment the first essential requirement is the exis'tence of an agreement between the bailor and the bailee. As you have read just now bailor is the person who bails the goods and bailee is the person to whom the goods are bailed. The agreement between the bailor and bailee, may be either express or implied.

ii) Delivery of goods: For bailment, it is necessary that the goods should be delivered to the bailee. It is the essence of the contract of bailrnent. It follows that bailment can be of movable goods only. It is further necessary that the possession of the goods should be voluntarily transferred and is in accordance with the contract. For example, A, a thief enters a house and by showing the revolver, orders the owner of the house to surrender all ornaments in the house to him. The owner of the house surrenders the ornaments. In this case although, the possession of goods has been transferred but it does not create bailment because the delivery of goods is not voluntary.

Delivery of possession may be actual or constructive. Actual delivery means actual physical transfer of goods from one person to another. For example, when a person gives his scooter for repair to workshop, it is actual delivery. When physical possession of goods is not actually given but some such act is done which has the effect of putting the goods in the possession of bailee, or putting the goods in the possession of any other person authorised by the bailee to hold them on his behalf, it amounts to constructive delivery. Sometimes the other person may already be in possession of the goods of the bailor, and subsequently a contract of bailment is entered into, whereby the other person promises to keep the goods as bailee. This also amounts to constructive delivery of the goods. A railway receipt is a document of title to goods, a transfer of the railway receipt effects a constructive delivery of the goods.

iii) Purpose: In a bailment, the goods are delivered for some purpose. The purpose for which the goods are delivered is usually in the contemplation of both the bailor and the bailee.

iv) Return of the goods: It is important that the goods which form the subject matter of the bailment should be returned to the bailor or disposed of according to the directions of bailor, after the accomplishment of purpose or after the expiry of period of bailment.

Where goods are transferred by the owner to another, in consideration of price, it is a safe. Similarly, where the goods are not to be delivered back in specie but their price is paid, it is not a bailment. Again, where money is deposited by a customer with a bank in a current, savings or fixed deposit account, and, therefore, there is no obligation to return the identical money but an equivalent of it, it is no bailment. But what is thus created is a relationship of creditor and debtor. But if valuables or even coins or notes in a box are deposited for safe custody there is a contract of bailment, for these are to be returned as they are, and not their monetary value.

Other common examples of a contract of bailment are where a watch is given for repairs, or diamonds are given for being set in a gold ring. In both these cases, the same watch or the same diamonds, should be returned after the purpose for which they were given, has been fulfilled. A pledge of a jewel on the security of which money is borrowed, gold jewels delivered to a bank for safe custody, goods delivered to a railway company for being carried and delivered to the consignee, are all examples of bailmcnt.

## 10.3 KINDS OF BAILMENT

Bailment may be classified on two bases, i.e., reward and benefit.

**On** the Basis of Reward

Bailment can bc classified as gratuitous and non-gratuitous bailment on the basis of whether the parties are getting or not getting some value out of the contract of bailment.. When there is no consideration involved in the contract of bailment it is called a gratuitous bailment. For example, when you lend your cycle to your friend so that he can have 3 ride or when you borrow his books to read, it is a case of gratuitous bailment because no exchange of money or any other consideration is involved. Neither you nor your friend would be entitled to any remuneration here.

A contract of bailment which involves some consideration passing between bailor and bailee, is called a non-gratuitous bailment. For example, if your friend hired a cycle from a cycle shop or you borrowed a book from a bookshop on hire, this would be a case of non-gratuitous bailment.

On the Basis of **Benefit**

On the basis of the benefits accruing to the parties, the contract of bailmcnt may be divided into the following types:

i) Bailment for the exclusive benefit of the **bailor:** This is the case where a contract of bailment is executed only for the benefit of the bailor, and the bailee does not derive any benefit from it. For example, if you are going out of station and leave your valuable goods with your neighbour for safety, it is you as bailor, who alone is being benefited by this contract.

ii) Bailment for the exclusive benefit of the bailee: This is the case where the contract of bailment is executed only for the benefit of the bailee and the bailor does not derive any benefit from the contract. For example, if you lend your books to a friend, without charge, So that he can study for his exams, it is your friend as the bailee, who alone is going to be benefited by this contract.

iii) Bailment for the mutual benefit of bailor and bailee: In this case both the bailor and the bailee derive some benefit from the contract of bailment. For example, if you give your shirt to be stitched by the tailor, both of you are going to be benefited by this contract, while you get a stitched shirt, the tailor gets the stitching charges.

**Check** Your Progress **A**

1) Write any two essentials of bailment.

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2) To create a valid bailment is it essential that the goods must be transferred physically from the bailor to the bailee?

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3) Which of the following statements are True or False.

i) Bailment and Pledge are examples of specific contracts. [ ]

ii) No bailment can be created without an agreement. [ ]

iii) In bailment, the purpose for which the goods are delivered is usually in the contemplation of both the bailor and bailee. [ ]

iv) When there is no consideration involved in the contract of bailment, it is called a non-gratuitous bailment. [ ]

v) In bailment, the person delivering the goods is called the bailee. [ ]

## 10.4 DUTIES OF BAILOR

A bailor has the following duties

1) Duty to disclose defects: The law of bailment imposes a duty on bailor to disclose the defects in the goods balled. Bailor is under an obligation to inform those defects in the goods which would interfere with the use of the goods for which the goods being bailed or would expose the bailee to some risk. Bailment of goods may he either gratuitous (in which neither bailor nor the bailee gets any reward) or non-gratuitous (bailrnent for reward). In case of gratuitous bailment, the law imposes a duty on the bailor to reveal all the defects known to him, which would interfere with the use of goods bailed. If the bailor does not disclose the defects and the bailee in consequence suffers some loss, the bailor would be liable to compensate the bailee for the losses so suffered. For example, A the owner of a scooter allows B, his friend, to take his scooter for a joy ride. A knows that the brakes of the scooter were not working well. A does not discloses this fact to B. Consequently, B meets with an accident. A is liable to compensate B for damages.

In case of Non-gratuitous bailment, i.e., bailment for reward, the bailor has a duty to keep the goods in a fit condition. The goods should be fit to be used, for the purpose, they are meant. In such a case the bailor is responsible for all defects in the goods whether he knows the defects or not is immaterial, and if the bailee suffers any loss, the bailee has to bear it. For example, A hires a tractor from B, for ploughing his field. The shaft of the tractor is broken but B is not aware of the defect. While A was ploughing his field because of the defect, the tractor overturns and A is injured. B is liable for A's losses.

You should note that in case of gratuitous bailment the bailor is responsible only for those defects which he is aware of and did not disclose to the bailec.

Duty to reveal is all the more important, where the goods bailed are of dangerous nature, otherwise the bailor would be liable for the resulting consequences. For example, A delivers to B, certain chemicals, to be carried to Bombay. These chemicals have a tendency to burst, if not kept below a certain temperature. A does not tell B to take this precaution. While carrying the chemicals, the chemicals burst and injure B. A is liable for all the damages.

2) Duty to bear expenses: The general rule in those bailments where the bailee is not to receive any remuneration is that the bailor should bear the usual expenses in keeping the goods or in carrying the goods or to have work done upon them by the bailee for the bailor. The bailor must repay to the bailee all the necessary expenses which the bailee has already incurred for the purpose of bailment. For example-if A, a farmer gives some gold to his friend B. who is a goldsmith, to make a gold ring. B is not to receive any remuneration for the job. But A has a duty to repay to B any expenses incurred by him in making the ring.

In cases of non-gratuitous bailments (where the bailee is to receive remuneration). bailor has a duty to bear extraordinary expenses, borne by the bailec. for the purposesof bailment. However, the bailor is not to bear ordinary or usual expenses. For example, if a horse is lent for a journey, the expenses for feeding the horse would be payable by the bailee. But, if the horse becomes sick and expenses have to be incurred, or if the horse is stolen and expenses are incurred for recovery. the bailor should pay those expenses.

3) Duty to indemnify the bailee: It is the duty of the bailor to indemnify the bailee, for any loss which the bailee may suffer because of the bailor's title being defective. The reason for this is that the bailor was not entitled to make the bailment or to receive back the goods bailed or to give directions regarding the goods bailed. For example, A asks his friend B to give him cycle for one hour. B instead of his own cycle gives C's cycle to A. While A was riding, the true owner of the cycle catches A and surrenders him to police custody. A is entitled to recover from B all costs, which A had to pay in getting out of this situation

4) **Duty to bear risks:** It is the duty of bailor to bear the risk of loss, deterioration and destruction, of the things bailed, provided the bailee has taken reasonable care to protect the goods from loss etc.

5) **Duty to receive back** the goods: It is the duty of the bailor that when the bailee, in accordance with the terms of bailment, returns the goods to him. the bailor should receive them. If the bailor, without any reasonable reason, refuses to take the goods back, when they are offered at a proper time and at a proper place, the bailee can claim compensation from the bailor for all necessary and incidential expenses, which the bailee undertakes to keep and protect the goods.

## 10.5 DUTIES OF BAILEE

A bailee has the following duties:

1) **Duty to take reasonable care of the goods bailed:** Section 151 of the Indian Contract Act lays down the degree of care, which a bailee should take, in respect of goods bailed to him. The bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed. The standard of care is same whether the bailment is gratuitous or for reward. So a bailee is liable when the goods suffer loss due to the negligence on the part of bailee.

However, under Section 152 of the Act, the standard of care of ordinary prudent man can be increased by entering into a contract, between the bailor and the bailee. In that situation the bailee, in order to save himself from any liability, would be bound to take as much care, as provided by the terms of contract. In the absence of any such contract, if the bailee has taken care as an ordinary prudent man of the goods bailed, he is not responsible for the loss, destruction or deterioration of the goods bailed. To take an example, if a diamond ring is kept by its owner A for safe custody with another person B and B is not to receive any reward for it. the bailee should keep it locked in an iron safe, or some other safe place but not keep it in his lumber room, simply because the bailment is gratuitous. Similary, if a cow is delivered for safe custody it is sufficient if it is kept in the backyard properly enclosed and even if it is for reward, no one would expect it to be kept in the drawing room. If the goods get stolen, lost or otherwise destroyed, even after the bailee has taken reasonably good care, the bailee would not be liable for this loss. The bailor, would have to bear this lass.

2) **Not to make any unauthorised use of goods:** The bailee is under a duty to use the bailed goods in accordance with the terms of bailment. If bailee does any act with regard to the goods bailed, which is not in accordance with the terms of bailment, the contract is voidable at the option of the bailor. Besides it, the bailee is liable to compensate the bailor for any damage caused to the goods. by an inconsistent use of the goods bailed. If he makes unauthoriscd use of goods, bailee would not be saved from his liability even if he has taken reasonable care of the ordinary prudent man. For example, A lends his car to B to be taken to Delhi from Hyderabad. The car was to be driven by B himself. B takes along with him a friend C, who has been driving his car for the last 10 years. B instead of going to Delhi, goes to Calcutta. The contract becomes voidable at the option of the bailor. On way to Calcutta, B allows C to drive the car. Inspite of the fact that C, in accordance with the directions of B, drives the carat a very slow speed, an accident takes place and the car is damaged. A is entitled to be compensated for the loss.

3) Duty **not to mix bailor's goods with his own goods:** Next duty of the bailee is to keep the goods of the bailor separate from his own. Sections 155 to 157 of the Act lays down this duty in the following ways:

i) If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced (Section 155).

ii) If the bailee, without the consent of the bailor, mixes the goods of the bailor with his goods, and the goods can be a separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear

the expense of separation or division, and any damages arising from the mixture (Section 156). For example, A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes these 100 bales with other bales of his own, bearing a different mark, A is entitled to have his 100 bales returned, and B is bound to bear all expenses incurred in the separation of the bales, and any other incidental damage.

iii) If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods (Section 157).

A bails a barrel of cape flour worth Rs. 50 to B. B without A's consent mixes the flour with country flour of his own, worth Rs. 20 a barrel. B must compensate A for the loss of his flour.

Where a bailee mixed his own goods with those of the bailor and when ordered to return the goods of the bailor he offered to return the goods without sorting them out. It was held that the bailor was entitled to refuse to take delivery in toto and claim compensation for loss or damage.

4) Duty not to set up adverse title: The bailee is duty bound not to do any act which is inconsistent which the title of the bailor. He should not set up his own title or the title of a third party on the goods bailed to him.

5) Duty to return the goods: It is the duty of the bailee to return or to deliver the goods according to the directions of bailor, without demand, on the expiry of the time fixed or when the purpose is accomplished. If he does not return or deliver as directed by the bailor, or tender the goods at the proper time, he becomes liable to the bailor for any loss, destruction or deterioration of the goods from that time. He is liable even without his negligence. For example, a book-binder kept books beyond the time allowed to him for binding, and they were lost in an accidental fire, the binder is liable. If however, the bailment is gratuitous, then the bailee will have to return the goods loaned, at any time on demand by the bailor, even though the goods were lent for a specified time or purpose. But if on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived.

6) Duty to return accretions to the goods: In the absence of any contract to the contrary, the bailee must deliver to the bailor, or according to his directions, any increase or profit which have accrued from the goods bailed. For example, A leaves a cow in the custody of B to be taken care of. The cow has a calf. B is bound to deliver the calf as well as the cow to A.

## 10.6 RIGHTS OF BAILOR

A bailor has the following rights.

1) Enforcement of bailee's duties: You have just now read the duties of the bailee. Duties of the bailee are the rights of the bailor. For example, when the bailee returns the goods bailed, he should also return all natural accretions to the goads. This is a duty of the bailee and it is the right of the bailor to receive all natural accretions in the goods baited, when the goods are returned to him.

2) Right to claim damages: It is an inherent right of the bailor to claim damages for any loss that might have been caused to the goods bailed, due to the bailee's negligence (Section 151).

3) Right to avoid the contract: If the bailee does any act, in respect of the goods bailed, which is inconsistent with the terms of bailment, the bailor has a right to avoid the contract. For example, A lends his car to B for Bs personal use. B starts using the car as a taxi. A can avoid the contract (Section 153).

4) Right to claim compensation: If any damage is 'caused to the goods bailed because of the unauthorised use of the goods. the baiior has a right to claim compensation

from the bailee. In the same way the bailor has a right to claim compensation, if some loss is caused to the goods bailed, due to unauthorised mixing by bailee, of bailee's own goods with the goods of the bailor (Sections 154. 155 and 156).

5) Right to **demand** return **of** goods: It is a sight of the bailor to compel the bailee, to return the goods bailed, when the time of bailment has expired or when that purpose for which the goods were bailed has been accomplished.

You have just now read that in the case of a gratuitous bailment, even if the goods have been bailed for a fixed time or for a fixed purpose, the bailor has a right to compel the bailee to return them, before the agreed time.

## 10.7 RIGHTS OF BAILEE

The duties of bailor are the rights of bailee and bailee can enforce his rights against the bailor by suing him in case of a default. The rights of bailee are as follows.

1) Right to claim damages: If the bailor has bailed the goods, without disclosing the defects in the goods, and the bailee has suffered some ioss, the bailee has a right to sue the bailor for damages. A hires a carriage of B. The carriage is unsafe, though B is cot aware of it, and A is injured. B is responsible to A for the injury (Section 150).

2) Right to claim reimbursement: In case of non-gratuitous bailment the bailee has a right to recover from the bailor, all necessary expenses, which the bailee had incurred for achieving the purpose of bailment. In case of a gratuitous bailment, bailee has a right to recover from the bailor, all extraordinary expenses, borne by the bailee lor the purposes of bailment (Section 158).

3) Right to recover losses: It is a right of bailee to recover from the bailor, all losses suffered by him by reason of the fact that the bailor was not entitled to make the bailment of the goods or to receive back the goods, or to give directions regarding them (Section 164).

4) Right to deliver goads to any one of the joint bailors: If the goods are owned and bailed by more than one person, the bailee has a right, in the absence of a contrary contract, to deliver back the goods to any one of the joint owners, or may deliver the goods back according to the directions of, one joint owner, without the consent of all. (Section 165).

5) Right to deliver the goods to bailor even if **his** title is defective: If the title of bailor Is defective and the bailee, in good faith returns the goods to the bailor or according to the directions of bailor, the bailee is not liable to the true owner in respect of such delivery (Section 166).

6) Right to lien: When the bailee, in accordance with the purpose of agreement has rendered any service involving the exercise of labour or skill, to the goods bailed, and his lawful payments are not made by the bailor, the bailee has a right to retain unless there is a contract to the contrary, the goods bailed, until he received his remuneration for the services rendered by him. This right to retain goods is known as bailee's lien (Section 170).

The bailee has a right of lien in respect of charges due to him for work of labour done in respect of goods bailed. As you have already read, the right of lien is a right to detain goods belonging to another, by a person in possession, until the sum claimed or other demand of the person in possession is satisfied. The Indian Contract Act has dealt with the following kinds of lien: (i) lien of a finder of goods (Section 168); (ii) particular lien'of bailee (Section 170); (iii) general lien of bankers, factors, wharfingers, attroneys and policy brokers (Section 171); (iv) lien of pawnees (Sections 173, 174); and (v) lien of agents (Section 221), and the lien of a pawnees is dealt separately in this unit. The item, lien oi' agents is discussed in the separate unit, "Contract of Agency".

Possession of goods is necessary to claim the right of lien. The possession must be rightful, not for a particular purpose and lastly it should be continuous. For example, A, a trader took on lease, B's warehouse for 5 years. It was also agreed between A and B that **A** can at any time deposit or take out his goods from the warehouse. After six months **A** stopped paying the lease rent. B detained **A's** goods and claimed lien.

B cannot claim lien because it was was agreed that A can take out his goods whenever he wanted.

A lien may be either a particular lien or a general lien.

**Particular Lien:** A lien which can be exercised only on goods in respect of which some payment is due is called particular lien. Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the-exercises of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he received due remuneration for the services he has rendered in respect of them (Section 170). For example, A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the service he has rendered. Again, A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat.

As a general rule a bailee is entitled only to particular lien, which means the right to retain only that particular property in respect of which the charge is due. The right is available subject to certain important conditions. The foremost among them is that the bailee must have rendered some service involving the exercise of labour or skill or expenses incurred in respect of the goods bailed. Further, a bailee's right of lien arises only where "Labour and skill" have been used so as to confer an additional value on the article. So, a person who takes an animal for feeding has no lien, but a veterinary surgeon who has treated the animals has right of lien. Further conditions are that the contract has been fully performed in accordance with the contract, and goods, as you already know, are still in possession of the bailee and there exists no contract for payment of price in future.

**General Lien:** The right of general lien, as provided for in Section 171, means the right to hold the goods bailed as security for a general balance of account. Whereas right of particular lien entitles a bailee to detain only that particular property in respect of which charges are due. Right of general lien entitles the bailee to detain any goods bailed to him for any amount due to him whether in respect of those goods or any other goods. The right of general lien is privilege and is specially conferred by Section 171 on certain kinds of bailees only. They are bankers, factors, wharfingers, attorneys of a high court, and policy brokers.

## 10.8 RIGHT OF BAILOR AND BAILEE AGAINST WRONGDOER

If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury. Section 180 of the Act enables a bailee to sue any person who has wrongfully deprived him of the use or possession of the goods bailed or has done them an injury. It says: If a *thirdperson wrongfully deprives the bailee of the use ofpossession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used is the like case if no bailrnent had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.*

Section 181 provides for apportionment of the relief obtained by the bailee and reads: *Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests.* For example, A, forcefully takes possession of a colour T.V. from B's repair shop. Now either the owner of the T.V. or B may sue A. If B files the suit, he shall hand over the amount received, after deducting his repair charges, to the owner of the T.V.

**Check Your Progress B**

I) Describe any three duties of a bailor.

.....

.....

2) Fill in the blanks:

i) The law of bailment imposes a duty on the bailor to ..... the defects in the goods bailed.

ii) In case of a Non-gratuitous bailment, the bailee has a duty to keep the goods in a ..... condition.

iii) The bailee is bound to take as much care of the goods bailed, as a man of ordinary ..... would under similar circumstance, take of his own goods of the same bulk and vnlue, as the goods bailed.

iv) In the absence of any contrary contract, the bailee must deliver to the bailor any ..... in the goods bailed.

v) Possession of goods is necessary to claim the right of .....

vi) Bailor has a right to claim ..... from the bailee for any loss caused to the goods bailed.

**3)** Describe any four rights of a bailee.

.....

.....

.....

.....

## 10.9 FINDER 'OF GOODS

A person who finds some goods, which do not belong to him, is called, finder of goods. It is his duty to find out the actual owner and surrender the goods to him. He has no right to sue the owner for compensation for trouble and expenses voluntarily incurred by him, in finding the owner and in preserving the goods found. But he has a right to retain the goods against the owner until he receives such compensation from the owner. If the owner has offered some specific award on the lost goods, the finder may sue the owner for the award and till then can exercise his right to lien over the goods.

As against every one save the true owner, the ownership of goods found in a public place, vests in the finder. Thus, a person who picks upon the floor of a shop, a packet of bank notes accidently dropped by a stranger, is entitled to the notes, as against the whole world except the true owner.

### 10.9.1 Rights of a Finder of Goods

Rights of a.finder of goods are as follows:

1) **Right of lien: A** finder of goods has the right to keep the goods in his possession till he is paid his expenses. He can exercise the right of lien against the goods found. This right is available against the true owner until the finder of goods receives compensation for expenses and trouble incurred by him is finding out the true owner and in preserving the goods found. However, he has no right to sue the real owner for such compensation.

2) **Right to sue for reward:** If the true owner of goods has declared some award for the return of lost goods, the finder can sue the owner for such award. He will have the right of lien, over the goods till he receives the award.

3) **Right of sale: A** finder of goods has a right to sell the goods found by him under the following circumstances:

i) where the owner cannot, with reasonable deligence, be found and if found, refuses to pay the lawful charges of finder of goods, or

ii) the goods found are such as is commonly the subject of sale, or

iii) the thing is in danger of perishing or of losing the greater part of their value, or

iv) when the lawful charges of the finder for preservation and finding out the owner, amount to two-thirds of the value of the thing.

### 10.9.2 Duties of a Finder of Goods

Under Section 71 of the Contract Act, a finder of goods has same duties with regards the goods found, as that of a bailee. Hence,

1) The finder should take reasonable care of the goods found.

2) He should not put the goods for his personal use.

3) He should not mix the goods found with his own goods.

4) It is the duty of the finder of goods to find the real owner of the goods and then to entrust the goods to him. For example, if at a birthday party, a guest finds a gold ring and he tells the host and few other guests about it, he has performed his duty to find the owner. If he is not able to find the owner he can keep the ring as bailee. Refer to Block 2, Unit (8).

## .10.10 TERMINATION OF BAILMENT

A contract of bailment comes to an end under the following cases:

1) **On** the expiry of fixed 'period: If the goods are bailed for a fixed time,, the bailment is terminated at the end of that period.

2) **On** the fulfilment of the object: If the goods are bailed for some specific purpose or purposes, the bailment is terminated on fulfilling the object.

**3)** Inconsistent use of goods bailed: If the bailee uses the goods in contravention of the terms of bailment, the bailor may terminate the bailment even before the term of bailment.

4) Destruction of the subject matter: A bailment is terminated if the subject matter of the bailment is destroyed or because of some change in the nature of goods bailed if the goods become incapable of being used for bailment.

5) Termination of gratuitous bailment: As you have already read, a gratuitous bailment can be terminated by the bailor at any time even though the bailment was for a fixed period or purpose. But in such a case, the loss to be suffered by the bailee from such premature termination should not exceed the benefit he had derived from the bailment. If the loss exceeds the benefit, the bailor shall indemnify the bailee.

6) Death: A gratuitous bailrnent is terminated by the death of either the bailor or the bailee.

**Check** Your Progress *C*

1) Fill in the blanks:

i) A person who finds some goods belonging to some other person is called ..... of good.

ii) A finder, of goods cannot recover the ..... voluntarily incurred by him, in finding the owner.

iii) If the owner of lost goods has declared some award for the return of lost goods, the finder can ..... the owner for such award.

iv) A bailment is terminated when because of some change in the ..... of goods bailed, the goods become incapable of being used for bailment.

v) A gratuitous bailment is terminated by the ..... of either the bailor or the bailee.

2) Which of the following statements are True or False.

i) **A** finder of goods has a right to retain the goods until he is paid his expenses by the owner,

ii) A finder of goods has a right to sell the goods found, if the lawful charges for preserving the goods amount to 3/5 of the value of the things. [ ]

iii) If the goods are bailed for a fixed period, the bailment does not necessarily terminate at the end of that period. [ ]

iv) A bailment is terminated if the subject matter of the bailment is destroyed. [ ]

v) A gratuitous bailmcnt cannot be terminated by the bailor before the expiry of the time for which the goods were bailed. [ ]

## 1011 MEANING OF PAWN OR PLEDGE

Pawn or Pledge is a special kind of bailment where a movable thing is bailed as security for the repayment of a debt or for the performance of a promise. For example, if you borrow rupees one hundred from B and keep your cycle with him as security for repayment, it is a contract of plcdge. The person taking the loan is called the pledger or pawnor and the person with whom goods are pledged is called the pawnee. Ownership of the pledged goods does not pass to the pledgee. The general property remains with the pledger but a "special property" in it passes to the pledgee. The special property is a right to the possession of the articles along with the power of sale on default. Delivery of the goods pawned is a necessary element in the making of a pawn. The property pledged should be delivered to the pawnee. Thus, where the producer of a film borrowed a sum of money from a financier-distributor and agreed to deliver the final prints of the film when ready, the agreement was held not to amount to a pledge, there being no actual transfer of possession. Delivery of possession may be actual or constructive. Delivery of the key of the godown where the goods are stored is an example of constructive delivery. Where the goods are in the possession of a third person, who, on the directions of the'pledger, consents to hold them on the pledgee's behalf, that is enough delivery. **A** railway receipt is a document of title of the goods and a pledge of the receipt operates as a plcdge of the goods.

## 10.12 WHO MAY PLEDGE

Any of the following persons may make a valid pledge:

i) The owner, or his authorised agent, or

ii) One of the several co-owners, who is in the sole possession of goods, with the consent of other owners, or

iii) A mercantile agent, who is in possession of the goods with the consent of real owner, or

iv) **A** person in possession under a voidable contract, before the contract is rescinded, or

v) A seller, who is in possession of goods after sale or a buyer who has obtained possession of the goods before sale, or

vi) A person who has a limited interest in the property. In such a case the pawn is valid only to the extent of such interest.

## 10.13 PLEDGE AND BAILMENT

Pawn and bailment have many similarities. In both the cases only the movable goods are delivered with the condition that the goods shall be delivered back after the purpose of contract is over or after the expiry of stipulated time. Both pawn and bailment contracts are created by agreement between the parties,

However, pawn differs from bailment in the sense that pawn is bailment of goods for a specific purpose i.e., repayment of a debt or performance of a duty. Whereas, the bailment is for a purpose of any kind. Secondly, the pawnee cannot use the goods pawned, but in bailment the bailee use the goads bailed if the terms of bailment so

provide. Thirdly, pawnee has a right to sell the goods, pledged with him after giving notice to pawnor, in case of default by the pawnor to repay the debt, whereas bailee may either retain the goods or sue bailor for his dues.

## 10.14 PLEDGE AND HYPOTHECATION

Both pledge and hypothecation are created by an agreement between the parties. In both, movable property is delivered as a security for repayment of loan or for the performance of a promise. The difference in hypothecation and pledge is that, that in hypothecation the debtor continues to enjoy the possession of goods. The debtor has a right to deal in the goods but only subject to the terms of contract. He has to send to the creditor, details of property hypothecated. The creditor, in hypothecation, has a right to inspect the goods, at his convenience, whereas, in case of pledge, the pawnor loses the possesssion of the porperty as well as his rights to deal in the property pledged.

## 10.15 RIGHTS OF PAWNEE

As you already know pledge is an extension of bailment, therefore the pawnor and pawnee have almost the same rights and duties as those of the bailor and bailee. Their rights may be studied as follows:

1) **Right of retainer:** The pawnee has right to retain the pledged goods till his payments are made (Sections 173 and 174).

   He can retain the goods for the following payments:

   a) for the payment of the debt or performance of the promise,

   b) interest on the debt, and

   c) for all necessary expenses incurred by him in respect of the possession or for the preservation of the pledged goods. This right of the pawnee to retain the pledged goods till he is paid, is known as pawnee's right of particular lien, In the absence of a contrary contract, the pawnee cannot retain the goods pledged for any debt or promise other than the debt or promise for which the goods are pledged. However, in the absence of any thing to the contrary, such a contract shall be presumed when subsequent advances are made without any further security. If fresh security is provided for the fresh advance, this presumption will not apply.

2) **Right to Extraordinary Expenses (Sec. 175):** The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. This right does not entitle the pawnee to retain the goods for recovery of such expenses, however, he can sue the pawnor to pay such amount.

3) **Right to Sale (Sec. 176):** Upon a default being made by the pawnor in the payment of the debt or performance of the promise, the pawnee gets two distinct rights. Firstly, the pawnee may bring a suit against the pawnor for the recovery of the due amount or for the performance of the promised duty and in addition to it he may retain the goods as a collateral security. Secondly, he may sell the goods pledged but only after giving reasonable notice of the intended sale, to the pawnor.

   If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance, If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus, to the pawnor.

   Further the pawnee cannot sell the goods to himself. If he does so the sale is void and the pawnor can take back the goods after paying the amount due.

4) **Right against the true** owner **of goods (Sec. 178 A):** When the pawnor has acquired, possession of pledged goods, under a voidable contract, but the contract has not been rescinded, at the time of pledge, the pawnee acquires a good title to the goods, even against the true owner, provide! the pawnee had no notice of the pawnor's defect in title and he acts in good faith.

## 10.16 DUTIES OF PAWNEE

A pawnee has the following duties:

1) Duty to take reasonable care of the pledged goods.
2) Duty not to make unauthorised use of goods pledged.
3) Duty to return the goods when the debt has been repaid or the promise has been performed.
4) Duty not to mix his own goods with the goods pledged.
5) Duty not to do any act which is inconsistent with the terms of pledge.
6) Duty to deliver increase (if any), to the goods pledged.

## 10.17 RIGHTS AND DUTIES OF PAWNOR

### 10.17.1 Rights of Pawnor

If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt o r performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before their actual sale; but he must, in that case, pay in addition, any expenses which have arisen from his default. Besides this, all the duties of a pawnee are the rights of a pawnor and so he has the right to get pawnee's duties duly enforced.

### 10.17.2 Duties of Pawnor

Following are the important duties of a pawnor:

1) It is the duty of pawnor to comply with the terms of pledge and repay the debt on the stipulated date or to perform the promise at the stipulated time.
2) It is the duty of pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.

## 10.18 PLEDGE BY NON-OWNERS

As you know that normally only the owner of goods can pledge them and that no one can pass a better title to the goods than what he himself has. But in order. to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left. You will now read those situations in which a non-owner too can make a valid pledge of the goods.

1) Pledge by a mercantile agent: Where a mercantile agent is, with the consent of the owner, in possession of goods or, the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be valid, provided that the pawnee acts in good faith and has, at the time of pledge, no notice of the fact that the agent has no authority to pledge. The necessary conditions of validity under the section are as follows:
   i) The person pledging the goods must be a mercantile agent,
   ii) Mercantile agent must be in possession either of the goods or the documents of title to goods,
   iii) Such possession must be with the consent of the owner. If possession has been obtained dishonestly or by a trick, a valid pledge cannot be effected,
   iv) Pledge must have been made by the mercantile agent, when acting in the ordinary course of business of a mercantile agent,
   v) The pledgee must act in good faith; and
   vi) The pledgee should have no notice of the pledger's defect of title. If the pledgee knows that the pledger has a defective title, the pledge will not be valid.

2) Pledge by person in possession under voidable contract: You have already read under earlier units that for the formation of a contract, the consent of parties should be free, i.e., the consent must not have been caused because of coercion, misrepresentation, fraud, undue influence or mistake or because of any of them. If the consent is caused because of any of them, such contract is voidable under Section 19 or 19 A of the Indian Contract Act, at the option of person, where consent was so obtained. Section 178 A of the Contract Act provides that where goods are pledged by a person who has obtained their possession under a voidable contract, the pledge is valid, provided that the contract has not been rescinded at the time of the pledge and the pledgee has acted in good faith and without notice of the pledger's defect of title.

3) Pledge where pledger has only a limited interest: Where the pawner is not the absolute owner of the goods, but has only a limited interest and he pawns it, the pledge is valid to the extent of that interest. A finder of goods, a mortgagee or a person who has lien over the goods, may make a valid pledge of such goods, to the extent of his interest in the goods. For example, A finds a defective watch lying on the road. He picks it up, gets it repaired and pays Rs. 50 for the repairs Later on he pledges the watch for Rs. 25. The true owner can recover the watch only on paying Rs. 50 to the pledgee.

4) Pledge by a co-owner in possession: Where the goods are owned by many persons and with the consent of other owners, the goods are left in the possession of one of the co-owners. Such a co-owner may make a valid pledge of the goods in his possession.

5) Pledge by seller or buyer in possession: A seller, in whose possession, the goods have been left after sale or a buyer who with the consent of the seller, obtains possession of the goods, before sale, can make a valid pledge, provided the pawnee acts in good faith and he has no knowledge of the defect in title of the pawnor. For example, A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to B, and acted in good faith. This is valid pledge.

**Check** Your Progress D

1) Describe the right of retainer of a pawnee.

.....

.....

.....

2) Which of the following statements are True or False:

i) Pledge is a special kind of bailment. [ ]

ii) In pledge, the ownership of the goods pledged does not pass to the pledgee. [ ]

iii) A pledge can be created both of movable as well as of immovable property. [ ]

iv) In hypothecation the debtor loses the right to enjoy the goods. [ ]

v) It is the duty of a pawnor to compensate the pawnee for all extraordinary expenses incurred by him for preserving the goods pawned. [ ]

vi) A person who has obtained the possession of goods under a voidable contract cannot create a valid pledge of such goods. [ ]

vii) In a contract of pledge, even after the expiry of stipulated period, the pawnor can recover the goods pawned. [ ]

## 10.19 LET US SUM UP

Bailment is delivery of goods by one person to another for some purpose upon the condition that the goods shall, when the purpose is accomplished be returned to the bailor or to any other person, according to the directions of bailor.

Bailment is classified into three categories i.e., for the exclusive benefit of bailor, for the exclusive benefit of bailee and for mutual benefit of bailor and bailee. On the basis of reward a bailment may be classified as gratuitous or non-gratuitous bailment.

Lien means bailee's right to keep the goods in his possession till he is not paid his dues. A lien may be either a Particular lien or a General lien. A particular lien is available only against the goods in respect of which the bailee has rendered any service, labour or skill. While general lien signifies the bailee's right to retain, the goods bailed as well as any other property of the bailor, until the claims of bailee are satisfied.

Bailment comes to an end on the expiry of fixed period on the fulfillment of the object of bailment, by doing some act which is inconsistent with the terms of bailment, with respect to the goods bailed and on the destruction of subject matter. A gratuitous bailment can be terminated even before the expiry of the term of bailment but then bailor is liable to compensate the bailee for the losses suffered by him.

Pledge on the other hand is a special kind of bailment, where a thing is delivered as security for the repayment of a debt or for the performance of a promise. By and large the pawnor anti pawnec have the same rights and duties as that of bailor and bailee. However, if the pawnor defaults in the payment of the debt or performance of duty, the pawnee can sell the goods after giving a notice to the pawnor, and satisfy his debt. If the proceeds of such sale are insufficient, the pawnor it still liable to pay the balance. But if the proceeds of such sale are greater than the amount due, the pawnee should refund the excess amount of the pawnor. Pawnee cannot sell the goods to himself.

Although the general rule is that no person can pass a better title to the goods than he himself has. It implies that only the true owner can pledge the goods. But under certain conditions pledge by a mercantile agent, pledge by person in possession of goods under a voidable contract, pledge by a person who has only a limited ioterest in the goods, pledge by a co-owner in possession, pledge by seller or buyer in possession, have also been recognised to create a valid pledge.

## 10.20 KEY WORDS

**Bailment: A** 'bailment' is the delivery of goods by some person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

**Bailor:** The person delivering the goods is called the bailor.

**Bailee:** The person to whom the goods are delivered is called the bailee.

**Factors:** The word 'factor' in India, as in England, means an agent entrusted with possession of goods for the purpose of selling them for his principal.

**General Lien.:** Bankers, factors, wharfingers, attorneys of a High Court, and Policy-brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.

**Mercantile agent:** It means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to buy goods, or to raise money on the security of goods.

**Particular Lien:** Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

**Pawn or Pledge:** This is a kind of bailment where a thing is delivered as security for the repayment of a debt.

**Wharfingers:** Wharfingers means a place contiguous to water, used for the purpose of loading and unloading goods, and over which the goods pass in loading and unloading. Wharfinger is he that owns or keeps a wharf, or hath the oversight or the management of it.

## 10.20 ANSWERS TO CHECK YOUR PROGRESS

A 1) Refer to 10.3 of this unit.
2) No
3) i) True ii) True iii) True iv) False v) False

B 1) Refer to 10.5 of this unit
2) 'i) disclose ii) fit iii) prudence iv) increase v) lien vi) damages
3) Refer to 10.8 of this unit.

C 1) i) Finder ii) expenses iii) sue iv) nature v) death.
2) i) True ii) False iii) False iv) True v) False

D 1) Refer to 10.16 of this unit.
2) i) True ii) True iii) False iv) False v) True vi) False.

## 10.21 TERMINAL QUESTIONS

1) Discuss the essentials of a contract of bailrnent and state the rights and duties of a bailee.
2) Examine the duties and rights of a bailor.
3) State the respective rights and responsibilities of pledger and pledgee.
4) What do you understand by lien? Describe particular lien and general lien of bailee,
5) What is meant by pledge? Describe its essential features.
6) Narrate the circumstances under which a person other than the owner can make a valid pledge.
7) Explain the rights and duties of a finder of goods.'
8) Write a note on pledge by mercantile agent.

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

# UNIT 11 AGENCY

**Structure**



## 11.0 OBJECTIVES

After studying this unit, yau should be able to:

- define an agent, differentiate between an agent, servant and an independent contractor and different classes of an agent
- explain how agency is created, and when an agent can delegate his authority
- describe rights, duties and extent of authority of an agent

  describe the circumstances when an agent is personally liable and the extent of liability of the principal to third parties
- explain how an agency can be terminated.

## 1 11 INTRODUCTION

One of the most striking features of modern business organisation is the emergence, growth and importance of the middleman. In a modern business organisation, it is not always possible for a man to do everything by himself. Hence it is necessary to delegate some of his acts to be performed by another, and that person is called an 'agent' and the contract by which he is appointed is called contract of 'Agency'. The law of agency is based on the principle "What a person does by another, he'does by himself".

In this unit you will learn the meaning of agency, creation of agency, authority, rights and duties of an **agent,** delegation of authority by an agent and difference between sub-agent and substituted agent. You will also learn about liabilities of an **agent** and principal to third parties and the methods of terminating agency.

## 11.2 WHAT IS A CONTRACT OF AGENCY?

According to Section 182 of the Contract Act An *'agent' is a person employed to do any act for another or to represent another in dealings with third persons. The person*

*for whom such act is done, or who is so represented, is called the 'principal'.* Thus, it is clear from the definition, that an agent is a connecting link between his principal and third parties. Merely because one person gives advice to another in matters of business, the former does not become an agent of the latter. A company promoter's status is not that of an agent as he is acting for a company which is yet to come into existence. A person employed by another to invest money on his behalf and to represent him with debtors is an agent within the meaning of Section 132 (Harbans Lal v. Producer Exchange Corporation). Since an agent is employed mainly to bring about 2 contract between the principal and third parties, it is absolutely essential that both the principal and the third party must he persons capable of entering into a contract.

### 11.2.1 Who can Appoint an Agent?

Section 183 provides as follows : *Any person who is of the age of majority according to the law to which he is subject, atzd who is of sound mind, ntay employ an agent.* Thus a minor, or a person of unsound mind cannot act as a principal. Though the section prohibits a minor from appointing an agent, does not perclude the guardian of a minor from appointing an agent to the minor *(Madanlal* v. *Bherulal).*

### 11.2.2 Who may be an Agent?

Section 184 of the Act provides answer to this question, which says *As between the principal and the third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained.* From this section it becomes clear that "as between the principal and third persons, any person may become an agent". Now the question arises, can a minor or a person of unsound mind also become an agent? The answer is yes. In view of the language used by this section even a minor or person of unsound mind is not debarred from being appointed as an agent. But as a rule of caution, they should not be appointed as agent because if the principal appoints them, he undertakes a great risk. Because whatever such incompetent person does shall be binding on the principal, but the principal shall not be able to proceed against the agent for his misconduct or negligence. Thus, any person can be appointed as an agent. For example, where A, a principal, entrusts to B, a minor a diamond ring worth Rs. 11,000 and instructs him not to sell the same for credit or for any amount less than Rs. 9,000. If B sells the same to C on credit for Rs. 5,000, this transaction will certainly be binding as between A and C but A will have no right to claim damages as against B for his misconduct, since B happens to be a minor, But, if B were an adult, he would be liable to A for damages sustained due to his misconduct.

### 11.2.3 Consideration for Agency

As you know, consideration is essential for the validity of every contract, and consideration, in the sense of detriment, is sufficient to support a contract. Section 185 expressly provides that *no consideration is necessary to create an agency.* The fact Chat the principal has agreed to be bound by the acts of the agent is a sufficient detriment to the principal. Therefore, it is not necessary that there should be a separate consideration. For example, when A employs B as his agent in as much as A's affairs are placed in B's hands, A .suffers a detriment, and therefore, no further consideration in the shape of remuneration need be present. Thus, it means that there can be a gratuitous contract of agency and a gratuitous agent will be as much bound by his contract as a paid agent,

### 11.2.4 Constitution and Proof of Agency

The relationship of principal and agent may be created by (i) express appointment by the principal, or by a person duly authorised by the principal to make such appointment; (ii) by implication of law, from the conduct or situation of the parties or from the necessity of the case; or (iii) by subsequent ratification by the principal of the acts, clone on his behalf. As to proof of agency, the actual status of the parties must be determined with reference to all the circumstances and not merely with reference to the words used. The crucial test of the status of an agent is that his acts bind the principal.

## 11.3 DIFFERENCE BETWEEN AGENT, SERVANT AND INDEPENDENT CONTRACTOR

There is too much of similarity between an agent and a servant as both are employed to act for and on behalf of principal. However, there is a lot of difference between the two. An agent has the authority to create contractual relationship between the principal and a third party, but a servant ordinarily, has no such authority. A servant usually serves only one master but an agent may work for several principals at the same time. A servant is generally paid salary or wages, whereas an agent may be paid on commission basis. Thus, we find that an agent is not a servant.

As for as the independent contractor is concerned he undertakes to produce a given result but in the actual execution he is not under the order or control of the person for whom he does it, and may use his own discretion. An agent work under the control and supervision of the principal. An agent represents his principal and can bind the principal by his acts but a contractor is independent and cannot bind his employer by his acts.

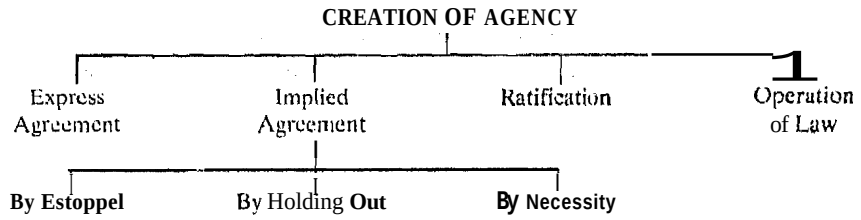
## 11.4 CREATION OF AGENCY

The relationship of principal and an agent may be created in any of the following ways:

1) express agreement,
2) implied agreement.
3) ratification, and
4) operation of law.

Look at the Figure 41.1 to have an overall view.

**Figure 11.1**




Let us discuss them one by one in detail.

1) **Express Agreement:** You know that when an agent acts within the scope of his authority, his acts bind the principal as well as the third party. The agent derives this authority by the contract by which he is employed as an agent. This contract may be express or implied. Section 186 of the Act says *"the authority of an agent may be expressed or implied'*. Section 187 further says, "an *uuthority* is ***said*** *to be express when it is* ***given*** *by words spoken or written. An authority is* ***said*** *to be* ***implied*** *when it is to be inferred from the circumstances of the case; and things spoken or written,* ***or*** *the ordinary course of dealing, may be* ***accounted*** *circumstances of the case",* For example, *A* is residing in Delhi and he has an agriculture farm at Bombay. A appoints B, by a deed called the power of attorney, as a caretaker of his farm. In this **way,** the relationship of principal and agent has been created between A and B by an express agreement (power of attorney).

2) **Implied Agency:** From Section **187, you** have seen that an agency may be implied when it is to be inferred from the circumstances of the case, things spoken or written, or ordinary course of dealing. For example, A has a car, but he cannot drive it. He allows his neighbour B to drive it. B while driving the car with A meets with an accident and injures C. C can sue A for damages because B is his implied agent. Let us take another example.

A and B are brothers. **A** lives in Delhi and B lives in Kanpur, B has a flat in Delhi. A with B's knowledge let out his flat. A used to realise the rent and remit the same to B who was accepting the same. Here A is the implied agent of B though he has not been expressly appointed, Implied Agency includes the following:

a) agency by estoppel,
b) agency by holding out and
c) agency by necessity.

a) **Agency by** Estoppel: First of all we should understand the meaning of the term 'estoppel'. The rule of estoppel says "where a person by his words or conduct has wilfully led another person to believe that certain set of circumstances or facts exists, and that other person has acted on that belief, then he is estopped or precluded from denying the truth of such statements, although such a state of thing did not exist in fact. Thus, when a person, by his conduct or statement, wilfully leads another person to believe that a certain person is his agent, then he is estopped or prevented from denying the truth of agency. For example, X tells Y in the presence and within the hearing of Z that he (X) is Z's agent. Z keeps quiet and does not contradict this statement. Later on Y enters into a contract with X, honestly believing that X is Z's agent. Z is bound by this contract, and in a suit between Z and Y, Z cannot be permitted to say that X was not his agent, even though X was not in actual fact his agent.

Section 237 of the Act deals with agency by estoppel. It says that *when an agent has, without authority, done an act or incurred an obligation to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct inducted such third persons to believe that such acts and obligations were within the scope of agent's authority.*

b) **Agency by** Holding **Out:** Agency by holding out is a type of agency by estoppel. Here, the alleged principal by his affirmative or positive conduct leads others to believe that person doing some act on his behalf is doing with his authority. For example, A allows his servant to purchase goods on credit from a nearby shop, and later on he pays for such goods. Later on, when the servant was not in A's employment, he buys goods on A's credit from the same shop. The shopkeeper can recover the price from A, because A-had held out the servant as his agent on earlier occasions, so **A** will be bound for. subsequent transactions entered into under similar circumstances.

**c) Agency by** Necessity: Sometimes, owing to the exigencies of circumstances, the law confers agency on some persons to act as an agent of another person without waiting for the consent of that person. However, before an agency of necessity can be inferred, the following conditions have to be satisfied:

(i) There should be an actual and definite necessity for acting on behalf of the principal; (ii) within the available time it should be impossible to obtain the principal's instructions; (iii) the person acting as agent must have acted bona fide. In such situations, the principal is bound by the acts of the agent. For example, some milk was consigned from Bombay to Delhi. The tanker carrying the milk met with an accident. The milk being perishable was sold by the transporter, The sale is binding upon the principal. In this case, the transporter became an agent by necessity.

The traditional examples of agency by necessity are those of the shipmaster who has powers to act during an emergency and the acceptor of a bill of exchange who is entitled to be reimbursed by the person whom he pays,

3) **Agency by Ratification:** By ratification, we mean, "where acts are dqne by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or disown such acts. If he ratifies them, the same effects will follow as if they have been performed by his authority", Ratification may be express or implied in the conduct of the person on whose behalf the acts are done. For example, without A's authority, his brother B lends his money to C. Later on, *C* pays the interest on the lended money and A accepts the interest. A's conduct implies a ratification of the loan, and it may be presumed that his (A's) brother B's conduct in lending the money is as valid as if it were done in pursuance of his (A's) prior authority and this kind of agency is called 'agency by ratification'

Effect of ratification: The effect of ratification is to make the agent's acts, done without prior authority as binding and valid upon the principal as if they had the prior sanction of the principal. In fact, ratification relates back to the date when the act was done by the agent and not to the date when the principal ratified the act.

4) By operation of Law: Another mode of creation of agency is by Operation of Law. In certain circumstances, the law treats one person as an agent of another. It can be better understood by the example that when a partnership is formed, every partner, by operation of law, automatically becomes the agent of other partners.

## 11.5 AGENCY RELATIONSHIP BETWEEN HUSBAND AND WIFE

Marriage does not of itself create the relation of agent and principal: A wife, in order to bind her husband by her dealings. must rceeivc authority from the husband either expressly or by implication from his conduct. The following principals may be noted in this connection:

i) If husband and wife are living together, and the wife is charged with the duty of looking atter the liouschold, presumption is raised that she has got the authority to plcdgc her husband's credit for necessaries (Debenham v. Mellon). But this presumption may be rebutted in the following cases:

   a) where the wife is forbidden from purchasing anything on credit or from contracting debts;

   b) where the goods purchased on credit are not necessaries;

   c) where the wife is given sufficient money for purchasing necessaries, and forbidden from pledging his credit (Movel Bros. v. Westrnoveland), or where an adequate allowance is made to her, or she has means of her own, either in money or in earning capacity (Biberfeld v. Bevens);

   d) where the trader has been expressly warned not to give credit to his wife.

ii) When the wife lives apart from the husband under justifiable circumstances, the husband would, in law, be liable to maintain her, and he would be bound to pay her bills for maintenance during that period. But if she is living separately without any valid reasons, then'she cannot pledge her husband's credit even for necessaries.

## 11.6 CLASSIFICATION OF AGENTS

Agents are classified in several ways. From the point of view of authority given to them, they can be divided into general agents and special agents. ***General*** agents have the authority to act in all matters concerning a trade or profession, or of a particular nature or to do some act in the ordinary course of his trade or profession. **Special** agents have authority only to act in a particular transaction, for example, when an agent is appointed to sell a car or sell a house. The authority of a special agent is limited to that paticular act only and his authority comes to an end when the work is over, Thus, the persons dealing with such agent are under an obligation to correctly ascertain from the principal the extent of his authority. On the other hand, a general agent has the authority to do all legal acts for the purpose of carrying on that trade or business, on behalf of his principal. It should be noted that unlike special agent, the authority of a general agent is continuous unless it is terminated.

A general agent is not the same thing as an universal agent, An universal agent can do all such things which the principal can lawfully do and delegate. He is authorised to transact all the business of his principal of every kind. He has an unlimited authority to bind the principal.

The most important classification of agents, however, is based on the nature of work performed by them. They can be classified as i) mercantile or commercial agents, and ii) non-mercantile or non-commercial agents. Mercantile agents may be of several kinds, e.g., brokers, factors, auctioneers, del credere agents; conimission

agents., insurance agents; bankers. Non-commercial agents may be estate agents house agents. lawyers, election agents, etc. Here we are mainly concerned with mercantile agents who are explained below.

***Broker:*** *A* broker is one who makes bargains for another, and receives commission (brokerage) for so doing. He is an agent whose ordinary course of business is to negotiate and make contracts for the sale and purchase of goods etc., of which he has neither possession nor control. Hc acts in the name of his principal.

**Factor:** A factor is a person who is entrusted with the possession of goods, and who has the authority to buy, or sell or otherwise deal with the goods or merchandise, or to raise money on their security. A factor, usually, sells goods in his own name. hc has a general lien on the goods.

**Auctioneer:** An auctioneer is an agent who is entrusted with the possession of goods for sale to the highest bidder at a public auction. He has the authority to deliver the goods on receipt of the price. He can sue for the price in his own name. However, unlike a factor, he has only a particular lien on the goods for his charges.

**Del Credere** ***Agent:*** A del credere agent is one, who in consideration of an extra remuneration called the Del Credere Commission, guarantees to his principal that the third person with whom he enters into contracts shall perform their obligations. Thus such an agent guarantees to his principal the payment of rhe. price.

**Commission Agent:** A mercantile agent who buys and sells goods on behalf of his principal and receives commission for his services. Actually, it is not a different category agent because brokers, factors may also act as commission agent.

**Banker:** Generally, the relationship between a banker and customer is that of a creditor anti debtor. However, when he collects cheques or buys or sells securities on behalf of his client, hc acts as an agent of the customer. A banker has the right of general lien in respect of the general balance of account.

## 11.7 SCOPE AND EXTENT OF AUTHORITY

An agent has the authority to do d l things necessary for carrying out tht: particular purpose fur which he has been appointed. When a person 3s held out as an agent for a particular purpose or business, persons dealing with him are entitled to presume that he has the authority to do al4 such acts as are necessary or incidental to such a business. Such authority is called apparent or ostensible authority of the agent, as distinguished from actual or real authority. Actual authority is created by agreements to which the principal and agent alone are parties.

It is ostensible authority that determines the scope of an agent's authority. The ostensible authority of an agent may be curtailed by his principal. The Indian law is laid down in Sections 188 and 237 as follows:

An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act; An agent having an authority to carry on a business has authority to do ever lawful thing necessary for the purpose, or usually done in the course of conducting such business (Section 188). For example, A employs B as his agent to carry on his business of a ship-builder. B may purphase timber and other materials, and hire workmen for the purpose of carrying on the business.

*"When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligutions were within the scope of the agent's authority"* (Section *237).* For example, A consigns goods to B for sale, and gives him instructions not to sell below a fixed price. C, being ignorant of B's instructions enters into a contract with B to buy the goods at a price below the reserved price. A is bound by the contract.

Though the scope of authority of an agent under normal circumstances is defined in Section 188, still, in cases of emergency he would have larger powers and Section 189 therefore enacts as fallows: *"An agent has authority, in an emergency, to do all such*

*acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances".* In such cases the authority is deemed to be conferred by what has been described above as agency by necessity. In Sims & Co. v. Midland Rail Co., where butter which was in danger of becoming useless owing to delay in transit was sold by the railway company for the best available price and it was found that it was impossible to obtain instructions of the principal, the sale was held binding upon the principal.

## 11.8 DELEGATION OF AUTHORITY BY AGENT

An agent, being himself a person who has got delegated authority from the principal, cannot further delegate except with the permission of the principal. This is expressed by the Latin maxim 'delegatus non potest delegate': a delegate cannot further delegate, i.e., one cannot delegate that which one has himself undertaken to do. Agency is a matter of trust and confidence and an agent is appointed only because the principal has got full confidence in his integrity or ability. So, the agent cannot without the permission of the principal, delegate his authority and ask some other person to do the work. To this rule the following are the exceptions:

i) where the duties of the agent do not require any skill or discretion, and can satisfactorily be performed by any one;

ii) where the custom of the trade permits delegation;

iii) where the principal knows that the agent intends to delegate;

iv) where the nature of the business requires delegation;

v) where an emergency makes it necessary to delegate.

**An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by ordinary custom of trade a sub-agent may, or, from the nature of the agency, a sub-agent** must **be employed.** A legal practitioner is permitted by the usage in the profession, to authorise any other practitioner to appear for him. But, in cases in which he has expressly undertaken to 'appear personally, he has no such right to'delegate his authority.

**Sub-agency**

Where an agent having authority expressly or irnpliedly to delegate his authority appoints another person to act in the matter of the agency, such other person is called a 'sub-agent', provided he acts under the control of the original agent; and a 'substituted agent, if the original agent drops out of the transaction and the newly appointed person carries on the business of the agency.

**Relationship between principal and sub-agent:** You have seen that in certain circumstances'an agent can appoint a sub-agent. In such cases the principal is bound by the acts of the sub-agent, since the sub-ngent is not responsible to the principal but he is responsible for his acts to the original agent only. The principal cannot take action against sub-agent, except in cases of fraud or wilful wrong. As between the original agent and the sub-agent, the relationship is that of the principal and agent.

In case the appointment of a sub-agent is not proper, the principal shall not be bound by the acts of the sub-agent. The original agent will, in such cases, be personally liable to both the principal as well as the third parties for the acts of the sub-agent. In such cases, the sub-agent is not responsible to the principal lor any of his acts.

## 11.9 SUBAGENT AND SUBSTITUTED AGENT

A sub-agent has been defined by Section 191 of the Indian Contract Act : "A *sub-agent is a person employed by and acting under the control of the original agent in the business of the agency)'. A substituted agent is defined by Section 194 thus : "Where an agent, holding an express or implied authority to name another person to act for the principal in the business of agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him".*

Thus the main difference between the two is that an agent not only appoints a sub-agent but the sub-agent works under his control, and the agent himself is liable for the acts of the sub-agent. But in case of substituted agent. the duty of the agent ends with appointing or naming a particular person for being appointed as a "substituted agent". The moment the substituted agent is appointed. privity of contract is established between him and the principal, and the original agent disappears from the scene altogether. The care that ought to be exercised by an agent in selecting a substituted agent is that which a man of ordinary prudence would exercise in his own case.

**Check Your Progress A**

1) Define an agent.

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**2)** What is implied agency?

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**3)** Can an agent exceed his authority in an emergency?

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4) Who is a sub-agent?

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5) What is meant by implied authority of an agent?

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

i) **An** agent **is** not differept from a servant. [ ]

ii) A servant is different from an independent contractor. [ ]

iii) A minor may be an agent. [ ]

**iv)** **A** contract of agency may be created expressly but not impliedly. [ ]

**v)** There **is** no privity of contract between a substituted agent and the principal. [ ]

**vi)** The principal is liable for all the acts of his agent. [ ]

vii) In general, a sub-agent is not directly under the control of the principal. [ ]

viii) A gratuitous contract of agency is invalid. [ ]

**7)** How would you decide the following cases?

i) B tells C in the presence and within the hearing of A that he (B) **is** A's agent in A's business and A does not contradict the statement. 'Subsequently, C

enters into a transaction with B bona fide believing that B is A's agent. Is the principal liable under that contract even when in fact B is not A's agent?

ii) A permits his agent B to purchase goods from C for credit. By using the authority B made credit purchases from C for his own case. Is the principal A liable to C?

iii) A, an advocate, delegated by tlie usage in the profession another practitioner 'B' to appear for him in the court. 'B' accordingly appeared. The case was lost. The client held A responsible. Is 'A' responsible?

iv) Z instructs his lawyer in another town to engage an estate agent to sell his house in that town. As per instructions, the lawyer selects B, the leading estate agent of the town, for the purpose. B is able to sell the house for a good price, but B delays to remit the purchase amount to Z and meanwhile becomes insolvent. Z holds his lawyer responsible for the loss. How would you decide this case? Slate your reasons.

## 11.10 AGENCY BY RATIFICATION

Sometimes a person may act for another person without any express or implied authority from that other person. The person in whose name the act has been done may either disown the act of that pcrson or may approve the actions. This act of affirmation by the pcrson in whose name the act has been done is known as .'ratification". For example, A may act as B's agent although A has no prior authority from B. When B comes to known of it, he may either disown the acts of A or may subsequently accept them. The effect of ratifying the unauthorised act is that it places the parties in that position in which they would have been if the agent had principal's authority at tlie time he made the contract. Similarly, where an agent exceeds his authority, the principal may either reject it or accept it. If the principal accepts the work done by agent, he will be liable for the acts of the agent. For example, A appointed B as his agent to buy wheat for him. In addition to buying wheat, B buys 10 bags of rice for A. 'Afterwards, A agrees to take the delivery of rice as well. A is liable to pay the price of rice. This is a case of ratification of unauthorised acts. Section 196 of the Contract Act provides *where acts ore done by one person on behalf of another, but without his knowledge or authority, he nzay elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they* **huve** *beert performed by his authority.* Further, Section 197 provides that ratification may be express or may be implied in the conduct of the person on whose behalf the acts are done. For example, A, without authority, buys goods for B. Later on, B sells those goods to C and deposits the sale proceeds in his bank account. B's conduct implies a ratification of the purchase made by A.

Here you should note that ratification relates back to the date when the act was done by the agent, i.e., it tantamounts to prior authority. Hence the relationship of agency shall be deemed to have come into existence from the time the agent first acted and not from the time when the principal ratified the act. For example, in *Bolton Partrters v. Lambert* the managing director of a company, without prior authority from the company, but acting on behalf of the company, accepted an offer made by B. B, later on, revoked the offer but the company ratified managing director's acceptance. It was held that because ratification relates back to the time of acceptance by managing director, B is bound by ratification and he cannot revoke his offer.

**Essentials of a Valid Ratification:** You have learnt that an agency may be created by ratification. However, for a valid ratification, following conditions should be fulfilled:

1) **The agent mmt act on behalf of another person who is identifiable!** When the agent enters into a contract, he should expressly contract as an agent. Further, the contract should specify an identifiable person as principal. Far example. A representing himself to be an agent of B, but without authority or knowledge of B, entered into a contract with *C* to buy 100 bales of cotton on behalf of B. Subsequently, the prices of cotton bales go up. B on becoming aware of the transaction purported to have been done on his behalf, ratifies it. *C* refuses to perform the contract. B can compel *C* to perform the contract. If the purported agent does not mention that he is acting on behalf of another person, although in his

mind he might be contemplating to act on behalf of the purported principal, such act cannot be ratified. It follows that acts done by the agent in his own name cannot be ratified later on.

2) Existence of the principal: For valid ratification it is necessary that the principal should be in existence at the time of when the act is done in his name. It is for this reason that when the promoters of a new company enters contracts for the company which has not yet come into existence, the company cannot ratify such contracts, when contract was entered into, the company (principal) was not in existence.

3) Principal **should** be competent to contract at the time **when** the act **was** done **as** well **as at** the time **of** ratification: For a valid ratification it is necessary that the principal should be cornpetcnt to contract when the contract was made and also at the time of ratification. You would recall that a minor is nor competent to contract, hence on attaining majority he cannot ratify the contracts made on his behalf during his minority.

4) Full **knowledge of all relevant facts:** No valid ratification can be made bv a person whose knowledge of the facts of the case is materially defective (Section 198). For valid ratification It is necessary that the ratifier should have the full knowledge of the acts of the case. For example, A employs B to take a house on reasonable rent in Delhi. B lets out his own house at a rent which is much higher than the prevailing rentals in that area. A starts living in the house. Later on, A comes to know that the house belonged to B. **A's** ratification is not binding upon himself.

5) Within reasonable time: The ratification must bc done without any unreasonable delay. If the ratification is not done within a reasonable time, it will not be binding.

6) **Ratification must** he **of whole transaction:** The ratification must be made for the whole transaction. **A** rntifier cannot ratify a part which is beneficial to him and reject the rest. When a person ratifies a part of the unauthorised transaction, it is treated as the ratification of whole transaction (Section 199).

7) No damage to third **party:** Section 200 puts a restriction on the power of the ratifier. It says, *An act done by one person on behalf of another, without such other person's authority, which if done with authority, would* have *the effect* of *subjecting a third person, to damages, or of terminating any right* or interest of a *third person, cannot, by ratification, he made to have such effect.* So any ratification which might cause any damage to third party or terminate any right or interest of a third party cannot be ratified.

For example:

i) A is in possession of a cow belonging to B. C without authority from B demands on behalf of B, the delivery of that cow. A refuses to deliver the cow to *C*. B cannot ratify the demand made by C so as to make A liable for damages for A's refusal-to deliver the cow.

ii) A holds a plot of land, which was leased to him by the owner B. The lease was terminable on three months notice. C, an unauthorised person, gives notice of termination of lease to A. B cannot ratify the notice so as to. be binding on A.

8) Act to **be** ratified must be lawful: Only those acts can be ratified which are valid and lawful. An act which is void, unlawful or illegal cannot be ratified. For example, A forged B's signature and withdrew some money from Bank. Subsequently, B ratifies A's act of withdrawing money. The ratification is not valid as forgery is an offence.

9) Act to be ratified **should** be within the power of the principal: The principal can ratify only such acts which are within his power. Hence an act which is beyond the competence of principal cannot be ratified. For example, if the director of a company does an act on behalf of the company which is ultra-vires the company, the principal (company) cannot ratify such act. Besides, to be valid the ratification must be communicated to the concerned party.

## 11.11 RIGHTS OF AN AGENT

1) **Right *to* Receive Remuneration:** You know that an agent is a person employed to do any act for another, and for his services, he is entitled to receive remuneration. The amount of remuneration shall be such as may be fixed by the terms of agency. In case the remuneration has not been fixed, the agent is entitled to receive a reasonable remuneration. In the absence of a contract to the contrary, agent's tight to receive remuneration would accrue only on the completion of the work. An agent is entitled for his remuneration when he has done what he had undertaken to do, even though the contract is not completed. For example, A was appointed as an agent by an export organisation to secure export orders. A secured some orders for the firm, but firm was dissolved. A is entitled to his commission, though the orders secured by him have not been executed. Section 219 provides that *in the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act, bur an agent may detain money received by him on account of goods sold although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.*

   So the pertinent question arises, when is the act complete? This is a question of fact depending upon the facts and circumstances of each case. But it is necessary that the transaction (act) should be tlie direct or indirect result of efforts of the agent. For example, A, a factory owner, employs a broker B, to arrange some raw material for A's factory. B introduced the supplier of that taw material to A. The supplier demanded some advance money which A was unable to pay. Later on, A directly contacted the supplier and entered into a contract for supply of raw material. B is entitled to his remuneration. However, under Section 220, an agent who is guilty of misconduct in the business of agency, is not entitled to any remuneration in respect of that part of the business, which he has mis-conducted. For example, A employs B to recover Rs. 20,000 from C and to invest the money in good securities, B recovers the money from C, invests Rs. 15,000 in good securities and Rs. 5,000 in securities which he ought to have known to be bad, whereby A loses Rs. 1,000. Here B is entitled to remuneration for recovering Rs. 20,000 and for investing Rs. 15,000. He is not entitled to receive any remuneration for investing Rs. 5,000 and he must make good the loss of Rs. 1,000 to A.

2) **Right of Retainer:** Section 217 of the Contract Act empowers the agent to retain, out of any sums received on account of the principal in the business of the agency for the following payments:

   a) all moneys due to himself in respect of advance made,

   b) in respect of expenses properly incurred by him in conducting such business, and

   c) such remuneration as may be payable to him For acting as agent.

3) **Right of Lien:** You have just now noted that the agent may retain principal's money until his proper payments have been made. Agent has another right i.e., right to retain his principal's goods, papers and other movable or immovable properties received by him until he is paid or accounted for his commission, disbursements and service charges. This lien of the agent is the particular lien. The right of lien has the following limitations:

   a) This right is available to the agent if there is no contrary to the contract.

   b) This right is available on those properties which have come into agent's possession lawfully. If the agent obtains possession by unlawful means, say by misrepresentation, or without authority from the principal, the agent cannot exercise lien.

   c) The lien is only a particular lien, By particular lien we mean that the agent can detain only such goods in respect of which some remuneration is due.

   d) Right of lien can be exercised subject only to all rights and. equities of third parties against the principal. For example, if the agent has sold certain goods belonging to his principal, he cannot refuse to deliver the goods to the buyer.

   e) Since the lien is a possessory right, it cannot be exercised once the possession is lost.

4) **Right to be Indemnified:** Sections 222 and 223 grant right to indemnify to an agent against his principal for the consequences of all lawful acts done by the agent in performing his obligations. Section 222 provides, *the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.* For example, B at Singapore, under instructions from A of Calcutta contracts with C to deliver certain goods to him. A does not send the goods to B, and C sues B for breach of contract. B informs A of the suit, and A authorises him to defend the suit. B defends the suit, and is compelled to pay damages and costs, A is laible to B for such damages, costs and expenses.

Agent's right to be indemnified extends even for those acts which are apparently lawful but are in fact unlawful or injurious to a third person. However, the right to indemnify is not available against those acts which on the face of it are unlawful or are criminal in nature, even if there is an express or an implied promise to indemnify the agent against the consequences of that act. For example, A employs B to put to fire C's growing crop and agrees to indemnify B against all consequences of the act. B, accordingly put to fire, B's growing crop and is made to pay damages to C. A is not liable to indemnify B.

Where one person employs another to do an act, which may cause an injury to the rights of a third person and the agent does the act in good faith, the principal is liable to indemnify the agent. For example, B at the request of A, sells goods in the possession of A, but which A had no right to dispose of. B does not know this, and hands over the proceeds of the sale to A. Afterwards C, the true owner of the goods, sues B and recovers the value of goods and costs. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses.

5) **Right to Compensation** : The agent has the right to receive compensation for the injuries or losses suffered due to the principal's neglect or want of skill (Section 225). For example, A employs B as a brick layer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put and B is, in consequence, hurt: A must pay compensation to B. It should however, be noted that if the injury is caused by the negligence of the agent himself, then he cannot claim any compensation.

## 11.12 DUTIES OF AN AGENT

Following are the statutory duties of the agent:

1) **Duty to Act According to the Instructions or Custom of Trade:** Section 211 lays down that it is the duty of an agent to conduct the business of the agency strictly according to the directions given by the principal. For example, if an agent is asked by his principal to insure the goods, the agent failed to do so and the goods are destroyed by the fire. The agent is liable to compensate the principal for the loss.

However, when the principal has not given any directions, in that case the agent should conduct the business according to the custom of the trade. For example, B, a broker in whose business it is not the custom to sell goods on credit, sells goods of his principal on credit. Before making the payment, the buyer becomes insolvent. The broker, B is liable to pay for the loss.

When the agent acts otherwise, if any loss incurred, the agent must make it good to the principal, and if any profit accrues, the agent must account for it. For example, A, the principal, instructed his agent B to put certain goods in a particular warehouse. Ignoring A's directions, B puts the goods in another equally safe warehouse. The goods were destroyed by fire without any negligence on the part of B. Here the agent was held liable to make good his principal's loss.

2) **Duty to Act with Reasonable Care and Skill:** It is the duty of an agent to conduct the businesaof the agency with reasonable care and skill. The degree of care and skill required from the agent depends upon the nature of business and circumstances of each case. For example, A, living in Bombay asked B at Delhi, to collect Rs. 10,000 from C. B collects the money and sends the amount by bank

draft, placed in a letter sent by register post to A. B has done his duty as a man of ordinary prudence would have done in his own case. However, if instead of sending the draft by registered post, B sends the draft by ordinary post, B would be responsible for acting negligently.

The agent is required to act with reasonable diligence, to use skill as he possess and to compensate the principal in respect of the direct consequence of agent's own neglect, want of skill or misconduct. For example, A, an insurance broker, was employed by B to effect an insurance on a ship. A insured the ship but failed to see that 'usual clauses' are inserted in the policy. The ship was lost in storm. Due to omission of the 'usual clauses' in the policy, nothing could be recovered from the insurance company. A is liable lo make good the loss suffered by B.

It follows from the above that the agent is not liable to compensate the principal in respect of loss or damage which are indirect or remotely caused by such neglect, want of skill, or misconduct.

3) **Duty to Render Accounts:** An agent is bound to render proper accounts to his principal on demand and to pay overall sums received on principal's behalf subject to any lawful deduction for remuneration or expenses properly incurred by him.

4) **Duty to Communicate with the Principal:** Section 214 enjoins an agent, in case of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

5) **Not to Deal on** His **Own Account: An** agent **is** not to deal on his own account in the business of agency, as no agent is *permitted to put himself in the* position *where his interest conflicts with* his *duty*. If an agent desires to deal on his own account in the business of agency, he must make a full and frank disclosure of all the material circumstances, which have come to his knowledge on the subject, to the principal and obtain his consent (Lever *Bros.* v. Bell). If, however, he fails to obtain such consent, and carries on the said business on his own account, or after giving the consent, the principal finds that either any material facts has been dishonestly concealed from him by the agent to his interests, the principal has two options. He may (i) repudiate the transactions entered into by agent and disclaim all losses, or (ii) claim from the agent benefit resulting from the transaction. For example, **A** directs B to sell his estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to **A.** B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A on discovering that B knew of the mine at the time he bought the estate, may either repudiate. or adopt the sale at his option. Take another example. A directs B, his agent, to buy a certain house for him. B tells **A** that the house cannot be bought and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he (B) gave for it.

b) **Not to Use Information Obtained in the Course of the Agency against the Principal:** Where an agent has obtained information during the course of the agency, it is the duty of the agent not to use the same prejudicially to the interests of the principal. Where an agent does make use of such information, the principal may restrain him from doing so by an injunction.

7) **Not to Set Up Adverse Title:** Where an agent has obtained goods or property from the principal as an agent, it is his duty not to set up his own title or the title of a third person. In other words, the agent should not dispute the ownership of the principal.

8) **Not to Make Secret Profits: As** you know that the relationship of principal and agent is based on mutual confidence, it is the agent's duty not to make any secret profits in the business of agency. For example, A appointed B, an auctioneer to sell certain goods belonging to him. B sold the goods to C, and received some secret commission from C in addition to the commission from A. It was held that B was bound to hand over the secret commission to A.

9) **Duty to Exercise His Authority Personally:** Section **190** of the Act requires an agent to perform acts personally which he has expressly or implied'ly undertaken to perform personally. In other words, an agent must not delegate the authority given to him. However, under certain circumstances, this authority can be delegated (discussed in 11.8).

**10) Duty on the Death or Insanity of** the **Principal:** Section 209 requires that when an agency is terminated by the principal dying or becoming of unsound mind. the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

**Rights and Duties of Principal towards** Agent

As should be clear to you from what you have studied so far that the rights of the principal are the duties of the agent and duties of the agent are the rights of the principal.

**Check Your Progress B**

**1)** What is agency by ratification?

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***2)*** 'Ratification is tantamount to prior authority' — Explain.

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**3)** Enumerate the conditions that are necessary before exercising a lien.

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4) Can an agent have the business dealing on his own account? If not, why?

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

i) X, without Y's authority lends Y's money to Z. Afterwards Y accepts interest on the money from Z. Y's conduct does not imply a ratification of the loan. [ ]

ii) The act of the agent to be ratified must be valid in itself and not illegal. [ ]

iii) A forgery of signature, though ratified, conveys no title. [ ]

iv) **A** person cannot ratify a part of the'transaction. [ ]

v) An agent who is guilty of misconduct in the business of agency is not entitled to any remuneration. [ ]

vi) The lien existing in favour of the agent is generally a particular lien. [ ]

vii) For a ,valid ratification the principal must be competent to contract at the time or ratification. [ ]

viii) Where the agent smuggled goods and paid for them, the principal can be compelled to indemnify the agent. [ ]

ix) An agent must not put himself in a position where his duty to the principal and personal interest conflicts. [ ]

## 11.13 PERSONAL LIABILITY OF AN AGENT

Ordinarily in a contract of agency, an agent being a person employed to create relationship between his principal and the agent, the agent can neither enforce the contract personally nor is he personally liable on the contract unless there is a contract to the contrary provides. *In the absence of any contract to that effect, an agent cannot*

*personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them. Such a contract shall be presumed to exist in the following cases:*

i) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;

ii) Where the agent does not disclose the name of his principal;

iii) Where the principal, though disclosed, cannot be sued.

However, there are circumstances when the agent becomes personally liable. These are as follows:

1) When the Agent Expressly Agrees: Sometimes the third party when contracting with an agent may sepecifically stipulate that the agent will be personally liable if the contract is not performed, in such a situation the agent will be personally liable. For example, A, an agent entered into an agreement with B to grant a lease of a house. In the lease deed it was mentioned that A was acting as an agent of the owner of the house C. However, in the subsequent portion of the lease deed it was provided that the agent would execute the lease. In this contract the agent will be personally liable if the contract is not performed, although the house belonged to C. Similarly, auctioner of property signing agreement of sale in their own name without qualification must be understood to contract personally and not as agents.

2) When Acting for a Foreign Principal: Where an agent enters into a contract for a foreign principal (a merchant residing abroad), the presumption is that the agent is personally liable for such contracts. This presumption came into existence because in earlier times it was difficult to sue foreign principal, hence it became customary that when the agent into a contract on behalf of a foreign principal, the agent would be personally liable. But now because of changed atomsphere of international trade, although the rule still exists, but the agent do not undertake personal liability and the contracts are entered manifestly laying that the liability would be that of the principal if the contract is not performed.

3) When Acting for an Undisclosed Principal: When a contract is made by an agent for an undisclosed principal, the agent is personally liable. The reason for it is that because the third party while making the contract, relied upon the credit of the known agent and consequently, the agent becomes responsible for the transactions.

4) Where the Principal though Discovered cannot be Sued: When the agent enters into a contract on behalf of a person who cannot be sued, as for example, where the principal is a foreign sovereign or an ambassador, or a minor or a lunatic, the presumption is that the third party gave credit to the agent, hence the agent is personally liable upon the contract.

5) When Principal is a Company which is yet to Come into Existence: When the promoters of a company enter into any contract on behalf of a company not yet incorporated, the promoters are personally liable for the obligation they create by any contract with any one. The reason for this is that the company, being not in existence at the time of formation of contract, cannot be sued.

6) When Agent's Authority is "Coupled with Interest": Where an agent has a special interest in the subject-matter of the contract, his authority is said to be coupled with interest. He is really a principal to the extent of his interest and may sue in his own name or be sued but only to the extent of his interest in the subject matter. For example, M authorises N to sell his land and out of the sale proceeds to pay himself the debts due to him from M. N's authority is coupled with interest.

7) When There is a Custom or Trade Usage: An agent may be held personally liable on contract entered by him, if there is some trade usage or custom, provided there is no contract to the contrary. For example, in the business of stock exchange it is a custom that a broker is personally liable for the contracts entered into hy him, so a jobber may hold the broker personally liable.

8) Money Paid by Mistake or Fraud: When a person untruly represents himself to be the authorised agent of another and thereby induces a third party to deal with him as such agent, or the agent exceeds his authority, and the (alleged) principal does not ratify his acts, the alleged agent is personally liable to the third party and the third party may recover from him compensation in respect of any loss or damage suffered by them (Section 235).

9) **When He Enters into Contract in his Own Name:** If an agent enters into contract with the third party in his own name i.e., without disclosing that he is contracting as an agent. For example, **A** took a loan from B and executed a hundi in his favour. The hundi appeared to be drawn by a firm. **A** did not sign the hundi as agent of the firm nor did he disclose to B the name of the principal who was the proprietor of the firm. The agent was held personally liable on the hundi.

As you have already read in Sectiun 233 *in* case *where the ugent is personally liable, a person dealing with him may either hold him or his principal or both of them liable.*

## 11.14 LIABILITY OF PRINCIPAL TO THIRD PARTIES

You have learnt that an agent enters into a contract with third parties on behalf of his principal, i.e., the principal is liable to third parties for the acts of the zgent. The liability of the principai to third parties may be studied under the following heads:

1) Where the name and existence of the principal is disclosed by the agent to the third party.

2) Where the name is not but principal's existence is disclosed or where we may conveniently say that the principal is unnamed, and

**3)** Where the principal is undisclosed i.e., neither the existence nor the name of the principal is disclosed.

1) **Liability of the Principal where Both the Existence and Name of Principal is Disclosed.**

a) Since the agent is employed for bringing about the contractual relations . beiween the principal and the third parties, contracts entered into by the agent binds the principal to the same extext, as if they had been made by the principal himself (Section 226).

b) The principal is generally liable for such acts of the agent which are within the scope of his authority. But if the principal gives the authority to represent him in a particular business, then the principal is bound by ever such act of the agent which is incidental to such business or which falls within the apparent scope of the agent's authority or as it is often called the "ostensible authority" of the agent. Where a pricipal while conferring authority upon an agent imposes conditions or limits the authority, the principal shall be liable for such acts which are in excess of the authority, only when the other party is not aware of the limitations. For example, where A authorises B to sell goods, but privately instructs him not to sell on credit but B sells them to C on credit, who does not know of the restrictions, the sale is binding upon A.

When the agent exceeds the authority given to him, the principal has the option that he may either disown or accept it. In case the work where the agent has exceeded his authority can be separated from that pzrt which falls within his authority, the principal is bound by the authorised work only (Section **227).** For example, **A** being the owner of a ship and the cargo in it, authorises B to procure an insurance for Rs. 5,000 on the ship. B procured a policy of Rs. 5,000 on the ship and another policy for the like sum on the cargo. A is bound to pay the premium for the policy on the ship only, but he is not bound to pay the premium for the policy on the cargo.

If the unauthorised portion cannot be separated from the authorised one, the principal may repudiate the whole transaction (Section **228).** For example, an agent is authorised to buy 100 pants. The agent, in addition to buying 100 pants, buys 100 shirts also for Rs. 10,000, the principal will not be liable and he may repudiate the whole transaction.

c) Any information which is material for the business of the agency if brought to the notice of the agent is deemed to have been brought to the notice of the principal. Section 229 accordingly provides that any notice given to or information obtained by the agent in the course of the business transacted by him for the principal shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal. For example, A is employed by B to buy from C certain goods of

which C is the apparent owner. In the course of negotiations, A learns that the goods actually belong to D and C is the agent only. B is not aware of this fact. B had some claim against C which he wanted to set off against the price. Now B cannot set off his claim because the goods belong to D and not to C. Here the knowledge of the agent is treated as the knowledge of the principal.

d) If during the course of the business of agency, the agent makes any misrepresentation or commits any fraud, it will have the same effect on the agreement as if they have been committed by the principal. For example, A, being B's agent for the sale of sugar, induces C to buy it by a misrepresentation. The contract is voidable, as between B and C, at the option of C. However, if the misrepresentation is made or fraud is committed by the agent, in matters which do not fall within agent's authority, the principal is not liable (Section 238).

2) Liability where only the Existence of the **Principal** has been Disclosed **but *not* His** Name (Unnamed Principal): If the agent while contracting with third parties discloses the fact that he is entering into the contract on behalf of his principal but does not discloses the name of the principal, the principal is bound by the contract. However, such acts must be within the scope of agent's authority and the unnamed principal must be in existence at the time of entering into the contract. For such contracts, the agent is not personally responsible unless there is something which shows that he agreed to be personally liable. But if the agent refuses to disclose his principal's identity when asked by third parties, then, the agent becomes personally liable.

3) **Undisclosed** principal: Sometimes, the agent contracts with a third party without disclosing the name and existence of the principal. He gives an impression as if he is independently making the contract, whereas, in fact he has entered into the contract on behalf of his principal, but the third party neither knows nor has reason to suspect that the person with whom they are dealing is an agent. In such a situation the principal remains undisclosed and may be called as an undisclosed principal. Mutual rights and liabilities of principal and agent in this case are as follows:

i) Because the agent has entered into the contract in his own name, therefore, the third party can hold him personally liable on the contract. The agent can be sued by the third party and he can sue third party as well, So far as his rights against the principal are concerned, he continued to enjoy all the rights of an agent against the principal.

ii) If the third party discovers that there is a principal, the third party has the option to sue the agent or the principal or both. This option is available to the third party, if it had already not obtained any judgement against the agent. If the third party decides to file a suit against the principal, he must allow the principal the benefit of all payments received by him (third party) from the agent. For example, **A,** an agent, without disclosing his principal, enters into a contract with B to buy certain goods for Rs. 10,000 and pays Rs. 500 as advance. In fact, A was acting as the agent of C. In case the contract is not performed, B (third party) may sue C, but B will have to give the credit of Rs. 500 which he (B) received from A.

It should be noted that the third party has to make a choice to sue either the principal or the agent or both. However, once the choice has been made, then he cannot sue the other (Section 234).

iii) Section 231 of the Act provides that if the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract. But this can be done only if he can prove that, if he had known who was the principal in the contract or if he had known that the agent was not a principal, he would not have entered into the contract. For example, in ***Said v. Butt*** case through an undisclosed agent, A bought for himself a ticket of theatre because on personal grounds theatre management would not have issued the ticket to A. Theatre owner may repudiate the contract and refuse **A** to enter the theatre hall.

iv) Where one person enters into a contract with other neither knowing nor having any ground to suspect that the person with whom he has entered into contract is an agent, the principal, if he requires the contract to be

performed, can obtain such performance subject only to the rights and obligations subsisting between the agent and the other party to the contract (Section 232). For example **A,** who owes Rs. 1,000 to B, sells Rs. 2,000 worth of rice to B. **A** is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set-off A's debt.

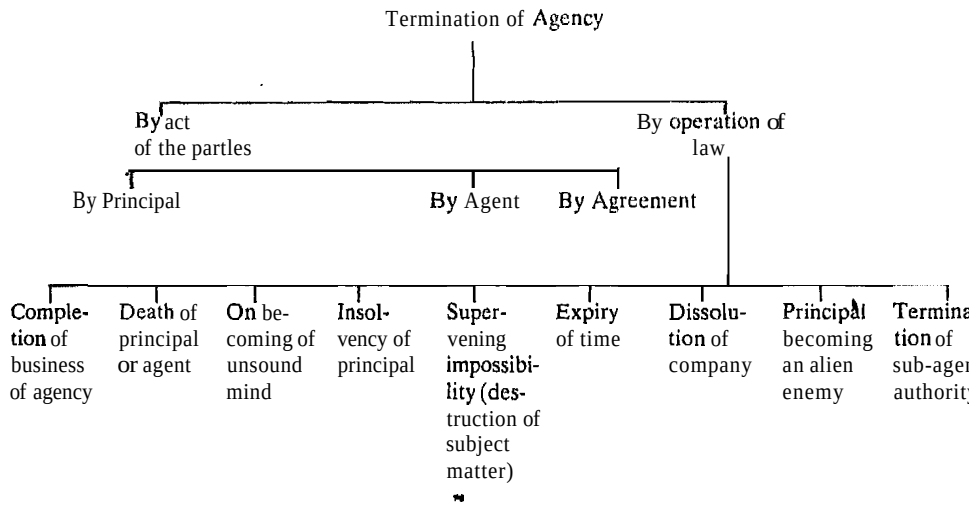
If there exists some express or implied term in the contract, the undisclosed principal cannot intervene. For example, if in a contract of sale of 100 quintals of woods the agent describes himself in the contract as the owner, such manifestation precludes the principal because it shows an intention to make a personal contract. However, the principal may be allowed to intervene and may be allowed to show that he is in fact the principal. For example, **A** lets out his flat to B through a property agent C. In the contract the agent described himself as the owner of the flat. The undisclosed principal may contradict it.

## 11.15 TERMINATION OF AGENCY

Except in those cases where the agency is irrevocable, the agency may be terminated in any of the ways mentioned in Section 201 which reads: An *agency is terminated by the principal revokirig his authority; ow by the agent renouncing the business of the agency or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated on insolvent under the provbions of any Act for the time being in force for the relief of insolvent debtors.*

So from the above description (see Figure 11.2) you will see that the agency may be terminated either (1) by act of the parties, or (2) by operation of law,

**Figure 11.2**




### By Act.of the Parties

i) **By Principal:** As you have already noted that the principal may revoke the authority of his agent at any time before the authority has been exercised so as to bind the principal. So the agency may be terminated if the principal revokes his authority. But if the agent has partly exercised his authority, the principal may revoke agency for future acts only. Where the agent has some personal interest in the business of agency, the agency cannot be terminated (This point is discussed in detail in Section 11.16 of this unit). Section 205 provides that, where there is an express or implied contract that the agency should be continued for any period of implied contract that the agency should be continued for any period of time, and any party, without any sufficient cause terminated the contract before the stipulated time, the defaulting party must make compensation to the other party for revocation or renunciation. If the agency is to continue for a fixed period of time, the principal must give a reasonable notice to the agent

before terminating the agent's authority. If such a notice is not given , the principal shall be liable to compensate the agent for any loss suffered by him.

ii) **By Agent:** The agency may be terminated even by agent himself renouncing the agency, after giving a reasonable notice to the principal, Section 206 stipulates that reasonable notice must be given of revocation or renunciation of agency otherwise the defaulting party is liable to pay damages resulting to the other party. Revocation and renunciation may be either express or implied. For example, A employs an agent B to sell his car. Later on, A sells the car himself. This is an implied revocation of agent's authority.

iii) **By Agreement:** The agency, like any other agreement may be terminated, at any time, by mutual agreement between the principal and the agent.

**By Operation of Law**

The relationship of principal and agent may be terminated by operation of law, under any of the following circumstances:

i) **Completion of the business of agency:** An agency is automatically terminated as soon as the business of agency is completed. For example, A employs B to sell his car. The agency will be terminated when the sale is completed.

ii) **Death or insanity of principal or the agent:** The relationship of principal and agent is terminated when the principal or agent dies or becomes of unsound mind. Section 209 imposes a duty upon the agent by providing that even after the death of his principal and consequent termination of agency, with a view to protect the interest of his deceased principal, the agent is bound to take, on behalf of the representatives of his late principal all reasonable steps for the protection and preservation of the interests entrusted to him.

iii) **Insolvency of the principal:** When the principal becomes insolvent, the agency too is automatically cancelled. The reason being that insolvent person is disqualified from entering into contract in respect of his property.

iv) **Destruction of subject matter:** When the subject matter of the contract cease to exist, any contract relating to that subject matter also comes to an end. Consequently, any agency created to deal in that subject matter is also terminated by the total destruction of the subject matter. For example, A employs an agent B to sell his car. The car meets with an accident and becomes unsaleable. The agency terminates after the accident,

v) **Expiry of time:** When an agent is appointed for a fixed period, the agency terminates after.the, expiry of the stipulated time, unless the term of agency has been extended. The agency is terminated even though the business of the agency has not bekn completed.

vi) **Dissolution of the company: If** the principal or the agent is a company and the company is dissolved, the agency also automatically comes to an end on such dissolution.

vii) **On principal becoming an alien enemy:** If a contract is entered between a principal and an agent who are citizens of two different countries and a war breaks out between the two countries, the agency is terminated because the consequence of war is that the citizens of belligerent countries become alien enemy and the contract of agency becomes unlawful.

**Effective Time of Termination of Agency**

When termination of agency takes effect? The law in this regard is laid down in Section 208 and is as follows:

1) The authority of an agent, so far as he is concerned, comes to an end only when the agent comes to know that his autliority has been terminated.

2) Likewise so far as third parties are concerned, tlie authority of the agent will be terminated only when they come to know that the authority has been revoked. In simple words, it can be stated that the termination is effective from tlie time when it comes to the knowledge of the agent or third parties. Thus, termination may be effective at a different time as regards the agent and as regards parties.

Hence, third parties may deal with the agent, as such, till they come to know of the termination of the authority. For example, A directs B to sell goods for him, 'and agrees to give B five per cent commission on the price fetched by the goods. Afterwards by letter, revokes B's authority. After the letter was sent, but before

B received it, B sold the goods for 100 rupees The sale is binding on A. and B is entitled to the agreed commission.

Let us take another example, A. at Delhi by letter directs his agent B, to sell for him some mustard oil lying in a warehouse in Calcutta. Later on. A by a letter revokes B's authority to sell and directs B to despatch the mustard oil to Delhi. B, after receiving the letter of revocation enters into a contract with C, who knows of the first letter and has no knowledge of the second letter, whereby C agrees to buy the mustard oil from the agent. C paid the price to the agent who runs away with the money. A is bound by the contract and C's payment is good as against A.

## 11.16 IRREVOCABLE AGENCY

The term 'irrevocable agency' means an agency which cannot be revoked or terminated by the principal. Contract Act envisages the following circumstances when the agency is irrevocable:

i) **If the agency is coupled with interest:** You have already learnt in this unit that when the agency is created for securing some benefit ta the agent in addition to his remuneration as agent, such agency is termed as 'agency coupled with interest'. In this regard let us read Section 202 which defines such agency. It says *where the agent has himself an interest in the property which forms the subject matter of the agency, cannot in the absence of an express contract, be terminated to the prejudice of such interest.* In other words, where an agent has some interest in the subject matter of the agency, it cannot be terminated so lang as the interest subsists. For example, A owes Rs. 10,000 to B and A authorises B to sell A's house in Agra and to pay himself. out of the proceeds. Once A has authorised B, A cannot terminate the agency nor will this agency be terminated by the death of A or on A's becoming of unsound mind. Here we should note that in order to avail the benefit of this principle, it must be remembered that the object of creating the agency is to secure some benefit to the agent. The rule is not applicable to those agencies in which the interest arises after the creation of agency. To distinguish this situation let us study this example, A entrusts 100 bales of cotton to B and directs B to sell them on A's behalf. Later on, B advances some money to A. A fails to repay the money and also directs B not to sell the bales of cotton. Ignoring A's directions and to recover his money, B sells the cotton bales. B cannot sell, because when the agency was created it was not coupled with interest, the agent's interest arose after the creation of agency.

ii) Where **the agent has partly exercised his authority:** Section 204 presents another situation where agency is irrevocable. It says *the principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations us arise from acts already done* in *the agency.* It means that the principal cannot revoke the agent's authority for the acts already done, and the principal shall he liable for such acts which have already been done on his behalf, For example, A authorizes his agent B to huy 1000 tons of stainless steel sheets on A's account and to make the payment out of A's money remaining in B's hands. The agent buys the sheets in the nape of his principal. A cannat revoke agent's authority so far as regards payment for 1000 tons of stainless steel sheets is concerned.

iii) When **the agent has incurred a personal liability:** If in pursuance of a contract of agency, the agent has entered into any contract and has incurred some personal liability,the principal cannot revoke the agency. Because if the principal is thus allowed to revoke the authority of the agent, it would expose the agent to the risk and liability already incurred by him. For example, if in the above-mentioned example, the ...,, nt buys the stainless steel sheets in his own name instead in the name of his principal, the agent makes himself personally liable. Hence, the agency becomes irrevocable and the principal cannot unilaterally terminate the agency.

**Check Your Progress C**

1) Mention any two circumstances in which an agent incurs personal liability.

.....

.....

2) Who is an undisclosed principal?

.....

.....

3) When does termination of an agency take effect?

.....

.....

4) How would you decide the following cases?

i) A, being B's agency with authority to receive money on his behalf, receives from C a sum of money due to B. Is C discharged of his obligation?

ii) R authorises E to buy 300 sheep for him. E buys 300 sheep and 100 lambs for a lump sum of Rs. 5,000. What remedy is open to R.

iii) A who owes Rs. 500 to B, sells Rs. 1,000 worth of rice to B. A is acting as agent for C in the transaction but B has no knowledge nor reasonable ground of suspicion that such is the case. What is the position of C against B in taking rice?

iv) A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. What is the right of A in this case?

v) A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of A's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price, Is A, the principal. bound by the contract?

## 11.17 LET US SUM UP

An agent is a person who represents another person, called principal, in dealings with third parties. A minor or a person of unsound mind can be an agent but nut a principal, The principal must be a major and of sound mind, No consideration is necessary to create an agency,

An agent is different from a servant and an independent contractor. He occupies an intermediate place between the two. A wife is not an agent of a husband. She must receive authority from her husband either expressly or by implication from his conduct. She can pledge the credit of her husband only under certain conditions.

An agency can be created (a) by express agreement, (b) implied agreement, (c) by ratification, (d) by operation of law. Agency by implied agreement may be by (i) holding out, (ii) estoppel, (iii) necessity. Authority of an agent may be express or implied and ostensible.

An agent cannot delegate his authority and appoint a sub-agent. But there are some exceptions to this rule. A sub-agent is different from a substituted agent,

If an agent exceeds his authority or does any act without authority, the principal may ratify or disown them. Ratification means affirmation and it relates back to the date on which the ratified act was originally done by the agent. For a valid ratification certain conditions must bc satisfied.

The rights of an agent are: (1) right to receive remuneration, (2) right of retainer, (3) right of lien, (4) right to be indemnified. The duties of an agent are: (1) to act according to the instructions or custom of the trade, (2) to act with reasonable care and skill. (3) to render accounts, (4) to communicate with principal, (5) not to deal on his own account, (6) not to use information obtained in the course of the agency against the principal, (7) not to set-up adverse title, (8) not to make personal secret profits, (9) to exercise his authority himself (10) to take all reasonable steps to protect the interest of the' principal on his death or insanity.

An agent is personally liable: (1) when he expressly agrees, (2) when acting for a foreign principal, (3) when acting for an undisclosed principal, (4) where the principal, though discovered, can't be surd, (5) where the principal is a company which is yet to come into existence, (6) when the agent's authority is "coupled with

interest", (7) if custom or trade usage is such, (8) where agent receives money by mistake or fraud (9) where agent exceeds ordeals without authority, (10) when agent enters into contract in his own name.

The liability of a principal to third parties fall under three heads: (a) Where both existence and name of the principal is disclosed (named principal), the principal is liable for acts of the agents that are within agent's authority. He is also liable for misrepresentation or fraud done by the agent, notice given to or information obtained or admissions made by the agent in the course of business. (b) If only existence and not the name of the principal is disclosed, the principal is, provided he is in existence at the time of the contract, liable for the contracts made by the agent. (c) Where neither the principal's existence nor his name is disclosed (undisclosed principal), the agent can sue or be sued by the third party as he is personally liable.

An agency may be terminated by (a) act of the parties i.e., by the principal or by the agent or by agreement of both, or (b) operation of law. This occurs on completion of business, on death or unsoundness of mind of any party, on insolvency of the principal, on destruction of the subject matter, on expiry of the fixed period of agency, on dissolution of company (either as principal or agent), or on principal becoming an alien enemy. The agency is terminated when agent comes to know of it and for third parties when they come to know of it.

An agency is irrevocable: (i) if the agency is 'coupled with interest', (ii) when authority has been partly exercised by the agent, and (iii) when the agent has incurred personal liability.

## 11.18 KEY WORDS

**Agent and Principal:** An agent is a person einployed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the principal.

**Agency by Estoppel:** When a person by his words or conduct has wilfully Icd another to believe that certain set of circumstances or facts exist, and that other person had acted on that belief, hc is estopped or precluded from denying the truth of such statements.

**Agency by Holding Out:** There is some affirmative conduct on the part of the principal.

**Agency by Necessity:** Sometimes, exigencies of circumstances require that a person, who is not really an agent, should act as an agent of another.

**Agency by Ratification:** If the agent had no authority to contract on behalf of principal or exceeds such authority, the principal, can subsequently validate the act by signifying his approval.

**Auctioneer:** Auctioneer is an agent who is entrusted with possession of goods for sale to the highest bidder in public competition.

**Actual Authority:** It is created by agreements to which the principal and agents alone are parties.

**Agency Coupled with Interest:** Where an agent has an interest in the subject matter of the contract which he signs.

**Broker:** A broker is one who makes bargains for another and receives commission (brokerage) for so doing.

**Del Credere Agent:** A Del Credere Agent is an agent, who in consideration of an extra remuneration called the Del Credere commission, guarantees to his principal that the third persons with whom he enters into contracts shall perform their obligations.

**Delegatus non potest delegare:** A delegate cannot further delegate, (i.e.,) one cannot delegate that which one has himself undertaken to do.

Factor: A person who is entrusted with the possession of goods, and who has the authority to buy, or sell or otherwise deal with goods or to raise money on their security.

Ostensible Authority of an Agent: When a person is held out as an agent for a particular purpose or business, persons dealing with him are entitled to presume that he has the authority to do all such acts as are necessary or incidental to such a business.

Special Agent: One who has authority to act in a particular transaction.

**Sub-agent:** A person who is employed by and acting under the control of the original agent.

Substituted Agent: An agent who is named by the original agent and he acts directly under the control of principal.

## 11.19 ANSWERS TO CHECK YOUR PROGRESS

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

7) i) This comes under agency by estoppel. In this case the principal A is liable to C.

ii) Yes the principal is liable to pay C on the principle of Agency by holding out. A, having hold out B as his agent on a previous occasion, becomes bound by subsequent transactions entered into under similar circumstances.

iii) No. A was not responsible. Delegation of authority by one advocate to another is a common usage in that profession, unless otherwise agreed upon by the client and the advocate 'A'. B is the substituted agent.

iv) A substituted agent is liable directly to the principal. Hence, lewyer is not responsible to Z.

B) 5) i) False ii) True iii) True iv) True v) True vi) True vii) False viii) False ix) True.

C) 4) i) Yes, C is discharged of his obligation to pay the sum in question to B (Section 226).

ii) R may repudiate the whole transaction (Section 228).

iii) C cannot compel B to take the rice without allowing him to set off A's debt. (Section 232).

iv) A may sue either B or C or both (Section 233).

v) A is bound by the Contract (Section 237).

## 11.20 TERMINAL QUESTIONS

1) Define 'agent' and 'principal'. Can a minor be an agent?
2) How can an agency be created?
3) To what extent a wife can pledge her husband's credit when (i) she is living with him and (ii) she is living separately?
4) Examine the rights and duties of an agent.
5) When may an agent sue or be sued personally on contracts entered into by him on behalf of his principal?
6) 'Delegatus non potest delegare'. Discuss the implications of this maxim in relation to agency and state the exceptions to the rule.
7) Explain the scope of principal's liability for the acts of his agent when the agent has acted: (i) with ostensible authority; (ii) in the course of his business.
8) 'A principal has the power to revoke the authority of the agent; but he does not have the right to do so'. Explain and illustrate the truth of this statement.

9) In what circumsrances may a person ratify a contract made on his behalf hut without his authority'?

10) If an agent acts for (a) a disclosed principal, (h) an undisclosed principal, and c) unnamed principal, state the respective rights of the agent, the principals, and the third parties.

I I) Examine the various ways by which a contract of agency may be terminated.

12) When is an agency irrevocable?

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

# UNIT 12 CARRIAGE OF GOODS

**Structure**



## 12.0 OBJECTIVES

After studying this unit, you should be able to:

- define a carrier and classify carriers;
- describe the rights, duties and liabilities of a common carrier and the responsibilities and liabilities of railways as carriers of goods;
- define contract of affreightment;
- differentiate between charter party and bill of lading;
- explain the various types of bill of lading and charter party;
- describe the duties end liabilities of carriers by sea;
- describe the various types of documents of carriage by air;
- explain the rights of the consignor and consignee and the extent of liabilities of the air carrier.

# 12.1 INTRODUCTION

All of you know that goods are transported by the seller to the buyer in trade. The goods may be carried by different means of transport. The carriage of goods take place either by land, by sea or by air. The law of carriage of goods, thus shall be studied under three distinct heads i.e., I) Carriage by land, 2) Carriage by sea, and 3) Carriage by air. The statutes dealing with these three heads are ,as under :

1. Carriage by land
   a) The Carriers Act, 1865
   b) The Indian Railways Act, 1890
2. Carriage by Sea
   a) The Indian Bill of Lading Act, 1856
   b) The Carriage of Goods by Sea Act 1925
   c) The Merchant Shipping Act 1958
   d) The Marine Insurance Act, 1963
3. Carriage by Air
   The Carriage by.Air Act 1972.

A contract whereby a person or a firm or company agrees to carry goods or people from one place to another in return for apayment is called a contract of carriage. The party who undertakes to carry the goods or people for payment is called 'the carrier' e.g. bus owner, railways, airlines or streamship company. The person who delivers the goods is called 'consignor' or 'shipper' and the person to whom the goods are addressed and to whom the carrier should deliver the consignment is called the 'consignee'.

You should note that the principle; of English common law apply where any of the above statutes are silent on any point.

# 12.2 CARRIAGE BY LAM)

Goods are carried by land either by road or by inland waterways or by railways. There are two laws dealing with caniage of goods by land. These are :

a) The Carriers Act 1865
b) The Indian Railways Act 1890

The Carriers Act 1865 deals with carriage of goods over land and inland waterways and does not apply to carriage of passengers. The Indian Railways Act 1890 deals with carriage of goods by railways.

First we shall discuss the provisions of the Carriers Act 1865. The Indian Railways Act, 1890, which deals with carriage of goods by railways will be discussed later.

## 12.2.1 Classification of Carriers

Carriers are classified into two types:
a) Common carrier
b) Private carrier

**a) Common Carrier**

A common carrier, as defined under the Carriers Act, 1865, is any individual, firm, or company (other than government) who transports goods, as a business, for money, over land or inland waterways, without discriinination between different consignors.

**Characteristics of a Common Carrier**

From this definition the following characteristics of a common carrier emerge:-

1. Common carrier may be an individual, firm or a company. The government is not included in this defmition. A post office is not a common carrier. Railways are not governed by the Carriers Act 1865 but by Indian Railways Act 1890.

2. The common carrier should be engaged in the business of transporting goods, not passengers.
3. The common carrier transports goods for hire, i.e., carry goods as a business for money, One who carries goods free of charge is called 'gratuitous carrier' and is not a common carrier. Similarly if ally one carries goods or passengers occasionally and not as business is not a common carrier
4. Goods may be transported overland or inland waterways, not by air.
5. The common carrier is bound to carry goods of any person, who chooses to employ him for the purpose, without discrimination, provided that there is accommodation in the carnage. If he reserves the right to reject or refuse to carry goods, he is not a common carrier.

A common carrier, however, can refuse to cany the goods of any person in following cases:

a) If there is no space or room available in his vehicle.
b) If the goods are not of the type he usually professes to carry.
c) If the goods are of dangerous nature and he is put to some extraordinary ; isk.
d) If the destination, to which the goods are to be carried, is not on his normal route.
e) If the goods have not been packed properly.
f) If reasonable charges for hire are not paid.
g) If the consignor refuses to disclose the nature of goods.

. The common carrier can be sued and is liable for damages if he refuses to carry goods except on grounds stated above.

b) Private Carrier

A private carrier carries goods for selected persons on special terms mutually agreed upon between him and sender of goods. He has the discretion to accept or reject the offer to carry goods. He carries goods only occasionally and not as a regular business. He may carry the goods not for money.

Carriers as **Bailee**

You have read the duties of a bailee in Unit 10. As you know, a bailee is responsible only when the goods entrusted to him are lost or damaged due to his fault. A private carrier is not governed by the Carriers Act, 1865. His position is that of a bailee. He is governed by Indian Contract Act 1872. However, carrier has to take care of goods as his own.

A common carrier, on the other hand, takes upon himself the responsibility of safe delivery of the goods. It is immaterial if the loss or damage is due to negligence of his or some one else. The common carrier is responsible even if goods are stolen or destroyed or damaged not because of his fault or if the goods are handed over lo a wrong person. Thus you note that a private carrier is like a bailee and rules of Contract Act 1872 apply to him. If he is a common carrier then the Carriers Act, 1865 will apply.
The rights, duties and liabilities of a common carrier are governed by the Carriers Act 1865.

## 12.2.2 Rights of a Common Carrier

The rights of a Common Carrier are as follows:

1. To get remuneration: He is entitled to the agreed remuneration or reasonable remuneration if the amount was not already agreed. If no remuneration is payable he is 'gratuitious carrier and not a common carrier.
2. Lien on goods : He has a right of lien on goods carried for his charges which can be enforced against the consignor or the consignee who has to pay his charges. He has a particular lien over the goods, He can refuse to deliver the goods unless Ids charges have been paid.
3. Recover damages: He can recover damages from the consignor if goods are of a hazardous nature, or not properly packed and the carrier suffers injury therefrom. If the consignor discloses the nature of goods then damages cannot be recovered.
4. Refuse to carry goods: He is not bound to carry goods of all types under all circumstances. There are certain circumstances where the common carrier can refuse to carry goods. This we have already discussed.

5 Recover reasonable expenses : If the consignee refuses to take delivery of goods, he can recover reasonable expenses incurred by him. But he must take reasonable steps as are necessary under the circumstances.

6. **Limit** his liability : He can limit his liability under certain circumstances by entering into a special contract with consignor.

### 12.2.3 Duties of a Common Carrier

A common carrier has the following duties :

1. To carry goods for every person who chooses to employ him.
2. To carry goods safely. If goods are damaged he is responsible,
3. To follow the agreed route or the customary and usual route if no route is agreed between him and the consignor.
4. To deliver the goods in time or within a reasonable time if no time is agreed upon.
5. To deliver the goods according to the instructions of the consignor. If the consignee refuses to take delivery of goods, the common carrier becomes a bailee.

### 12.2.4 Liabilities of a Common Carrier

In order to determine the liabilities of a common carrier, goods may be classified into two types. These are : a) Scheduled goods, b) Non scheduled goods. The liability of a common carrier depends upon whether the goods are "Scheduled goods" or "Non scheduled goods". Scheduled goods are goods as enumerated in the schedule of the Common Carriers Act 1865, all other goods are known as "Non scheduled goods". Scheduled goods include, *inter alia,* gold and silver coins, ornaments, precious stones, clocks and timepieces of any descriptions, bills, hundies, bank notes, maps, writings, paintings, photographs, sculptures, works of art, glass, - china or marble. silk, shawls, furs, opium, articles of ivory, coral, sandalwood or ebony and musical and scientific instruments.

A carrier is not liable for loss or damage of scheduled goods over Rs. 100 if at the time of delivery their description and value are not expressly made known to the carrier. But he is liable if the goods are lost or damaged by gross negligence or any criminal act of the carrier himself, his servant or agent, and for unlawful act or misfeance, whether goods are scheduled or non scheduled. He cannot limit his liability in respect of scheduled goods by any special clause or contract with the consignor. Such limit shall be null and void. He is however entitled to charge extra freight for carrying scheduled goods.

As regards non-scheduled goods, carried by him, the liability of a common carrier is that of an insurer. He is liable for loss or damage to the goods while they are in transit, except when the loss is caused under exceptional circumstances. These circuinstances are: (a) an act of God, (b) damage caused by country's enemies, (c) defective packing, (d) fraud by the consignor, (e) inherent vice in the things carried.

In case of non-scheduled goods, the carrier may limit his liability'by a special clause or contract with the consignor.

In case of loss or damage, the claimant must inform in writing to the carrier his claim within six months of the date when he first knew of such loss or injury. Thus, in case of scheduled goods, the carrier cannot limit his liability, but in case of non-scheduled goods, he can limit his liability by a special contract or clause. The carrier is always liable for loss or damage to goods, caused by him or his agent's/ servant's negligence or unlawful acts.

As regards goods of dangerous character, the consignor is under a duty to inform the carrier. The consignor is liable, if an implied warranty exits to the effect that the goods are fit to be carried, even though the consignor is unaware of dangerous character of goods. If such implied warranty does not exist, the consignor is not answerable for loss, if the carrier knew about the dangerous character of the goods carried.

# 12.3 CARRIAGE BY RAIL

You have already read that carriage of goods over land may be by railways as well. Carriage by rail in India is regulated by the Indian Railways Act, 1890, as amended in 1961, 1972 and 1975. The 'Railway Administration' is the legal authority set up to look after the administration and working of railways.

Goods are transported by railways noimally by 'goods train'. Goods may be transported also in 'passenger trains' to ensure quick delivery. Perishable goods and small packages are transported by passenger trains but the freight charges for passenger trains are. higher than goods train. Before we discuss the administration of railways, let us note that there are two important documents used in carriage of goods by railways. These are : (a) Forwarding Note and (b) Railway Receipt.

(a) **Forwarding** Note

According to Section 72 of the Indian Railways Act 1890, every consignor of goods or animals has to execute a note in the form prescribed by the railway administration and approved by the central government. This note is called 'Forwarding Note or Consignment Note' and the required particulars are filled in by the consignor. For different types of goods there are different forms of consignment note. The consignment/forwarding note contains description of the goods, the train that is to carry the goods or animals, the number of packages, weight, the names and addresses of the consignor and the consignee, articles carried at owner's risk or railways risk. The note is also to contain particulars of articles of special value, goods with defective packages, or perishable goods or articles of dangerous nature. It may be marked either 'freight paid' or 'freight to pay' accordingly as consignor has paid the freight or consignee will pay the freight. The terms and conditions on which goods or animals are carried are printed on the back of the note.

**(b) Railway Receipt (R/R)**

After the consignor has submitted the forwarding note to the railway parcel office, the consignor is given a receipt by the railways, The receipt is called R/R (railway receipt). This receipt is the acknowlcdgrnent of the goods and is an undertaking to carry them according to the conditions printed at the back of the receipt and the instructions given by the consignor. This receipt is a document of title to the goods and a semi-negotiable instrument. This receipt is sent by the consignor to the consignee so that on presenting it at the destination to the railway office, the consignee can take the delivery of the goods.

## 12.3.1 Duties of the Railway Administration

Now we shall discuss the duties of the Railway Administration. The duties of the Railway administration laid down under Sec. 27, 27A, 28 and 42A of the Indian Railways Act. 1890 are as follows:

1. To afford all reasonable facilities for the receiving, forwarding and delivery of traffic without unreasonable delay.
2. Not to give any undue or unreasonable preference or advantage to, or in Iavour of, any particular person or any particular description of traffic, in respect whatsoever or subject any particular person or any particular description of traffic to any undue or unreasonable prejudice or disadvantages in any respect whatsoever.
3. To comply with any directions given by central government with regard to transport of goods. The central government is empowered to give special facilities or preference to the transport of any goods or class of goods consigned to central or state governments or such other goods or class of goods as may be specified in the order. Any action taken shall not be deemed to be in contravention of point 2 stated above. Any order so made shall cease to have effect after the expiry of six months from the date thereof. It may be renewed from time to time.
4. The Railway Administration is bound (like a common carrier) to carry goods of every person who is ready and willing to pay the freight and observes the other requirements.

## 12.3.2 Liabilities of the Railway Administration

You should note that railways are like common carriers in India and their liabilities are also like those of a common carrier. We shall now discuss their liabilities during and after transit and liabilities in case of goods of special value and in case of defective condition or packing, etc.

**1.** Liabilities during Transit : The Railway Administration is liable for loss, destruction, damage or deterioration of goods in transit. But the liability depends upon the instructions of the consignor in the forwarding note as to whether goods or animals are to be carried at 'railway's risk' (ordinary rate) or at 'owner's risk' (reduced rate). The rate of the former are higher than that of the latter. The goods or animals shall be deemed to have been tendered to be carried at 'owner's risk' rate unless the consigner or his agent elects in writing to pay the 'railway risk' rate. A certificate is issued by the railways for railway risk rate.

(a) Railway's Risk : If the goods are carried at 'Railway's Risk', the Railway Administration is liable for any loss or destruction etc., in transit in respect of goods, arising from any cause except the following:

(1) act of God, (2) act of war, (3) act of public enemies, (4) arrest, restrain or seizure under legal process, (5) order or restrictions imposed by the government, (6) Act or omission or negligence of consignor or the consignee or the agent or servant of either, (7) latent defects, (8) fire, explosion or any unforeseen risk. The position of Railway Administration is that of an insurer of goods and thus Administration will be liable if the goods are stolen, while in its custody, even without negligence on its part.

(b) Owner's **Risk** : The Administration cannot be made liable for any loss, destruction or damage, in transit of such goods, from whatever cause arising except upon proof that such loss or damage was due to negligence or misconduct on the part of the Administration or any of its servants. The position of the Administration is that of a bailee.

Thus there are two major differences between owner's risk and railway's risk. In case of owner's risk the liability of railways it is that of a bailee and in case of railway's risk it is that of an insurer. In case of the former the railway is liable only if the loss is caused by its negligence and in case of the latter the railway is liable (except in the cases given above) unless it proves that it had used reasonable foresight and care in the carriage of goods or animals.

Liability for delay or detention during transit : The Administration shall be responsible for loss etc, of goods or animals if the owner proves that such loss or destruction, damage or deterioration, was caused by delay, or detention in transit. It can, however, escape liability by proving that the delay or detention arose without negligence or misconduct on its part or on the part of its servants .

**2.** Responsibility of deviation **of** route : The Railway Administration shall not be guilty of breach of contract if due to causes beyond its control or due to the congestion in the yard or other operational reasons, goods or animals are carried over a route other than the route by which they are booked (the usual or customary route) .

**3.** Responsibility for Wrong Delivery: When the Railway Administration delivers the goods in good faith to the person who produces the original railway receipt, it shall not be responsible on the ground that such person is not legally entitled thereto or that endorsement on the R/R is forged or otherwise.

***4.*** Liability after termination of Transit : Transit terminates on the expiry of the free time allowed (after the arrival of consignment at destination) for its unloading from railway wagon without payment of demurrage and where such unloading has been completed within free time so allowed, transit terminates on the expiry of free time so allowed for removal of goods from railway premises without payment of wharfage.

Free time means time within which delivery of goods must be taken on arrival by the consignee. Demurrage is an extra charge to be paid if delivery of goods is taken after free time and wharfage is rent paid for accommodation occupied at railway godown.

**5.** Liability in case **of** articles of special value: Where any articles mentioned in second schedule of the Act (Articles of special value like gold, silver,.) are contained in a parcel or packages delivered for carriage and the value of such articles exceeds Rs. 500, the railways shall not be responsible for the loss, destruction etc. unless the consignor declared the value and contents thereof in the forwarding note and had paid higher freight, if required.

*6.* Liability for damage to **goods** in defective condition or packing : The Railway Administration shall not be liable for any loss goods are in a defective condition or defectively packed and such defect was noted by the consignor or his agent on the forwarding note. But it shall be liable if loss or damage etc.in such case was due to the negligence or misconduct on the part of administration or its servants.

### 12.3.3 Exoneration of Responsibility in Certain Cases

The Railway Administration shall not be responsible for any loss, destruction or non delivery of goods in the following cases:

a) Where the goods have been dispatched with a false description and the loss or damage is, in any way, brought about by false description.
b) Where a fraud has been committed by the consignee or consignor or agent of either.
c) Where it is proved by the Administration that loss or damage has been caused by or has arisen from either (i) improper loading or unloading by consignor or consignee or their agent, or (ii) riot civil commotion, strike, lock out, stoppage or restraint of labour from whatever cause, whether general or partial.
d) Where there is any indirect or consequential damage or loss of particular market.

### 12.3.4 Notice of Claim

The claim for damages can be made by the consignor The claim must be made within six months from the delivery of goods for carriage by the railways. The notice must be in writing and may be given to the Chief Commercial Superintendent or manager of railways. The claim for refund of any overcharge can be made either to the administration to which goods or animals were delivered or on whose railway the destination station lies or the loss, damage or destruction occurs.

Check Your Progress **A**

1. State whether the following statements are true or false:
   i) A common carrier carries persons and goods.
   ii) A common carrier can refuse to accept goods from any person.
   iii) Scheduled goods are goods of high value.
   iv) Railways are not liable for loss of goods due to theft.
   v) Responsibility of railway for goods consigned at railway risk is that of a bailee.

2. What is owner's risk?

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3. Define demurrage and a forwarding note.

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## 12.4 CARRIAGE BY SEA

### 12.4.1 Contract of Affrieghtment

In international trade, goods are mostly carried by sea, i.e., by ship. A contract of carriage of goods by sea is called 'contract of affreightment'. The consignor is called shipper and the consideration is called 'freight' i.e., the price of carriage of goods. **A** contract of affreightment may take either of two forms :

(a) Charter Party, (b) Bill of Lading.

Both these contracts are mainly governed by the Carriage of Goods by Sea Act 1925 and the Bill of Lading Act 1856. Note that two other related Acts to carriage by sea are Merchant Shipping Act 1958 and the Marine Insurance Act 1963.

A charter party is a contract where an entire, or a principal part, of a ship is hired. A bill of lading is a contract where the goods are carried in a general ship.

There are certain 'Implied warranties', in both these forms of contract. Let us discuss these warranties in detail before discussing charter party and bill of lading.

## 12.4.2 Implied Warranties

A warranty may be express or implied. Express warranties are those warranties which are decided by the parties and implied warranties are implied by law:

In a contract of affreightrnent, the following implied warranties are provided under Marine Insurance Act, 1963:

1. The ship is seaworthy and reasonably fit to encounter the 'perils of sea'. The ship should be seaworthy at the commencement of each stage of the voyage. It means that the ship is worthy to undertake the particular voyage and to carry the particular cargo. According to the Merchant Shipping Act 1958, a ship is unworthy when the materials of which she is made, her construction, the qualifications of the master, the number, the description and the qualification of the crew including officers, and the weight, description and storage of the cargo and ballast, the condition of her hull and equipment, boilers and machinery are not such as to render her in every respect lit for a proposed voyage or service.
2. The 'ship shall be ready to commence the voyage agreed on and to load the cargo to be carried and shall proceed upon and complete the voyage without all reasonable dispatch.
3. The ship shall carry out the voyage in the usual and customary manner. It shall not deviate from the prescribed or usual course, Deviation takes place even if the ship starts on a usual course, deviates later on and again resumes the usual course.
4. The shipper shall not ship dangerous goods or illegal cargo. Breach of warranty before the commencement of voyage gives right to repudiate the contract and claim damages, and after the commencement, gives a right to claim damages only.

## 12.4.3 Charter Party

You know that the contract of affreightment may take the form of (a) Charter Party or (b) Bill of lading.

A 'Charter party' is a contract of affreightment entered into for hiring the whole ship or a part of it to carry the goods, at the disposal of charterer, It binds the ship owner to carry the goods to a particular place on payment of freight. It also refers to the formal written document in which the contract of hiring of the whole or part of the ship is expressed.

You should note the following points:

a) The charter party may be under seal, but it must be stamped.
b) A bill of lading is issued as an acknowledgment of the receipt of goods in case of general ship and a charter party is a receipt of goods in case of a chartered ship. Thus bill of lading is different from charter party.
c) The bill of lading in case of a general ship must be signed by the owner or master of ship.

### 12.4.3.1 Kinds of Charter Party

A Charter party may be :
(a)' Time Charter party, or
**(b)** Voyage Charter party

**Time Charter Party is** for aparticular period.

**Voyage Charter party is** for aparticular Voyage.

Sometimes the terms of a charter party may operate as a lease (also called demise) of a ship. The ship is given on lease to the charterer by the ship owner. The charterer pays 'rental' to the ship owner. Alongwith the ship the master and crew also become the servants of the charterer. Such a contract of lease of a ship is not a contract of carriage but hiring of the ship itself.

### 12.4.3.2 Forms and Clauses of Charter Party

There is no specific form of a charter party. It differs from trade to trade depending upon the prevailing customs. There may be a special form used in a trade. However, it generally contains the following clauses:

1. Name and description of the ship owner and the 'charterer and the fact of their agreement.
2. The name of the ship, its rating (i.e. A or B etc.) with Lloyds Register and tonnage (measurement of the ship).
3. The location of the ship, place of loading and unloading.
4. The ship owner's guarantee that the ship is sea worthy and fit for the contemplated voyage.
5. The statement that the cargo shall be lawful merchandise both at the port of dispatch and the port of discharge. The weight and volume of cargo.
6. The names and places where the ship is to go in between.
7. The liability of the charterer to pay freight i.e. to be paid in advance or on completion of voyage. The charterer is under an obligation to pay the freight for full carrying capacity even if it is used not for only the quantity agreed upon. He has to pay 'dead' freight if he fails to produce or load the agreed amount of cargo.
8. Cesser Clause : Under this clause the charterer is exempted from liability when the cargo is loaded. The shipowner acquires a lien on cargo for nonpayment of freight and demurrage.
9. The duties of the Master or the captain of the ship.
10. Prosecution of the Voyage : A clause stating that the voyage shall be prosecuted with all convenient speed i.e., voyage shall commence soon after the clearance from port authorities has been obtained.
11. Delay through break down: In cases where delay is caused through break down of the machinery or other damage to the ship or the deficiency of the crew for 24 hours, the hire ceases till such time as the ship is again fit to sail.
12. Excepted Perils and Negligence : This clause contains those risks for which shipowner is not liable for the loss. Such risks are called 'excepted perils'. These perils arise from 'Act of God', the action of foreign enemies, restraints of princes and rulers, fire and every other dangers and accidents of the seas, rivers and navigation, of whatever nature and kind. The ship owner has to exercise reasonable care and diligence to avoid such perils.
13. Circumstances under which the contract shall be deemed as cancelled and the panalties to which the parties shall be liable for breach of contract.
14. Lay days and demurrage: Lay days are the days allowed for loading and unloading the ship, The charterer is liable to pay demurrage if loading or unloading takes more than lay days.
15. Delivery of goods in the usual manner: The master of the ship should have the ship properly moved when it reaches the port. He has to get the cargo out of the ship's and put them on the deck. Thereafter the charterer has to take the goods off the ship.

### 12.4.4 Bill of Lading

This is a very important document in the carriage of goods by sea.
A bill of lading is a document issued by the shipowner or his servant when the cargo is delivered for carriage to a general ship, The position of a shipowner is that of a common carrier,

When the goods are delivered on board a ship, a receipt is issued by the master of the ship. This receipt is called "MATE's Receipt".

A bill of lading may also be issued when entire ship is chartered. In that case, the bill of lading just serves as a receipt of goods.

A bill of lading must be stamped and signed by the shipowner. It must certain the following particulars:

a) The main terms of contract.
b) The leading marks necessary for identification of the goods; the marks must be legible till the end of the voyage.
c) The number of packages, pieces or the quantity or weight in writing.
d) The apparent order and condition of the cargo.

### 12.4.4.1 Characteristics of a Bill of Lading

A bill of lading is prima facie evidence of the following:

a) It is an acknowledgment of the receipt of goods on board. It is a symbol of goods during transit and remains till goods are delivered.
b) It is an evidence of the contract for the carriage of goods.
c) It is a document of title to goods. It is a "key which in the hands of a rightful owner is intended to unlock the door of the warehouse, floating or fixed, in which goods may be".
d) It contains the terms and conditions of the carriage of goods.
e) It is a semi Negotiable Instrument. It can be transferred to another person by indarsement and delivery, if the goods under the bill of lading are deliverable to a particular person or 'his order', and by mere delivery if the goods under the bill of lading are deliverable to the bearer, This characteristic of a bill of lading resembles that of a negotiable instruments, In strict legal sense it is not a negotiable instrument because the transferee takes it subject to all the defects of the transfer even though transferee took it bonafide and for value. It is negotiable in commercial sense.

### 12.4.4.2 Bill of Lading and Charter Party - Comparison

Now you are in a position to know that a Rill of Lading and `Charter Party' are different.

Following are the differences between the two :-

1. A bill of lading is an acknowledgment of the receipt of goods,on board the ship. A charter party is just receipt of goods.
2. A bill of lading is a document of title to the goods but the charter party is not such a document.
3. A bill of lading is not issued on lease of a ship, whereas a charter party contract is made on lease (demise) of a ship or part thereof.
4. A bill of lading can be transferred by endorsement and or delivery whereas a charter party cannot he transferred.
5. A bill of lading is for a particular destination and charter party may be for a particular voyage or time.

### 12.4.4.3 Forms and Kinds of Bill of Lading

There is no special form of a bill of lading. It differs from trade to trade and according to means of carriage. The bill of lading may be of the following types:

1. Clean bill of lading : Where the cargo is in apparent good order and condition and the bill of lading acknowledges this, it is called clean.
2. Foul or dirty or clausedbill of lading: When condition of the goods received for shipping is not good the words "shipped in good order and condition" are cancelled out. In such a case the bill of lading is foul (dirty or clauscd) bill of lading.
3. **Through** bill of lading : When goods are partly carried by sea and partly by land, the bill of lading issued is called "through bill of lading"
4. Freight **paid/Freight** collect bill of lading: The bill of lading is marked as 'freight paid' if it is paid in advance; if it is to be paid later it is `freight collect' bill of lading.
5. Stale bill of lading : It is that bill of lading which is retained by the consignor for a longer time than necessary.
6. Received Bill of Lading and On Board Bill **of Lading** : The received Bill of Lading is issued before the cargo has been loaded on board the ship and "on board" when the cargo has been loaded on board the ship.

## 12.4.5 Right of Stoppage in Transit

A consignor has right to stop the goods in transit. If a bill of lading is lawfully transferred to any person as buyer or owner of goods, and that person transfers the documents by way of sale to one who takes it in good faith and for value, the right of lien and stoppage in transit is defeated. But if the transfer is merely by way of pledge, the consignor has right to stop the goods in transit, subject to the payment or tender to the pledgee the amount of the advance.

## 12.4.6 Duties of a Carrier by Sea

In every contract of carriage of goods by sea, the carrier is subject to the following responsibilities:

1. The shipowner shall be bound, before and at the beginning of the voyage, to exercise due diligence to
   a) make the ship seaworthy
   b) properly man, equip and supply the ship
   c) make holds, refrigerating and cool chambers and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage and preservation.
2. The carrier must properly and carefully load, handle, stow, carry up, keep care for and discharge the goods carried.
3. The master or agent or the shipowner has to issue a bill of lading after the goods have been received.

## 12.4.7 Liabilities of a Carrier by Sea

1. **Loss or damage due to negligence:** The carrier of goods by sea is liable only for loss or damage arising from his negligence, fault or failure in the duties and obligations provided in the Act and not otherwise, He is not liable even for the loss caused by neglect or default of the master mariner, pilot or the crew in the navigation or in the management of the ship.
2. **No limitation :** The carrier cannot limit or lessen his liability arising from his negligence or failure in the duties and any clause in the contract to that effect shall be null and void,
3. **No liability for misstated value:** The carrier shall not be liable for any loss or damage to goods if the nature or value thereof has been knowingly misstated by the shipper in the - Bill of Lading.
4. **Extent of liability :** The carrier shall not be liable for loss or damage in any event to the goods in an amount exceeding £ 100 per package or unit, unless the nature and value of such goods have been declared by the shipper before shipment and, by agreement, fixed another maximum amount, provided that such maximum shall not be less than the figure above named.
5. **Liability in case of dangerous goods:** Goods of an inflammable, explosive or dangerous nature to the shipment, where of the carrier, master or agent of the carrier, has not consented, with knowledge of their nature and character, may, at any time before discharge, be landed at any place or destroyed or rendered innocuous by the carrier without compensation. The shipper of such goods shall be liable for all damages and expenses directly or indirectly arising out of or resulting from such shipment.
6. **Time Barred liability :** The carrier shall be discharged from all liability for loss or damage unless suit is brought within one year after delivery of the goods or the date when the goods shall have been delivered.

## 12.4.8 Shipowners' Lien and Maritime Lien

There are two types of rights available in case of carriage of goods by sea: (a) Shipowners', lien - this right is of shipowners, and (b) Maritime Lien - this right is available against the ship, cargo and freight. Let us explain them.

A shipowners' lien is the right of a shipowner to retain possession of goods carried by him until freight and other charges due to him under the contract of carriage have been paid. It is a possessory lien. Any charges paid over and above the freight by custom (e.g. tips) is called "PRIMAGE".

A "maritime lien" is a claim on ship, cargo and the freight in respect of services rendered to them. This right is given by law to all persons who have rendered some services to save the ship or cargo in time of danger. By virtue of this right, the parties can recover their charges from the shipowner or cargo owner. Until their charges are paid, the ship is not allowed to leave the port and ship or cargo may be ordered by the court to be sold. This right of lien is available to seamen for their wages, the holder of "bottomery bond" for his dues, persons who rescue ship or property from the charges in connection with salvage, and persons who have a claim against the ship, for damages caused by collision due to negligence.

A maritime lien can be exercised independently of possession of cargo or ship by filing a suit in a court.

### 12.4.9 Bottomry and Respondentia Bond

When a ship needs urgent repairs in course of its voyage and it is not possible for the master of the ship to communicate with shipowner to arrange the necessary funds, the captain of the ship may borrow money on the security of tlie ship or cargo by executing a bond. If only cargo is given as security, the bond is called "Respondentia Bond". If the ship, cargo and freight are hypothecated, the bond is called 'Bottomry Bond".

**Check Your Progress** B

1. Define Charter Party and Bill of Lading.

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2. Is bill of lading a negotiable instrument ?

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3. Define a contract of affreightment, Bottomery and Respondentia Bonds, Primage, Shipowners lien and Maritime lien.

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4. Tick (√) the statements that are true.
   i) Carrier is liable for loss or damage of goods even if misstated by the consignor.
   ii) The rights of an indorsee are different from the original holder of bill of lading.
   iii) Implied warranties in a contract of carriage of goods by sea can be waived by agreement.
   iv) Bill of Lading is 'negotiable instrument' in commercial sense.
   v) Lay days are days allowed for loading and unloading the ship.
   vi) Primage and Demurrage are same type of charges.

## 12.5 CARRIAGE BY AIR

In modem days, as you know, the goods can be carried by air quickly and to long distances. But carriage by air is expensive as compared to carriage by land or sea.

The carriage of goods and passengers by air in India is governed by the Carriage by Air Act 1972. This Act is based on Warsaw Convention 1929, as amended by the Hague Protocol signed in 1955.

The Carriage by Air Act 1972 contains two schedules. Scheduie I contains the Warsaw convention rules, which are applicable to international carriage by air of countries which have not yet signed the Hague Protocol. Schedule lI contains the amended rules (as amended in 1955) applicable to international carriage by air of countries which have signed the Hague Protocol. The Central government is empowered to make the rules contained in these schedules as may be applicable to internal (domestic) carriage by air. Some important defmitions under the Act are given below.

## 12.5.1 Definitions

There are certain definitions of some special terms used in carriage by air. Some of these definitions are given below:

**Convention** : It means the convention for the unification of certain rules relating to international carriage by air signed at Warsaw on 12-10-1929 [Sec 2(ii)] " Amended Convention" means Warsaw convention as amended by the Hague Protocol signed on 28-9-1955 [(Sec 2 (ii)].

**High Contracting Party:** It means all the parties originally signatories to tht: convention, together with those who adhere thereto subsequently. India is a signatory to the amended convention.

**International Carriage :** It means any carriage in which according to the agreement between the parties the place of departure and the place of destination, whether or not there be a break, in the carriage or transhipment, are situated either within the territories of two high contracting parties or within the territory of **a** single high contracting party if there is an agreed stopping place within the territory of another state, even if that state is not a High Contracting Party. Carriage between two points within the territory of a single High Contracting party, without an agreed stopping place within the territory of another state is not international carriage.

## 12.5.2 Documents of Carriage

Just as there are certain important documents used in carriage by land or by sea, similarly there are some important documents used by carriage by air. These are mainly : Passenger Ticket, Baggage check, and Air Way Bill. In Chapter II of the Second Schedule to the Act the documents of carriage have been mentioned.

a) **Passenger Ticket** : This ticket is issued for carriage of passengers, indicating the place of departure and destination (embarking and disembarking) and place of one or more agreed stopping places. This ticket is a prima facie evidence of the conclusion, and conditions of the contract of carriage. The absence, irregularity or loss of the passenger ticket does not affect the existence of the validity of the contract of carriage (Rule 3).

b) **Baggage Check (Luggage Ticket)** : This check is issued for the carriage of luggage, other than small personal objects of which passenger takes charge himself. It is made out in duplicate, one part is for the passenger and the other part for the carrier. The ticket constitutes ***prima*** facie evidence of the registration of the luggage and cortditions of the contract of carriage. The absence, irregularity or loss of baggage check does not affect the existence or the validity of the contract of carriage. But if the carrier accepts baggage without delivering a baggage check, he shall not be entitled to the benefit of the provisions which limit his liability in respect of loss of, or damage to, the baggage.

c) **Airway Bill (Air Consignment Note)** : This note is prepared by the consignor, in triplicate, one copy for the carrier, one for consignee and one for consignor. The airway bill is signed and stamped by the carrier. The absence, irregularity or loss of airway bill does not affect the existence or the validity of the contract of carriage. But, if the carrier allows the loading of cargo on board the aircraft without an airway bill, his liability shall not be limited.

The airway bill contains many details including the name and address of the consignor and consignee, the nature of goods, the amount of freight, conditions of goods, number of packages, place of departure and destination, value of goods and other documents handed over alongwith the airway bill.

The consignor is responsible for the correctness of the note and liable to pay for loss suffered by the carrier for incorrect airway bill.

The airway bill may be negotiable. It is the prima facie evidence of the conclusion of the contract.

### 12.5.3 Right of Disposition of Cargo

The consignor has the right to dispose of or call back or stop,the cargo at any time before it is handed over to the consignee. He can change the name of the consignee as well. He has a right to dispose of or call back the cargo if the consignee declines to accept the airway bill or cargo.

### 12.5.4 Rights of the Consignee

Unless it is otherwise agreed, the consignee has the right to receive notice from the carrier as soon as the cargo arrives at the port of destination.

The consignee has right to receive the airway bill and on payment of charges to take delivery of the cargo. On loss or arrival of cargo after seven days from the date on which it ought to have arrived, the consignee may enforce the right as agreed upon in the contract.

### 12.5.5 Liabilities of a Carrier

The carrier by air is liable to pay damages if (a) destruction, loss or damage is caused to any registered baggage or any cargo during the carriage, i.e., period during which the baggage or cargo is in charge of the carrier in any place; (b) the damage is occasioned by delay in the carriage of baggage or cargo.

### Limit to carrier's liability

The carrier is not liable to pay damages if he proves that the damage was caused or contributed to by the negligence of the injured person or he and his servants or agents have taken all necessary measures to avoid the damage or that it was impossible for him or them to take such measure.

The maximum liability in case of loss or damage or delay is limited to a sum of 250 Franks per kilogram, unless the consignor has made a special declaration showing the value of the package and has paid additional freight if the case so requires. The carrier will be liable to pay a sum not exceeding the declared sum, unless the declared value is greater than the real value. In case of loss or damage or delay of part of registered baggage or cargo the amount of liability of the carrier is limited to the damaged part of the cargo rateably unless the damaged cargo affects the value of other packages covered by the same airway bill.

### In Case of Passengers

Though we have to read only about liabilities of the air carrier for cargo, yet for general information you should know about liabilities of air carrier in case of passengers,

a) **In the event of** death **or** bodily **injury:** The carrier is liable for damage sustained in the event af the death or injurs of a passenger or any other bodily injury suffered by a passenger, if the accident which caused the damage so sustained took place on board the aircraft or in the course of operations of ernbarking or disembarking. The liability of the carrier for each passenger is limited to 1,25,000 Francs (raised in the second schedule to 2,25,000 Francs).

b) **Luggage in** charge **of** the passenger: As regards objects of which the passenger takes charge himself, the liability is limited to 5000 Francs per passenger. The carrier's liability cannot be lower or he cannot be relieved of this liability. An action can be taken for damages, in case of death of the person liable in accordance with these rules, against those legally representing his estate.

You should note the following points:

a) These rules apply equally to gratuitous cairiage by aircraft performed by an air transport carrier.
b) These rules do not apply to carriage of mail and postal packages
c) These rules apply notwithstanding anything contained in rule of law in force in any part of India.

d) Receipt by the person entitled to delivery of luggage or goods without complaint is *prima facie* evidence that the same have been delivered in good condition.

e) In the case of damage of cargo, the person entitled to delivery must lodge a complaint within three days from the date of receipt of goods and in case of delay within fourteen days from the date on which luggage or goods have been placed at his disposal. If no complaint is lodged within prescribed time, no action lies except in case of fraud on the part of the carrier.

**Check Your Progress C**

1. Who prepares an airway bill ?

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2. What documents of carriage are to be issued when goods and passengers are carried by air ?

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3. How far can the liability of a carrier be modified by a special contract ?

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4. What is the minimum liability of a carrier by air ?

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5. What is a consignment note ?

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## 12.6 LET US SUM UP

Goods may be carried by either land or sea or air, The carriers are persons who carry goods and are of two types : (a) common carriers (b) private carriers. A common carrier carries goods of any one who employs him and a private carrier carries goods only for selected persons. A common carrier can refuse to carry the goods under certain circumstances.

**Carriage** by **Rail:** It is governed by the Indian Railways Act, 1890 and may be at owner's risk rate or railway risk rate. In case of owner's risk rate the railways' liability is like that of a bailee and in case of railway risk it is like that of an insurer. The railways ace liable for delay or detention of goods during transit. The railways are not liable for loss or damage to goods for deviation of route, delivery of goods to a wrong person who providzs receipt, or for goods in defective condition. The liability of railways for any loss of goods within a period of seven days after termination is that of a bailee.

**Carriage by Sea: A** contract of carriage of goods by sea is called "Contract of Affreightment", and may be (a) a charter party where the entire ship or part of it may be hired, or (b) a bill of lading, where the goods are to be carried in a general ship which is ready to carry the goods of any person who intends to use it for that purpose. The implied warranty in a contract of affreightment is that the ship should be sea worthy, should not deviate from the usual or customary route and voyage should be legal.

A charter party is an agreement by which a shipowner agrees to place an entire ship or a part of it at the disposal of the merchant for carriage of goods. In case of a charter party, a bill of lading is used only as a receipt of goods. A time charter party is a contract for a definite time period and a voyage charter party is for a definite voyage.

A bill of lading is a *prima facie* evidence of (a) acknowledgement of the receipt of goods, (b) document of title to the goods, (c) evidence of a contract, (d) and terms and conditions of the carriage of goods. It is strictly not a negotiable instrument.

**Carriage by Air:** The carriage of goods and passengers by air in India is governed by the carriage by Air Act 1972.

The document of carriage by air for luggage of passenger is called 'Baggage check' and is issued by the airline. For cargo the consignor prepares a "consignment note" giving details of the cargo. The consignor has a right to dispose of the cargo. The carrier's maximum liability is limited under the Carriage by Air Act 1972.

## 12.7 KEY WORDS

**Common Carrier :** A carrier who undertakes for hire to transport goods from one place to another of any person who chooses to employ him.

**Act of God :** This is some unforeseen accident caused by the forces of nature e.g. floods, earthquake, etc.

**Scheduled Goods :** These are goods which are enumerated in a schedule to the Common Carriers Act, 1865.

**Contract of Affreightment :** A contract of carriage of goods by sea.

**Charter Party :** A contract of carriage of goods by sea where the entireship or a part of it is hired.

**Bill of Lading:** It is a document which acknowledges the receipts of goods. It is a document of title to the goods and is a semi negotiable instrument.

**Lay days:** The days allowed for loading and unloading the ship.

**Mate's Receipt:** A receipt given by the master of the ship to the shipper.

**Primage:** In olden days tips used to be paid to master of the ship over and above the usual freight; such tips are called primage.

**Bottomry Bond :** A bond executed by the captain to borrow money for repairs on the security of the ship, cargo and freight.

**Respondentia bond:** A bond executed by captain for borrowing money on the hypothecation of cargo only.

**Airway Bill/Consignment Note:** It is prepared by the consignor in three parts, giving details about the cargo.

**Baggage Check :** It is also called luggage ticket i.e, the ticket given by airlines to the passenger for the baggage.

**High Contracting Party :** All the parties who were originally signatories to the Warsaw Convention 1929, together with those who adhere thereto subsequently.

## 12.8 SOME USEFUL BOOKS

Kapoor N. D. Elements of Mercantile Law Sultan Chand & Sons, New Delhi (Chapter 9, Part 2)

Chawla R. C. and Garg K. C. Mercantile Law Kalyani Publishers, New Delhi (Chapter 1-3, Law of Carriage)

## 12.9 ANSWERS TO CHECK YOUR PROGRESS

A (i) False (ii) False (iii) False (iv) False (v) True
B (i) False (ii) False (iii) False (iv) True (v) True (vi) False

## 12.10 TERMINAL QUESTIONS/EXERCISES

1) State the respective rights, duties and liabilities of common carriers and private carriers. To what extent Railways in India discharge the duties of carriers?

2) Define a contract of affreightment. What are the implied warranties in a contrct of carriage by sea? If any of them is broken, what is the legal consequence ?

3) Distinguish between a bill of lading and charter party. What are their characteristics ?

4) What are the duties and liabilities of carrier under Carriage of Goods by Sea Act 1925?

5) What 'documents of carriage' are to be issued, when goods and passengers are carried by air under the second schedule to the Carriage by Air 1972 ? Discuss fully.

6) What is a consignment note ? Who prepares it ? What is its purpose ?

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

# UNIT 13 DEFINITION AND REGISTRATION OF PARTNERSHIP

**Structure**



## 13.0 OBJECTIVES

After studying this unit you should be able to:

- define partnership and explain its characteristics
- determine whether a group of persons is or is not a partnership
- distinguish between partnership and co-ownership
- distinguish between partnership and Joint Hindu Family
- explain how registration of a partnership firm can be effected and what are the consequences of non-registration
- describe different types of partners
- explain the position of a minor when he is admitted to the benefits of the firm.

## 13.1 INTRODUCTION

Partnerships in India are governed by the Indian Partnership Act, 1932. Partnership is formed as a result of an agreement between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Hence, the general principles of law of contracts and agency (as contained in the Indian Contract Act 1872) also apply to partnerships except where the Act specifically provides to the contrary. The Act mainly contains the provisions relating to the formation of partnership, the rights, duties and liabilities of partners and the procedure for its dissolution etc. In this unit you will learn about the definition and test of partnership, its difference with co-ownership and Joint Hindu Family, the procedure for its registration, and various types of partners including the position of a minor partner.

## 13.2 DEFINITION AND CHARACTERISTICS

In simple words, a partnership is an association of persons who have agreed to share the profits of business. The persons who have entered into partnership with one another are called individually as 'partners' and collectively a 'firm' and the name under which their business, is carried on is called the 'firm's name'.

Section 4 of the Indian Partnership Act has defined partnership as ***Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.***

This definition clearly indicates the following characteristics of partnership.

1 It is an association of two or more persons.
2 It must arise out of an agreement.
3 The agreement must be to carry on a business.
4 The agreement must be to share the profits of the business.
5 The business must be carried on by all or any of them acting for all.

All the above elements must be present before an association of persons can be called a partnership. Let us now discuss these elements one by one.

**Two or more persons :** There should be at least two persons to form a partnership if the number of partners gets reduced to one by any reason, say death or insolvency of partner it would cease to be a partnership. As for the maximum number of partners in a firm, the partnership Act is silent. However, Section 11 of the Indian Companies Act limits the maximum number of partners to ten in case of a banking business and 20 in case of any other business. If the number exceeds this limit, the partnership becomes an illegal association. Thus, in any partnership firm the number of partners should not exceed 20, and if it carries on a banking business, it should not exceed 10.

**Agreement between persons :** A partnership originates from an agreement between persons. This agreement may be express (written or oral) or implied. It should also be noted that a partnership does not arise out of status as in the case of Joint Hindu Family or by operation of law as in the case of co-ownership. It is essentially the creation of a contract between two or more persons and all elements of a valid contract must be present. For example, the persons must be competent to contract, the object of partnership must be lawful, and so on.

**Business :** Partnership can be formed only for the purpose of carrying on some business. An association created primarily for charitable, religious and social purposes are not regarded as partnership. Similarly, when two or more persons agree to share the income of a joint property, it does not amount to partnership. Such relationship is termed as co-ownership. According to Section 2(b) of the Act, the term 'business' includes every trade, occupation and profession. Thus, business does not refer merely to trade or industry, but also includes profession like architecture, legal practice, chartered accountancy, etc.

**Sharing of profits :** Sharing the profits of business is the essence of partnership. Unless otherwise agreed, sharing of profits of a business implies sharing of its losses as well. However, a person can become a partner on the understanding that he will not share the losses. The ratio in which the profits and losses will be shared is a matter of agreement amongst the partners, It should be noted that though sharing of profits of a business is essential, it does not follow that everyone who participates in the profits of a business is necessarily a partner. For example, a manager who as a part of his remuneration shares in profits of the business can only claim to be an employee of the firm and not a partner.

**Business carried on by all or any of them acting for all :** The underlying principle which governs partnership is the agency relationship amongst the partners. The business of the firm may be carried on by all the partners or by any of them acting for all. This means that a partner is both an agent and a principal. He can, by his acts, bind the other partners and is bound by the acts of the other partners. Thus, the partners have relationship of mutual agency between them and the ***law of partnership is regarded as an extension of the general law of agency.***

It should also be noted that it is not essential that all partners should actively participate in business, The business may be managed by one or two partners and the remaining partners will be bound by their acts provided such acts relate to carrying on the business of the firm and have been done in the name of the firm.

## 13.3 TEST OF PARTNERSHIP

According to the Partnership Act, the liability of partners is joint and several. It means that the creditors of a firm can realise their dues from any partner of the firm. It is quite possible that a person, in order to escape his liability, may deny the fact of his being a partner in the firm. In such a situation, it becomes necessary for the creditors to prove that the person concerned is a partner in the firm

To determine whether or not a group of persons constitutes partnership and whether a particular person is or is not a partner in the firm, we have to ascertain the real relationship amongst the parties. If the parties have drawn an express contract, their real relation may be known from the terms of partnership contract. But, if they have not drawn an express contract, their real relationship is to be gathered from other relevant factors such as conduct of parties, circumstances under which the contract took place, books of account, statement of employees, etc. Section 6 of the Act clearly states that *in determining whether a group ofpersons is or is not afirm, regard shall be had to the real relation between the parties as shown by all relevant facts taken together.*

When all the facts taken together show that all essential elements of partnership as outlined earlier are present, the group shall be regarded as partnership. It needs to be emphasised that *sharing of profits is an important evidence of partnership.* In other words, if a person has been sharing profits of a business he is normally regarded as a partner. But it is not true in all cases. There may be persons who are in receipt of a share in profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, but are not partners. Such persons are:

i) Creditors of the firm who, on having lent money to the firm, may agree to take a share in profits;
ii) the widow or child of a deceased partner who receives share of profits of business as annuity;
iii) a person receiving a share of profit in consideration of sale of business or goodwill of the business that he has sold to the firm, and
iv) a servant or an agent receiving share in the profits of the business in consideration of his association with the firm.

**Examples**

1 A and B who are partners in a firm, borrow money from C who lends it on the condition that'he will take 10% share in profits and have the right to inspect the hooks of accounts. Despite these factors C cannot be regarded as a partner because there was no intention to associate C as a partner.

2 B, a contractor, appointed one of his servants to manage his business of loading and unloading railway wagons. The servant was to receive 50% of the profits of this business and also bear the losses, if any. The servant was simply an agent of B, and not a partner,

Similarly, two persons who jointly own a house, let it out on a rent of Rs. 6,000 per annum and share the rental income equally, are not regarded as partners. They are simply co-owners of the property. As per explanation 1 to Section 6, the joint owners of some property sharing profits or gross returns arising from the property do not become partners.

While there can be no partnership without sharing of profits of the business, sharing of profits alone does not constitute partnership. *The true test* of *partnership* lies in *the existence of mutual agency relationship i.e., the capacity of* a partner to bind other partners by his acts done in firm's name and be bound by the acts of other partners. This relationship of principal and agent distinguishes a partnership from co-ownership and the simple agreements for sharing profit. It should also be noted that the following persons are not deemed to be partners:

i) The members of a Joint Hindu Family carrying on family business.
ii) A Burmese Buddhist husband and wife carrying on a business.

## 13.4 PARTNERSHIP AND CO-OWNERSHIP

As staled earlier, sharing of profits or gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such persons partners. Thus, the mere fact that two or more persons own some property jointly and share its income does not mean that they are partners. They are called co-owners. For example, sons who inherit some property from the father, are not partners though the property were to be managed jointly and its income shared by them. Such relationship is regarded as co-ownership. If, however, the sons enter into an agreement to run a coffee house in that building and share the income thereof, they will be regarded as partners.

***According to Lord Lindley the main points of difference between co-ownership and partnership are as follows:***

1 Co-ownership is not necessarily the result of an agreement, but partnership is.

2 Co-ownership does not necessarily involve profit or loss, but partnership does.

3 One co-owner can, without the consent of the others, transfer his interest to a stranger. A partner cannot do this without the consent of all the other partners.

4 A co-owner is not an agent of the other co-owners, but a partner is.

5 A co-owner has no lien on the property owned in common for outlays or expenses nor for what may be due from the others as their share of a common debt, but a partner has.

6 Co-ownership does not necessarily exist for the sake of gain, but partnership exists for no other purpose.

Besides the above differences, a few more points of distinction between the two are also worth noting. These are:

7 In co-ownership there is no maximum limit of co-owners. In partnership the maximum limit of partners has been fixed at 10 for a banking business and 20 for any other: type of business.

8 Co-ownership does not necessarily involve carrying on of a business but a partnership does.

9 A co-owner has the right to claim partition of property owned with other co-owners. A partner has no such right. He can simply sue the other partners for the dissolution of the firm and accounts.

## 13.5 PARTNERSHIP AND JOINT HINDU FAMILY

Joint Hindu Family is a unique form of business organisation prevailing only in India. It is the business which belongs to Hindu undivided family and is governed by the provisions of Hindu Law.

In Hindu Law there are two schools :

a) *Mitakshara* : It is applicable to the whole of India except Bengal and Assam. According to this school, a Hindu inherits property from his father, grandfather and great-grandfather. Thus, three successive generations in the male line (son, grandson, and great-grandson) inherit the ancestral property. They are called coparceners' and the senior most member of the family is called *'Karta'*. The Hindu Succession Act, 1956 has extended the line of coparcenary interest to female relatives of the deceased coparcener or male relatives claiming through such female relatives.

b) *Dayabhaga* : It is applicable in Bengal and Assam. According to this, the male heirs become members only on the death of the father.

According to Hindu Law. a business is an inheritable asset. After the death of a Hindu, the business will be jointly owned by all the coparceners. The elder person among the coparcencrs becomes the new Karta and manages the business. If any property is inherited from any other relative, or acquired from personal resources. such property is regarded as personal property and treated as distinct from ancestral property.

*Important features of the Joint Hindu Family firm are* :

1 Business is managed by the senior member of the family called Karta. Other members do not have the right to participate in the management of the firm.

2 Other members cannot question the authority of the Karta. Their only remedy is to get the family dissolved by mutual agreement.

3 Karta has the power to borrow funds for the business. The liability of the Karta is unlimited whereas the other coparceners are liable only to the extent of their share in the business.

4 If the Karta has misappropriated the funds of the business, he has to compensate the other coparceners to the extent of their shares in the joint property.

5 The death of any member of the family does not dissolve the business of the family.

6 Through mutual agreement, the Joint Hindu Family firm can be dissolved.

Comparing the above features of a Joint Hindu Family with the essential characteristics of a partnership firm, we can easily ascertain ***the points of difference between the two.*** These can be summarised as follows.

1 Creation : Partnership comes into existence by 'an agreement. A Joint Hindu 'Family is created by status or operations of law, no agreement is needed for it.

**2 Regulating law** : A partnership is governed by the provisions of the Indian Partnership Act, 1932. A Joint Hindu Family business in governed by Hindu Law.

**3 Admission of new members** : No person can be admitted to the existing partnership without the consent of all the other partners. A person becomes a member (coparcener) in Joint Hindu Family merely by his birth.

**4 Minor member** : A minor cannot become a partner in a firm, he can be admitted only to the benefits of the firm. In Joint Hindu Family, a person becomes a coparcener right on his birth.

**5 Number of members :** There is a limit on the number of partners in a firm. But, there is no limit on the number of coparceners in Joint Hindu Family.

**6 Authority for active participation** : Each partner can participate in the business of the firm and bind the other partners by his acts. In Joint Hindu Family this authority rests with Karta only. Of course, the other members can be allowed by Karta to take part in family business.

**7 Liability of members** : In partnership, the liability of all the partners in unlimited; they are personally liable to third parties for the debts of the firm. In Joint Hindu Family only Karta's liability is unlimited, the other coparceners liability is limited only to their shares in the family property.

8 **Right to demand accounts** : Each partner has a right to inspect and copy the account books and, on severing connections with the firm, he can demand even the account of the past dealings. The coparceners have no right to ask for the account of part dealings, they can ask for the position of the existing assets only.

9 **Death of a member :** In the absence of any agreement to the contrary, partnership is dissolved on the'death of any partner. The Joint Hindu Family continues to operate even after the death of a coparcener.

**Check Your Progress A**

1 Assess the following situations. Can the relationships given below be called partnership. Answer in Yes or No.

i) Two computer firms, each having 12 partners, combine by agreement into one firm.

ii) A and B jointly own a car which they use for themselves on sundays and holidays, and occasionally they let it on hire and divide the earnings equally.

iii) Several men form an association to which each member contributes Rs. 1000/- annually. The purpose is to produce sarees for free distribution to refugees.

iv) Two brothers A and B convert their family house into a hotel and agree to divide equally the earnings from this business. Each of them also acts as the agent for each other and that of the business.

v) B has a business styled as B & Co. He employed X as manager of the business who is entitled to 50% share in profits.

2 Fill in the blanks.

i) The maximum number of partners in a partnership firm may be ..... in case of an ordinary business and .....in case of a banking business.

ii) Partnership is created neither by .....nor by operation of law.

3 Tick mark the correct answers.

a) Sharing of profits is
   i) a conclusive test of partnership
   ii) merely a strong evidence of partnership

b) In a co-ownership
   i) the maximum number of co-owners can be 10.
   ii) there is no limit on maximum number of co-owners.

c) Carrying on a business is the necessary characteristic of
   i) partnership
   ii) co-ownership.

## 13.6 PARTNERSHIP DEED

You have learnt that a partnership is formed by an agreement. This agreement may be oral or in writing. But, in order to avoid any dispute, with regard to the terms of partnership, it is considered desirable to have it in writing. The document in which the terms of partnership as agreed by the partners arc set forth, is called a 'partnership deed'. It should be drafted with care and signed by all the partners. The partnership deed usually covers the following.

1 Name of the firm
2 Names and addresses of all partners
3 Nature and place of business
4 Date of commencement of partnership
5 Duration of partnership
6 Amount of capital contributed or to be contributed by each partner
7 Management of firm's business
8 Ratio of sharing profits and losses
9 Interest, if any, on partners' capital and drawings
10 Interest on loan advanced by a partner to the firm
11 Salaries, commission, etc., if payable to any partner
12 The safe custody of books and other documents
13 Mode of auditor's appointment, if any
14 Rules to be followed in case of admission
15 Retirement, death, etc. of a partner
16 Method of settling disputes amongst partners
17 Settlement of accounts on dissolution of the firm

It should be noted that the terms laid down in the partnership deed may be varied by the consent of all the partners. But, it should not contain any terms which are in contravention with the rules given in the Partnership Act.

## 13.7 REGISTRATION

Registration means getting the partnership registered with the Registrar of firms of the area in which the place of business of the firm is situated or proposed to be situated. Under the Partnership Act, it is not compulsory for a partnership firm to get itself registered. Hence, it is for the partners to decide whether to get their firm registered or not. But, indirectly, by creating certain disabilities from which an unregistered firm suffers, the law has made the registration of firms desirable, These disabilities are such that. sooner or later, every firm has to get itself registered. It should be noted that registration does not create a partnership. It is only an evidence of the existence of a partnership, and the facts entered in the records of the Registrar

of firms are treated as conclusive proof by the courts.

## 13.7.1 Procedure for Registration

Since, registration of a firm is not compulsory, it can be effected at any stage. When the partners decide to get the firm registered, they have to file a statement in the prescribed form and send the same along with the prescribed fees by post or deliver it to the Registrar of Firms of the area in which any place of business of the firm is situated or is proposed to be situated. The statement must be signed by all the partners or by their authorised agents. It shall state

a) the name of the firm;
b) the principal place of business of the firm;
c) the names of other places where the firm carries on business;
d) the date when each partner joined the firm;
**e)** the names in full and permanent addresses of the partners; and
f) the duration of the firm.

As required under Section 58(1), the contents of the statement should be duly verified by the persons signing it. Further, the firms are restrained from using the words in the name such as 'Crown', 'Emperor'. 'Imperial', 'Royal', etc, or any other such name by which it would appear as if the firm has some sanction or patronage of the government. When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the statement in a register called 'Register of Firms' and shall file the statement. He shall then issue a certificate of registration. If, later on, any change is made, (i) in the name of the firm, (ii) in the location of its principal place of business, (iii) in the names and/or addresses of partners, or (iv) in the constitution of the firm, the same should be duly notified to the Registrar so that he can incorporate the same in the register of firms.

## 13.7.2 Effects of Non-Registration

As stated earlier, though registration of firms in India is not compulsory. But, it is considered desirable because if the firm is not registered, it suffers from many disabilities. These disabilities have been clearly stated in Section 69 of the Act and are termed as 'effects of non-registration'. These are summarised below.

1 **No suit can be filed in a civil court by a partner against the firm or the other partners:** If any dispute arises among the partners or between a partner and the firm or between a partner and the ex-partners, and the dispute is related to the rights arising from the partnership agreement or to the rights conferred by the Partnership Act, a partner of an unregistered firm cannot file suit against the firm or the partnerlpartners. This is possible only when the firm is registered and the person has been shown in the register of firms as a partner in the firm. Thus, if a partner of an unregistered firm is not paid his share of profits, he cannot claim it through the court. However, criminal proceedings can be brought by one partner against the other(s). For example, if a partner steals the property of the firm or puts fire to the buildings of the firm, any partner can prosecute him for the same.

2 **No suit in a civil court by the firm against third parties :** An unregistered firm cannot file a suit against a third party to enforce any right arising from contract, Fur example, such firm cannot go to the court for the recovery of the price of goods supplied. Of course, criminal proceedings can be brought against the wrong doers. It may be noted that if the third party has any claim against the firm or its partners it can certainly file a suit. Thus, it is only a suit by the firm or its partners against a third party which is prohibited and not a suit by the third party against the firm or its partners.

3 **The firm or its partners cannot make a claim of set-off or other proceedings based upon a contract :** The above two disabilities also apply to a claim of set-off or other proceedings to enforce any right arising from a contract, Thus, if a third party sues the firm to recover a sum of money, the firm cannot claim a set-off, i.e., the firm cannot say that since the third party also owes some money to the firm the same should be adjusted against the claim in qucstion.

**Exceptions**

Non-registration of a firm 'does not. however, affect the following rights :

1 The right of third parties to sue the firm or any partner,

2 The right of the firm to institute a suit or claim of set-off if the value of suit does not exceed Rs. 100.

3 The right of partners to sue for the dissolution of the firm or for the accounts of a dissolved firm, or the right or power to realise the property of a dissolved firm i.e., for claiming share of the assets of a dissolved firm or for recovering money from the firm's debtors.

4 The power of an official Assignee, Receiver or Court to realise the property of an insolvent partner and to bring an action on behalf of the insolvent partner.

5 The rights of the firm or the partners of the firm having no place of business in India.

*6* The right of an unregistered firm to bring a suit to enforce a right arising otherwise than out of a contract.

It must now be clear to you that though there is no compulsion under the law that a firm must be registered, the disabilities that beset a firm make it advisable to register it.

**Check Your Progress B**

1 Answer the following by stating Yes or No.

i) A, a publisher, agrees to publish, at his own expense, a book written by B and to pay to B half of the net profits. Can B claim half share? Is B liable to C, a paper merchant who had supplied paper to A for B's book'? .....

ii) The sole proprietor of a business dies and his heirs inherit his business. Are heirs partners? .....

iii) A, a sole owner of firm, admits B as a partner. B does not bring any capital. He is not liable for any loss and is to receive salary every month in lieu of profits and have all powers of a partner. B deals with third parties. Will he bind the firm? .....

**2** State whether each of the following statements is True or False.

i) Registration of firm is compulsory under the Indian partnership Act. .....

ii) Registration of firm provides protection to,the outsiders dealing with the firm. .....

iii) An unregistered firm can sue a third party to enforce any right arising out of a contract. .....

iv) A firm whether registered or not, can always claim a set-off in proceedings instituted against it by a third party. .....

v) In case of an unregistered firm the official assignee or receiver can realise the property of an insolvent partner. .....

## 13.8 DURATION OF PARTNERSHIP

While forming a partnership firm the partners may fix some specific term for its duration or decide that it may be terminated any time at will of the partners. Thus, a partnership firm in terms of duration can be (i) partnership at will, or (ii) particular partnership.

**Partnership at will** : When there is no provision in partnership agreement for duration of the partnership, the partnership is called 'partnership at will' (Sec. 7). In such a situation, the partners are free to terminate their relationship at will i.e, simply by giving a notice to that effect to al! other partners. Thus, such partnership is for an indefinite period.

**Particular partnership**: When a partnership is formed for a specific venture or for a particular period, it is called particular partnership (Sec. 8). Such partnership automatically comes to an end on the completion of the venture or on the expiry of the period. If, however, the partners want to dissolve the partnership before the fixed period, it can be done only by the mutual consent of all the partners. Similarly,

if the partnership is continued after the expiry of term or completion of the venture, it is deemed to be a partnership at will.

## 13.9 PARTNER, FIRM AND FIRM'S NAME

As stated earlier (13.2), persons who have entered into partnership are individually called 'partners' and collectively "a firm", and the name under which their business is carried on is called the "firm name" (Sec. 4). In law "a firm" is only a convenient phrase for describing the group of partners. But, ***the firm has*** no ***legal existence apart*** from ***the partners.*** It is not a separate entity like a company. It is simply a collective name of members of a partnership firm.

As regards the "firm name", partners are free to choose any name and style provided they do not violate the rules relating to trade name or goodwill. They must not adopt a name calculated to mislead the public into confusing them with a firm of repute already in existence with a similar name. They must not use a name implying the sanction or patronage of the Government.

## 13.10 TYPES OF PARTNERS

An outsider dealing with a firm must know who the partners in the firm are and to what extent each partner is liable. This becomes all the more necessary when there is default'by the firm. The extent of partner's liability, to some extrnt, can be ascertained with reference to the type of partners they are. Hence it becomes necessary to know what are the various types of partners. They are as follows :

i) **Active or ostensible partner : A** person entering into partnership by contract and taking active part in the conduct of business is called 'active' or 'ostensible' partner. For all acts done in the ordinary course of business he acts as an agent of other partners, He thus, has the capacity of binding himself and other partners vis-a-vis the third parties for all acts done in the firm's name and in the ordinary course of business. In the event of his retirement he must give a public notice of his retirement in order to absolve himself of liabilities for acts of other partners done after his retirement.

ii) **Sleeping or dormant partner : A** sleeping partner is one who contributes to the capital of the firm and has a share in the profits of the firm. Rut, he does not take an active part in the conduct of the business of the firm. Though the third parties'may be unaware of his existence as partner, he is equally liable for all debts of the firm like an undisclosed principal. In the event of his retirement from partnership, however, he need not give a public notice.

iii) **Nominal partner :** A partner who neither contributes to the capital of the firm nor takes a share in the profit or takes part in' the management of the firm is called 'nominal partner'. Such a partner merely lends his name to the firm and does not have any real interest in the affairs of the firm. But he, along with other partners is liable to third parties dealing with the firm only for all the debts of the firm.

iv) **Partner in profits only :** If it has been agreed among partners that a particular partner shall have a share in the profits only and not he liable for losses, such a partner is known as 'partner in profits' Towards the thud parties, however, he is liable for all the acts of the firm Since the liability of partners is joint and several, he may have to contribute the major share if the firm hears heavy losses and other partners are not in a position to pay the debts of the firms.

v) **Sub-partner :** When a partner agrees to share his profits derived from the firms with a third person, that third person is known as 'sub-partner'. A sub-partner is in no way connected with the firm. He has no rights against the firm nor does he carry any liability for the debts of the firm.

vi) **Partner** by **estoppel or holding out : (Sec. 28)** : Normally a person becomes a partner only by agreement. But, for outside world, a person can also be treated as a partner by virtue of his conduct. This happens by way of estoppel or holding out. According to Section 28(1), "when a person, by words spoken or written, or

by his conduct, represents himself or knowingly permits himself to be represented to be a partner in a firm, he is liable as a partner in that firm to any one who has on the faith of any such representation gives credit to the firm." The person so representing himself is called a partner by estoppel or holding out. For example, a renowned sportsman assumed the honorary presidentship of a publishing business bringing out a sports magazine because the other partners requested him to do so. He would be considered liable for all the debts of the firm to all those third parties who gave credit to the firm in the bonafide belief that this sportsman was a partner in the firm. Similarly, Shyam had business in the name of Ram Shyam & Co. He employed a person, whose name was Ram, as a manager of the firm's business. The third parties dealing with the firm treated him a partner of the firm. Ram neither objected nor disclosed his true status. It was held that Ram was a partner by estoppel.

To hold a person liable as a partner by estoppel or holding out the following two conditions must be satisfied:

i) He must have represented himself to be a partner by word, spoken or written, or by his conduct (active representation), or knowingly allowed himself to be represented as a partner (tacit representation); and

ii) The third person acting on the belief of such representation must have given credit to the firm. It is immaterial whether the person so holding himself out. to be a partner is aware or not that the representation has reached the third party.

A retiring partner who has not given a public notice of his retirement, can also be held liable on grounds of holding out if his name is still being used by the other partners in the firm. It is because the third parties may continue to believe that he is still a partner. However, where in the event of death of a partner, the firm continues the business and uses the deceased partner's name as part of the firm's name, the estate of the deceased partner or his legal representatives cannot be held liable for acts of the firm done after his death.

Check Your Progress C

1 State whether the following statements are True or False.

i) A firm has no legal existence apart from its partners. .....

ii) If firm has already been doing business under certain name, the new firm cannot adopt such name. .....

iii) Partnership for a fixed term automatically comes to an end on the expiry of the said fixed term unless the partners agree otherwise. .....

iv) A particular partnership cannot be continued after the completion of the adventure for which it was formed. .....

2 Fill in the blanks.

i) A partner actively engaged in the conduct of the business of partnership is called ..... partner.

ii) A nominal partner contributes only his .....to the firm..

iii) A retiring partner not giving public notice of his retirement can be held liable for the acts of the firm after his retirement on grounds of .....

iv) A sub-partner ..... represents himself to outsiders as a partner.

v) A person who is not a partner in a firm, represents himself or knowingly allows himself to be represented to be a partner in that firm is called a partner by ..... or holding out.

## 13.11 POSITION OF A MINOR AS A PARTNER

You know that an agreement by, or with, a minor is void ab *initio*. Since partnership is created by an agreement, a minor cannot enter into partnership. He can however, be admitted to the benefits of the firm with the consent of all other partners by an agreement executed between his guardian and the'partncrs of the firm. The rights

and liabilities of a minor admitted to the benefits of a partnership are as follows :

### 13.11.1 Rights

i) In accordance with the agreement, the minor has a right to share the profits and the property of the firm. But he cannot take part in the conduct of the business of the firm.

ii) He has a right to have access to, and inspect and copy, any of the accounts of the firm. But, he does not enjoy such right in respect of books other than account books as they may contain secrets which may be restricted to partner only.

iii) He has a right to file a suit for his share of profits or the property of the firm when he is not given his due share of the profits. However, he can exercise this right only when he decides to sever his connections with the firm.

iv) He can become partner in the firm on attaining majority and shall be entitled to the same share which he was getting as a minor.

v) On attaining majority he also has the option to sever his connections from the firm and, if necessary, sue the firm for accounts and his share in profits and property of the firm.

### 13.11.2 Liabilities

The minor partner is liable only to the extent of his share in the profits and the property of the firm. He is not personally liable to the third parties and so his private property cannot be used for payment of the firm's debts incurred during his minority. He cannot be declared insolvent if the firm's debts cannot be repaid out of the property of the firm,

On attaining majority, however, if he becomes a partner in the firm, he shall become personally liable to third parties for all the acts of the firm done since he was admitted to the benefits of the firm.

### 13.11.3 Position on Attaining Majority

Within six months of his attaining majority or his obtaining knowledge that he had been admitted to the benefits of firm, whichever date is later, the minor partner has to decide whether he shall remain a partner or leave the firm. If he decides to sever his connections with the firm, he must give a public notice of his intention failing which it must be presumed that he has opted to become a partner in the firm.

**When he becomes a partner** : If the minor becomes a partner of his own volition or by his failure to give notice within the specified time, his rights and liabilities as given in Section 30 (7) are as follows :

i) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of the firm.

ii) His share in the property and profits of the firm remains the same as he was entitled as a minor.

**When he elects not to become a partner** : If he decides to severe his connection with the firm, his rights and liabilities as given in Section 30 (8) will be as follows: ,

i) His rights and liabilities continue to be those of a minor up to the date of giving public notice.

ii) His share is not liable for any acts of the firm done after the date of the public notice.

iii) He is entitled to sue the partners for his share of the property and profits in the firm.

**Check Your Progress D**

State whether the following statements are True or False.

i) A new partnership cannot be formed with a minor. .....

ii) In the event of firm's failure to pay off its debts, the minor partner can also be declared insolvent, .....

iii) The liability of a minor partner to a third party is limited to the extent of his share in the partnership property. .....

iv) If a minor on attaining majority, elects to become a partner, he is not liable for acts of the firm done before the date of his becoming partner. .....

v) A minor admitted to the benefits of the firm can file a suit against the partners for his share of the profits or the property of the firm without severing his connections with the firm. .....

vi) **A** minor partner can inspect books of account of the firm. .....

## 13.12 LET US SUM UP

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The main characteristics of partnership are: (i) It is an association of two or more persons, (ii) It arises out of an agreement, (iii) It is to carry on a business, (iv) It is for sharing the profits of the business, and (v) It has an element of mutual agency amongst the partners.'

Persons entering into partnership are individually called partners and collectively a firm. The name under which the firm carried on its business is called the firm's name: While selecting a name, however, partners should ensure that it does not violate the rules relating to trade name or implies the patronage of the government.

To determine whether a group of persons is or is not a firm, we have to ascertain the real relationship amongst the partners with the help of their agreement or from other relevant facts taken together. Sharing of profits is a strong evidence of partnership. But, the mutual agency relationship between them is the real test of partnership. The partnership is different from co-ownership and Joint Hindu Family.

Registration of firms is not compulsory under the partnership Act. But it is considered desirable because an unregistered firm suffers from a number of disabilities. These are : (i) The partners cannot file a suit against the firm or any other partner for enforcing his contractual rights or rights accruing under the partnership Act. (ii) The firm cannot file a suit against a third party for enforcing rights arising out of contracts with him, and (iii) It cannot claim any set-off. The firm can be registered any time by supplying the necessary particulars to the Registrar of firms along with the prescribed fees.

Based on their conduct or sharing of profit, the partners can be of various types such as actual partner, sleeping partner, nominal partner, partner in profits only,, sub-partner, partner by estopple or holding out. The liability of a partner to third parties to a great extent, is determined by the type of partner a person is.

Being incompetent to contract a minor cannot become a partner in a firm. He can, however, be admitted to the benefits of partnership with the consent of all the partners. In that case, his liability is limited to his share in the partnership business. He has a right to share the profits and enjoys full access to the account books. On attaining majority he can also opt to become a partner. But, if he wants to sever his connection with the finn he can do so by giving a public notice to that effect.

## 13.13 KEY WORDS

Association of Persons : A body of persons associated for a common purpose.

Co-owner : A person owning a property jointly with the other or others.

Co-ownership : Joint ownership of property.

**Firm** : A collective name for partnership.

**Illegal** Association : **A** firm in which the number of partners exceed the prescribed limit.

Joint **Hindu Family** : A Hindu Undivided Family carrying on business inherited from its ancestors.

Minor Partner : A minor admitted to the benefits of a firm,

**Mutual Agency Relationship.:** A relationship between persons whereby each member is authorised to act on behalf of the other members.

**Nominal Partner :** A partner who just lends his name to the partnership firm, neither invests any capital nor participates in the management.

**Ostensible Partner :** A partner who actively participates in the business of the firm (an active partner).

**Partner :** A person who has entered into partnership with the other person(s).

**Partner** by Estoppel : A person whose conduct creates an impression that he is a partner in a particular firm.

**Partner** by Holding **Out :** A person who allows himself to be represented as a partner and makes no effort to disclaim even after coming to know about it.

**Partner in** Profits **only : A** partner who only shares the profits of the business and not the losses.

Sleeping **Partner : A** partner who does not actively participate in the business of the firm (dormant partner).

## 13.84 ANSWERS TO CHECK YOUR PROGRESS

A 1 i) No ii) No iii) No iv) Yes v) No
2 i) 10,20 ii) status
3 a) ii b) ii c) i

B 1 i) Though it is not a partnership, B can claim his share in profits. But he cannot be held liable for paper supplied by C.

ii) No, there is no agreement amongst the heirs. It is case of Joint Hindu Family.

iii) Yes, all essentials of a partnership are fulfilled and B is a partner. Bringing of capital and sharing of losses is not relevant.

2 i) False ii) False iii) False iv) False v) True

C 1 i) True ii) True iii) True iv) False.
2 i) Actual ii) Name iii) holding out iv) cannot v) estoppel

D i) True ii) False iii) True iv) False v) False vi) True

## 13.15 TERMINAL QUESTIONS

1 Define Partnership and describe the essential characteristics of a partnership.

2 Explain how you will determine whether a group of persons is a partnership or not.

3 Explain briefly the procedure for registration of firms. What are the consequences of non-registration?

4 Enumerate the different types of partners and briefly explain the extent of their liabilities.

5 Can a minor be admitted to a partnership? If so, what are his rights and liabilities during minority and after he has attained majority?

6 Explain the circumstances under which a person can be made liable as a partner even if he is not a partner,

7 Comment on the following statements
a) The relationship of partnership arises from agreement and not from status.
b) Mere participation in profits of a business is not a conclusive test of the existence of partnership.
c) The Indian Partnership Act has effectively ensured the registration of firms without making it compulsory.

8 Distinguish between :

a) Partnership and Co-ownership
b) Partnership and Joint Hindu Family

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

# UNIT 14 RIGHTS, DUTIES AND LIABILITIES OF PARTNERS

**Structure**



## 14.0 OBJECTIVES

After studying this unit you should be able to:

- describe the mutual rights and duties of partners
- explain the concept of the property of the firm
- explain the extent of implied authority
- describe the rights and duties of incoming and outgoing partners.

## 14.1 INTRODUCTION

In Unit 13 you learnt that a partnership is formed by an agreement between two or more persons called pnrtners. The rights, duties and liabilities of partners are usually determined by the terms specified in the agreement. But, the agreement may not provide for all the rights and dutics of partners. In such a situation, the provisions of the Partnership Act become automatically applicable. You have also learnt that the law of partnership is an extension of the law of agency. A partner is both a principal and an agent. Hc is, therefore. bound by the acts of other partners and binds other partners by his acts done on behalf of the firm. In this unit you will learn about the provisions of the Partnership Act which govern the mutual rights and duties of partners and those which determine the extent of the authority of a partner to bind the firm by his acts. In this connection, we shall also discuss the position of the incoming and the outgoing partners.

## 14.2 MUTUAL RELATIONS OF PARTNERS

It is generally believed that since partnership comes into existence by an agreement, the mutual rights and dutics of partners will he determined only by the provisions made in the agreement. But, this is not the true position. The partnership agreement may not specifically provide for all rights and duties of partners. In that case, the provisions of the Act will become applicable. Thtn. there arc certain rights and duties given in the Act (Sections 9 and 10) which cannot be changed by agreement. They are mandatory and are binding on all the partners. Thus. the mutual rights and duties of partners are governed by the partnership agreement as well as the Partnership Act

Sections 9 to 13 and Sections 16 to 25 of the Partnership Act lay down the majority of rules that govern the mutual rights and duties of partners. As indicated earlier, except sections 9 and 10 which lay down absolute duties of partners, all other provisions given in the Act can be changed by an agreement amongst the partners, Let us now discuss the main provisions of the Act governing the mutual rights and duties of partners.

### 14.2.1 Rights of Partners

**Unless otherwise agreed** by the partners, every partner has following rights :

i) **Right to take part in the conduct of business** : Each partner can participate in the conduct and management of the business of the firm.

ii) **Right to be consulted** : Each partner has the right to express his opinion and be heard in all matters affecting the business of the firm. All decisions will, however, be made by majority with the exception of certain matters like change in the nature of business and reconstitution of the firm.

iii) **Right to have access to books** : Each partner has the right to inspect and copy any of the books of the firm. But, a minor admitted to the benefits of the firm can inspect and copy only the books of account. He cannot claim access to other books of the firm.

iv) **Right to share profits equally** : Each partner will share the profits of the business of the firm equally.

v) **Right to claim interest on capital** : Normally, no interest is allowed on the capital contributed by the partners. But, if the partnership agreement provides for the payment of interest on capital, it shall be payable only out of the profits. In other words, if there are losses, the interest on capital will not be allowed.

vi) **Right to interest on advances** : If partner has advanced some amount as loan to the firm, he will be entitled to interest at a rate agreed upon, and where no rate is decided, at six per cent per annum. Interest on loan will be payable even if there are losses.

vii) **Right to be indemnified** : A partner has to be indemnified by the firm in respect of all expenses and liabilities incurred by him in the ordinary and proper conduct of business. He will also be entitled to claim reimbursement for all payments made by him in an emergency for protecting the firm from loss provided he acted in a manner as a person of ordinary prudence would have acted in similar circumstances in his own case.

viii) **Right to use partnership property** : Every partner is, as a rule, a joint owner of the partnership property and is entitled to have held and applied exclusively for the purpose of the business.

ix) **Right in emergency** : A partner has the right in an emergency to do all such acts as are reasonably necessary for protecting the firm from loss.

x) **Right to stop the admission of a new partner** : Every partner is entitled to prevent the introduction of a new partner into the firm. As per rules, unless otherwise agreed, no new partner can be admitted without the consent of all the partners,

xi) **Right to retire** : Each partner has the right to retire from the partnership either as per the terms of the partnership agreement or with the consent of all the partners, or if the partnership is at will by giving notice of his intention to retire.

xii) **Right not to be expelled** : Every partner has a right to continue in the partnership. He cannot be expelled from partncrship by majority of partners unless such power is conferred by partnership agreement and is exercised in good faith and for the benefit of the firm.

xiii) **Right to do competing business** : Every outgoing partner has a right to carry on a competing business. But, he cannot (i) use the firm's name (ii) solicit the firm's customers, or (iii) represent the firm.

xiv) **Right to share profits after retirement** : Unless otherwise agreed, an outgoing partner has the right to claim a share in the profits of the firm or claim interest @ 6% per annum on his share in the property of the firm till his account is finally settled. This rule is also applicable in case of the death of a partner.

### 14.2.2 Duties sf Partners

As stated earlier, certain duties are mandatory while others are subject to agreement amongst the partners. These are summarised below.

Mandatory Duties

The partnership is based on mutual trust and confidence. Hence, each partner must act in good faith and carry on the business of the firm for mutual benefit and not for his personal benefit. Section 9 has clearly stated that all partners are bound (i) to carry on the business of the firm to the greatest common advantage, (ii) to be just and faithful to each other, and (iii) to render true accounts and full information of all things affecting the firm to any partner or his legal representative. Similarly, Section 10 lays down that every partner shall indemnify the firm for loss caused to it by his fraud in the conduct of the business of the firm. These duties given in Section 9 and 10 are absolute provisions of the Act and are mandatory. They cannot be changed by an agreement amongst tlie partners.

Duties Subject to Agreement by Partners

Besides the provisions of Sections 9 and 10, the other duties of partners as provided in tlie Act are subject to the agreement by partners. They can be changed by partners by making necessary provisions in their agreement. Such duties are :

i) To attend diligently to his duties in the conduct of the business.

ii) To perform partner's duty without receiving any remuneration for taking part in the conduct of the business.

iii) To contribute equally to the losses sustained by the firm.

iv) To indernnify the firm for any loss suffered by the firm due to wilful neglect in the conduct of the business of the firm.

v) To ensure that the property of the firm is held and used by the partners exclusively for the business of the firm.

vi) To account for and to pay to the firm any private profits derived by the partner from any transactions of the firm or from the use of property or business connections of the firm.

vii) To account for and to pay to the firm all profits made by a partner by carrying on any private business, Normally, there is no restriction on the partner to carry on any business other than and of the firm. But, if the partners have agreed that no partner shall do any business other than that of the firm, he should not carry on any other business, whether competing or not competing with that of the firm, without the consent of other partners.

viii) To act as an agent of the firm for the purposes of the business of the firm.

ix) To act within the scope of actual or apparent authority. In case a partner exceeds his authority and the other partners do not approve of it, he will be liable to other partners for the loss suffered on account of his such acts.

x) Not to assign his rights and interests in the firm to the outsiders without the consent of all other partners.

xi) To be liable jointly with all other partners and also severally for all acts of the firm done while he is a partner. This means that the creditors of the firm can realise their dues from any partner.

## 14.3 PROPERTY OF THE FIRM

You know that all partners are joint owners of the property of the firm (unless there is an agreement to the contrary) and it should be held and used exclusively for the firm by the partners, Hence, it becomes necessary to ascertain what constitutes the property of the firm. Normally the partners, by an agreement, are free to determine as to what shall be the property of the firm and what shall be treated as a separate property of one or more of the partners. But, when there is no such agreement, and you want to know whether a certain property is the property of the firm or not, you will have to ascertain the source from which the property had been acquired, the purpose for which it was acquired and the manner in which it has been dealt with. According to Section 14, when there is no contract to the contrary, the property of

the firm includes:

i) all properties, rights and interests originally brought to the stock of the firm,

ii) the property acquired by purchase or otherwise by or for the firm,

iii) the property acquired with money belonging to the firm, and

iv) the goodwill of the business of the firm.

Thus, whatever is brought to the common stock of the firm and whatever is added to or obtained by means of this common stock during the continuance of partnership either directly or by conduct of business, is included in the property of the firm unless a contrary intention can be shown. However, if a partner's property is used for the purpose of the business of the firm it does not automatically become the property of the firm. It can only become the property of the firm if the partners show an intention to make it so. For example, a piece of land which is bought in the name of one partner but is paid for by the firm (or out of the profits of the firm) shall be deemed to be the property of the firm unless there is an intention to the contrary. Similarly, if two persons take a lease of a coal mine for the purpose of working it in partnership, the lease will be treated as the property of the firm.

**Check** Your Progress A

1 Answer the following with 'Yes' or 'No'

i) Can a partner be prevented from taking part in the partnership business? .....

ii) Is a partner liable for the acts of the firm before his joining the firm? .....

iii) Can a majority of partners by an agreement expel a partner? .....

iv) Can a person to whom a share of profits has been assigned be asked to share losses also? .....

v) Does a minor admitted to share the profits of a **firm** have a right to inspect and copy. any books of the **firm?** .....

2 If there is no express provision in the partnership agreement how would the partners

a) charge interest on capital .....

b) divide profits between them .....

3 **A** and B are partners of a firm. B was appointed to buy sugar for the firm. Without the knowledge of **A,** he supplied his own sugar to the firm at market price and made huge gain. Is he accountable to firm?

.....

.....

.....

4 State by 'Yes' or 'No' whether the following constitute firm's property or not.

i) Property belonging to a partner who enters into an existing partnership. .....

ii) Share bought by a partner in his own name without the consent of other partners but with the money of the firm. The other partners later adopt the transaction. .....

iii) Land bought with partnership money on account of, and for the sole benefit of, one partner who becomes a debtor to the firm for the amount of the purchase money. .....

iv) Goodwill of the firm having a saleable value. .....

## 14.4 RELATION OF PARTNERS WITH THIRD PARTIES

In unit 13 you learnt that mutual agency is an essential element of partnership. Each partner acts both as the agent and the principal. It is this position of the partners which governs their relationship with the third parties. Section 18 clearly states that

trom the point of view of the ***third parties, a partner is an agent of the firm, for the purposes of the business of the firm. In that capacity,*** he binds all other partners by his acts done on behalf of the firm provided these are done in the ordinary course of business and in the name of the firm. So, all partners are liable to third parties for such acts.

### 14.4.1 Implied Authority of a Partner

In the context of a partnership firm, the authority of a partner means his authority to bind the firm by his acts. This authority may be express or implied. The authority conferred on a partner by mutual agreement is called an express authority. But, where there is no agreement or where the partnership agreement is silent, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm (Section 19). This capacity of a partner to bind the firm by his acts is called the 'implied authority of a partner'. In order that his act may fall within the scope of his implied authority, the following conditions must be fulfilled.

1 ***The act done by the partners must relate to the normal business of the firm.*** If it is of a nature which is not common in the type of business carried on by the firm, it will not bind the firm even if it has been done in the name of the firm. For example, an exporter of readymade garments places an order for a huge quantity of liquor in the name of the firm. As this act does not relate to the normal business of the firm, it will not fall within the scope of implied authority. The firm, therefore, will not be bound by it.

2 ***The act must have been done in the usual way of carrying on the firm's business.*** In other words, the act should be such as is usual in the type of business carried on by the firm. For example, X and Y are partners in a retail business. Goods were sold on credit to Z. Lafer on, X received the amount from him (Z) on behalf of the firm. Y does not know of this receipt and X utilises this amount for his personal use. Receiving money from debtors is an act done in the usual course of business. Hence, the firm cannot claim the amount from Z on the plea that X had no authority to receive the amount. It is difficult to clearly lay down as to what is usual and what is unusual in a business. It will depend on the nature of business and the usage of trade. For example, buying and selling of goods, drawing and accepting bills of exchanges, taking loan, etc. are considered normal activities in case of a trading concern. But, in case of an auctioneering firm or a firm of solicitors, taking loan is not considered to be a usual activity.

3 ***The act must be done in the firm's name or should, in some manner, imply an intention to bind the firm.*** For example, A and B are partners in a stationery business. A goes to a wholesaler and buys on credit certain quantity of pencils in the firm's name. He uses these pencils for the family. Since this act is of the kind usually done in the stationery business and is done in the firm's name, it will bind the firm.

**Act within the implied authority of a partner :** The implied authority of a partner shall normaily include :

i) purchasing, on behalf of the firm, goods in which the firm deals or which are used in the firm's business;
ii) selling the goods of the firm;
iii) receiving payment of the debts due to the firm and giving receipt therefor ,
iv) settling accounts with third parties dealing with the firm;
v) employing servants necessary for carrying on the firm's business;
vi) borrowing money in the credit of the firm;
vii) pledging goods of the firm as security for the purpose of getting loans;
viii) drawing, accepting and endorsing negotiable instruments on behalf of the firm; and
ix) employing solicitor to defend action against the firm

**Acts outside the implied authority of a partner :** Sections 19(2) has restricted the scope of implied authority of a partner. According to this section, in the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not

enable him to:

i) submit to arbitration a dispute relating to the business of the firm;

ii) open a bank account on behalf of the firm in partner's own name;

iii) compromise or relinquish any claim or portion of the claim by the firm;

iv) withdraw a suit or proceedings filed on behalf of the firm;

v) admit any liability in a suit or proceedings against the firm;

vi) acquire immovable property on behalf of the firm;

vii) transfer immovable property belonging to the firm, and

viii) enter into partnership on behalf of the firm.

However, the partners, by mutual agreement, can restrict or extend the implied authority of a partner.

**Partner's** authority in an emergency : According to Section 21, in an emergency a partner will have an authority to do all such acts to protect the firm from loss as a prudent man would undertake under similar circumstances in his own case. These acts do not form part of the implied authority of the partner but, nevertheless, they would bind the firm. For example, the partners of a trading firm by an express contract decided that no partner would have the authority to sell goods of the firm above the value of Rs. 10,000 without consulting all other partners. Owing to a sudden slump in market, the prices, crashed. One partner, in order to save the firm from loss, sold all the stock worth Rs. 1,00,000 without consulting any other partner. The firm is bound by such act of the partner.

### 14.4.2 Implied Authority and Third Parties

All partners are liable to third parties for all acts of a partner which fall within the scope of his express or iinplied authority. Their liability to the third parties for such acts can be discussed under the following heads.

1 Extension or restriction of partner's implied authority : As stated earlier, the partners of a firm by mutual agreement, may extend or restrict the scope of implied authority of any partner. But, the third party is not bound by any restriction imposed on the implied authority of a partner unless it has the knowledge of such restriction. In other words, the third party remains unaffected by any secret restriction on the implied authority of any partner. For example, a trading firm limited the authority of partners to purchase goods on credit upto Rs. 1,000. A third party who had no knowledge of such restriction sold goods worth Rs. 1,500 on credit to a partner of the firm. The firm is liable to pay the full amount to the third party.

2 Effect of admission by a partner : Since, for the purpose of the business of the firm, a partner is an agent of the firm, any admission or representation by a partner about the affairs of the firm is sufficient evidence against the firm, provided the admission is made in the ordinary course of business.

3 Effect of notice to an asting partner : You already know that a notice to an agent on matters relating to agency is notice to the principal. The same rule applies to parmership. Thus a notice of any matter relating to the affairs of the firm, when given to a partner who habitually receives it in the ordinary course of business of the firm, is taken to be a notice to the firm. ***This*** rule would ***not apply in case of a fraud committed by the partners and the third party against the firm.***

4 Liability of partners for acts of the firm : For all acts of the firm, done while he is a partner, every partner is jointly and severally liable to third parties. This means that for every act of the firm, the third party can sue each partner individually and also jointly with other partners.

5 Liability for wrongful acts of a partner : When a partner, in the ordinary course of business, commits a wrongful act, the firm is liable for such an act. Section 26 specifically provides that if on account of the wrongful act or omission of .a partner acting in the ordinary course of business or with the authority of other partners, some loss or injury is caused to any third party. or any penalty is incurred, the firm is held liable to the same extent as the partner. For example, A, B and C are partners in a newspaper business. A is also the editor of the newspaper. A allows the publication of a defamatory article about a prominent person P, without

checking its validity. P sues the firm for libel. The firm will be liable for this act of the editor partner as the omission which caused loss of goodwill to P was done in the usual course of business.

6 Liability of firm for misapplication by partners : Section 27 provides that the firm is liable to the third parties where (i) a partner, acting within his apparent authority, receives money or property from a third person and misapplies it, or (ii) the firm in the course of its business receives money or property from a third party and the money is misapplied by any of its partners while it is in the custody of the firm. For example, X, Y and Z are partners in a business. K, a debtor of the firm repays his debts of Rs. 10,000 to Z who does not inform Y and Z about the repayment and misuses the money. K would be discharged of the debts on account of payment made to X.

Check Your Progress B

1 What is meant by the implied authority of a partner to bind the firm.

.....

.....

.....

2 Fill in the blanks.

i) The authority of a partner to bind the firm may be ..... or implied.

ii) In order to bind the firm the, acts done by a partner under his implied authority must relate to the ..... business of the firm.

iii) In the case of ..... in order to prevent losses to the firm, a partner may exceed his express or ..... authority.

iv) In the absence of any usage or custom of trade to the contrary, a partner acting in his implied authority ..... submits a dispute relating to the firm's business to arbitration.

3 In which of the following cases the firm is liable to the third parties for the acts of the partners. Answer with Yes or No.

i) The managing partner of a firm laying sewerage lines does not gel the manholes covered as required by law. A worker falls in the manhole and is injured.

ii) A, B and C partners in a business as construction contractors. A manages to get a contract for the firm worth Rs. 5,00,000. But, he secured this contract only after paying a bribe of Rs. 5,000 to an officer in the client's business. He charges this amount to the account of the firm. But, the other partner's objected.

iii) X, Y and Z are partners in a business of supplying construction material. K, a regular buyer dealing with firm, places a verbal order with X to sdpply the required material, X forgets to inform the other partners. The goods are not delivered. K sues the firm for the lion-delivery of goods.

iv) A, B and C are partners in a trading firm. By an agreement between them, they decide that no partner shall have the right to buy or sell goods beyond the value of Rs. 10,000 without the consent of other partners. Unaware of this restriction, a third party T sells goods worth Rs. 17,000 to C who does not consult his partners about this transaction. T sues the firm for the price of goods.

## 14.5 POSITION OF INCOMING AND OUTGOING PARTNERS

When there is any charge in the composition of the partnership, it is called 'reconstitution of the partnership firm'. The reconstitution takes place when

1 a new partner is admitted

2 a partncr retires

3 a partner is expelled
4 a partner is declared insolvent
5 a partner dies
6 a partner transfers his interest to another person.

On the happening of the above events there is some change in the rights and liabilities of partners. Let us now study the relevant provisions of the Act which govern the above situations and know their effect on the rights and liabilities of partners.

### 14.5.1 Admission of a Partner

A person cannot be admitted as a partner in an existing firm without the consent of all the partners. This rule is however, subject to any provision to the contrary in the partnership agreement. For example, the partnership agreement between A, B and C provides that A could introduce into partnership any of his sons on attaining the age of majority. In such a situation, there is no need for the consent of B and C if A decides to admit his son (who has attained majority) as a partner.

An incoming partner is not liable for any debts of the firm, incurred before his admission as partner. His liability is limited only to those acts of the firm which are done after he becomes a partner. This general rule has to two exceptions which are as follows.

a) By mutual agreement, he may undertake to share the liabilities for the past acts of the firm. But, this does not entitle the creditors to proceed against the new partner for the recovery of old debts unless (i) the new firm has assumed the liabilities of the old firm, and (ii) the creditors have accepted the new firm as their debtor and discharged the old firm from its liability.

b) A minor admitted to the benefits of the firm who, on attaining majority decides to become a partner, shall be personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

### 14.5.2 Retirement of a Partner

Any partner may retire from the firm in any of the following ways :
i) with the consent of all the other partners; or
ii) in accordance with an express agreement among the partners; or
iii) where the partnership is at will, by giving a notice in writing to all other partners of his intention to retire,

Liabilities : A retiring partner continues to remain liable for all the acts of the firm done before retirement or acts pending at the time of his retirement. He may, however be discharged from his liability towards the third parties by mutual agreement. Such agreement should be entered into between the three parties viz., all members of the reconstituted firm, the retiring partner and the concerned third party. Such an agreement may be express or implied.

Until public notice of the retirement of a partner is given, the retiring partner continues to be liable to third parties for any act done by any of the partners even after his retirement, which would have been an act of the firm if done before his retirement. However, the retired partner will not be liable to any third party who deals with the firm without knowing that he was not a partner. This would generally hold good in case of the retirement of a sleeping partner. (Public notice of retirement may be given either by retiring partner himself or by any other partner).

Rights : A retiring partner has the following two rights.

1 He can carry on business competing with that of the firm and may advertise such business. But, in the absence of any agreement to the contrary, he cannot (i) use the name of the firm; (ii) represent himself as carrying on the business of the firm, or (iii) solicit the old customers. By mutual agreement, however, some more restrictions can be imposed on the retiring partner. For example, he may be restrained from carrying on the competing business in a specified area for a specified period. This shall not be treated as restraint of trade.

2 If there is no final settlement of accounts between the retiring partner and the remaining partners and they continue to carry on business with the property of the firm, the retiring partner is entitled to claim (i) such share of the profits earned after his retirement which is attributable to the use of his share of the property of the firm, or (ii) interest at the rate of 6% p.a. on the amount of his share in the property. He can choose any of these two alternatives.

### 14.5.3 Expulsion of a Partner

Normally a partner cannot be expelled from partnership. However, the expulsion of a partner is possible if following three conditions are satisfied.

i) the power to expel a partner is available by an express agreement between the partners;
ii) the power has been exercised by a majority of the partners, and
iii) the power has been exercised in good faith and for the benefit of the firm.

A partner who is expelled from the firm is subject to the same right and liabilities as those of a retired partner.

### 14.5.4 Insolvency of a Partner

Where a partner of a firm is declared insolvent by a court of competent jurisdiction, he ceases to be a partner in the firm on the date on which the order of adjudication is made. It is not necessary that the firm is dissolved when a partner is declared insolvent. If, in accordance with the provisions of the partnership contract, the firm is not dissolved on the insolvency of a partner, the estate of the insolvent partner is not liable for any act of the firm, and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made.

### 14.5.5 Death of a Partner

Normally the firm is dissolved on the death of any of its partners. But, if the partnership contract provides that on the death of any partner the firm will not be dissolved, the remaining partners can continue with the firm's business.

In that case, the estate of a deceased partner can be held liable only for those acts of the firm, which were done during the life time of the deceased partner. It shall not be liable for any act of the firm clone after the date of his death. No public notice is required on the death of a partner.

## Transfer of Partner's Interest

A partner has the right to transfer his interest in the firm, fully or partially, to a third person. But, such a person (the transfree) is not treated as a partner. Neither he can take part in the conduct of the business of the firm not inspect its account books. He can simply claim his share in the profits of the firm.

If, however, the partner transfers his share in the firm on its dissolution or on ceasing to be a partner, the transferee will be entitled to claim the share of the transferring partner in the assets of the firm and for the purpose of ascertaining that share he can ask for on account as from the date of dissolution.

As a matter of fact, no partner can transfer his interest in the firm with the intention of making him a partner in the firm without the consent of all the other partners.

You should note that whenever some change takes place in the constitution of the firm, the mutual rights and liabilities of the old partner in the reconstituted firm continue to remain the same as they were before the reconstitution took place. For example, A, B, C and D are partners who share profits in the ratio of 4:3:2:1. They admit a new partner E who is entitled to one-third share in the profits of the firm. In this situation, unless the partners decide otherwise. A, B, C and D shall continue to share the remaining two-third of the firm's profits in the ratio of 4:3:2:1, the new profit sharing ratio being 5:4:3:2:1.

**Check Your Progress** C

1 List various ways in which a change in the constitution of the firm takes place.

.....

.....

.....

2 State whether each of the following statements is True or False.

i) A partner in a particular partnership cannot retire from the firm by giving a notice in writing to other partners. .....

ii) A partner may be expelled from the firm only with the consent of all the other partners. .....

iii) A firm is dissolved when any partner of the firm is declared insolvent. .....

iv) When some change occurs in the constitution of the firm, in the absence of any agreement to the contrary, the partners of the reconstituted firm have the same rights and liabilities as they were having before. .....

## 14.6 LET US SUM UP

The mutual rights and duties of partners in a firm are generally governed by their agreement. But, where the agreement does not specify certain rights or duties the same shall be governed by the provisions of the Act. The Act also specifies certain rights and duties of partners that are binding and cannot by changed by an agreement.

Unless otherwise agreed, the main rights of a partner as per the provisions of the Act are : (i) to take part in business, (ii) to be consulted, (iii) to have access to books , (iv) to share profits equally, (v) to claim interest @ 6% p.a. on advances to the firm, (vi) to be indemnified for all expenses incurred by him in conduct of firm's business, and (vii) not to do competing business.

The duties of each partner can be divided into two categories (a) mandatory duties and (b) duties subject to agreement among partners. The mandatory duties are : (i) to act in good faith and carry on the business of the firm for mutual benefit, and (ii) to indemnify the firm for loss caused to it by his fraud. The main duties subject to agreement are : (i) to perform partner's duty without any remuneration, (ii) to contribute to losses equally, (iii) to account for and pay to the firm any private profits derived from any transactions of the firm, (iv) to act as an agent of the firm (v) to act within the scope of his authority, and (vi) to be liable jointly and severally for all acts of the firm done while he is a partner.

Unless there is an agreement to the contrary, all partners are joint owners of the property of the firm and such property should be held and used exclusively for the purpose of the firm's business. The property of the firm includes all property originally brought to the common state of the firm or later acquired by or for the firm.

The relation of partners with third party is governed by partner's capacity to act as an agent of the other partners. The third parties may bind the firm by all acts of the partners done within his express or implied authority.

Implied authority covers the acts of a partner which is done to carry on in the usual way business of the kind carried on by the firm. However, there are certain restrictions on the scope of the implied authority of a partner.

There are various ways in which a partnership firm is reconstituted. It could be admission of a pnrtner, retirement of a partner, expulsion of a partner. insolvency of a partner. death of the partner or transfer of his interest by a partner to a third person. In the absence of a contract to the contrary, a partner is liable for all acts of the firm, done by the firm till he ceases to be a partner Similarly, unless otherwise agreed, the mutual rights and duties of the remaining partners of the old firm continue to be the same.

## 14.7 KEY WORDS

**Arbitration**: Determination of a matter in dispute by the judgement of one or more persons called arbitrators.

**Common Stock** : Property held in common ownership.

**Implied Authority** : The authority of a partner as conferred by law to bind the firm by his acts done on behalf of the firm in the firm's name.

**Incoming Partner** : New partner admitted to a partnership firm.

**Insolvent Partner** : **A** partner whose assets (including his interest in the firm) at their present fair valuation are insufficient to pay his debts.

**Mandatory** : Absolute provisions of law that are compulsory and cannot be changed by agreement.

**Order of Adjudication** : **A** judicial order declaring a person insolvent.

**Outgoing Partner** : A partner who leaves the partnership firm by way of retirement, death, expulsion, insolvency, etc.

**Partnership Property** : Property originally brought to the common stock of the firm or acquired later by or for the firm.

## 14.8 ANSWERS TO CHECK YOUR PROGRESS

A 1 i) No ii) No iii) No, unless their is a provision in the agreement iv) No v) No, this right is restricted to books of account.

2 a) No, interest on capital is allowed
b) equally

3 Yes, B will have to surrender the whole of the profit from the transaction

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

B 2 i) express ii) normal iii) emergency, implied iv) cannot
3 i) Yes ii) No iii) Yes iv) Yes

C 2 i) True ii) False iii) False iv) True

## 14.9 TERMINAL QUESTIONS

1 Discuss the mutual rights and duties of partners in the absence of any express agreement between them.

2 Are the partners absolutely free to lay down their rights and duties? **If** not, state the provisions that cannot be changed by agreement amongst partner?

3 What is partnership property? State how far is the partnership property liable for the separate rlebts of the partners.

4 What do you understand by an implied authority of a partner? Describe the restrictions on the implied authority of a partner.

5 What is the extent of the implied authority of a partner. How far is a firm liable to third parties for acts of an individual partners?

6 Explain the rights and duties of (i) incoming partners. and (ii) an outgoing partner.

7 State the liabilities
a) of the partners for the acts of the firm;
b) of the firm for wrongful acts of a partner, and
c) of the firm for misapplication of money or property of partner.

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

# UNIT 15 DISSOLUTION OF PARTNERSHIP FIRMS

**Structure**



## 15.0 OBJECTIVES

After studying this unit you should be able to:

- distinguish between dissolution of partnership and dissolution of firm
- describe the modes of dissolution of firm
- explain the rights and liabilities of partners consequent to dissolution of firm
- explain how accounts are settled among partners on dissolution.

## 1 INTRODUCTION

You have learnt about the formation of a partnership firm and the provisions of the Indian Partnership Act relating to mutual relationship of partners and their liability towards third parties. In this unit, you will learn about the rules relating to dissolution of a firm which includes modes of dissolution, right and liabilities of partners on dissolution and the mode of settlement of accounts among the partners.

## 15.2 DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF FIRM

The Indian Partnership Act makes a distinction between dissolution of partnership and dissolution of firm,

### 15.2.1 Dissolution of Partnership

Dissolution of partnership simply means a change in the relation of the partners. Such a change is usually caused when a firm is reconstituted i.e., when a new partner is admitted or when an cxistingpartner retires, dies, becomes insolvent or is expelled. The dissolution of partnership may or may not involve the dissolution of a firm. A firm, after a change in relation of the partners, may decide to continue as a reconstituted firm. But, when a firm is dissolved, it necessarily involves the dissolution of partnership.

For example, A, B, C and D are carrying on trading business as a partnership firm. A, is declared insolvent by the court. The partnership between A, B, C and D comes to an end and a new partnership between B, C and D comes into existence. This new partnership between B. C and D shall be known as 'reconstituted firm'. Thus, on declaration of A as insolvent, the partnership stands dissolved, but the firm continues with the remaining partners B, C and D.

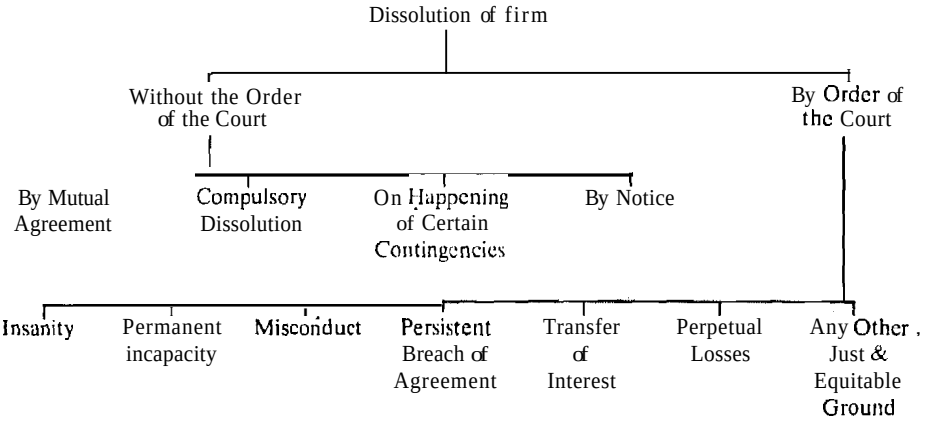
### 15.2.2 Dissolution of Firm

Dissolution of a firm means the dissolution of partnership between all the partners of a firm (Section 39). It occurs when there is complete breakdown of relationship between all the partners. In such a situation, the business of the firm is completely stopped, its assets are realised, the liabilities paid off and the surplus distributed among the partners according to their share in the property of the firm. Thus, the partnership is completely discontinued.

## 15.3 MODES OF DISSOLUTION OF FIRM

The dissolution of firm may take place either without the order of the court or by an order of the court. The circumstances under which such dissolutions take place are shown in Figure 1.

**Figure 1 : Modes of Dissolution of Firm**




### 15.3.1 Dissolution without the Order of Court

Dissolution of firm without the order of the court may take place in the following ways:

1 Dissolution by mutual agreement : You know that a firm comes into existence by mutual agreement, It can also be dissolved by mutual agreement among the existing partners.

2 Compulsory dissolution : A firm is automatically dissolved.

   i) if all the partners, or all but one partner, of the firm are declared insolvent. or

   ii) if some event takes place which makes it unlawful for the business of the firm to be carried on. For example, a war breaks out and some partners of the firm are declared alien enemies. In such a situation, it becomes unlawful for the business of the firm to be carried on. Take another case where a firm is carrying on the business of trading in sugar and a law is passed by which trading in sugar is prohibited. In this case also the business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved. In this connection, you should also note that where a firm is carrying on more than one business, the illegality of one or more shall not necessitate the dissolution of the firm. The firm can carry on those ventures which remain lawful.

3 Dissolution on the happening of certain contingencies : According to Section 42, in the absence of a contract to the contrary, a firm will be dissolved on the happening of the following contingencies :

   i) where the firm is constituted for a fixed term, it is dissolved by the expiry of the fixed term,

   ii) where the firm is constituted for completion of one or more adventures or undertakings, the firm is dissolved when those adventures or undertakings have been completed.

   iii) on the death of a partner, and

   iv) on the adjudication of a partner as insolvent.

4 **Dissolution by notice** : When a partnership is at will, the firm may be dissolved by any partner by giving notice in writing to all the other partners of his intention to dissolve the firm.

If the partners has, in his notice, mentioned some specific date for the dissolution of the firm, the firm is dissolved from that date. But if no date has ben mentioned, the firm is dissolved from the date when the notice is communicated. It should be noted that a notice once given, cannot be withdrawn without the consent of all other partners.

## 15.3.2 Dissolution by an Order of Court

Section 44 of the Partnership Act deals with those situations where the court may, on receipt of a petition by a partner, order for the dissolution of the firm, provided it is satisfied that in the interest of justice, it is necessary to order for the dissolution of the firm. Under this section, the court can order even for premature dissolution when the firm is created for a fixed period. When a petition is brought before the court, the court will give other partners an opportunity to put forward their defence against passing an order for dissolution of firm. It is only after evaluating all the evidences before the court that the court shall pass an order for dissolution of the firm. Let us now study the grounds on which a petition can be presented before the court for obtaining a dissolution order. These grounds are :

1 **Insanity** : When a partner becomes insane, he is incapable of forming a rational judgement. Hence, it is treated as a valid ground for the dissolution of the firm. On this ground a suit may be filed either by any other partner of the firm or by the next friend of the partncr who has become of unsound mind. In either case the court may order dissolution of the firm. In the case of a dormant partner, however, the court may not order dissolution because such a partner does take an active part in the conduct of firm's business.

2 **Permanent incapacity** : When a partner has become permanently incapable of performing his duties as a partner, any other partner can file a petition for the dissolution of firm. However, the court will not pass an order for dissolution if the incapacity of a partner is only temporary. For example, a partner in a firm had an attack of paralysis. Another partner of the firm filed a petition for dissolution of the firm. The court refused to pass on order, according to doctors, paralysis was of a temporary nature and the patient's condition was improving. *(Whitwell v. Arthur)*

3 **Misconduct** : When a partner, other than the partner suing, is guilty of misconduct which is likely to adversely affect the carrying on of the business, the court may dissolve the firm. In determining the gravity of misconduct to order dissolution, regard is to be had to the nature of businccss. For example, an immoral conduct of a partner in a firm of medical men may be considered an adequate ground for dissolution but it may not be so in case of a firm trading in Coal.

4 **Persistent breach of agreement** : When a partner, other than the partner suing, wilfully or persistently commits breach of agreement relating to the management of the affairs of the firm or he conducts himself in such a manner or that it is not practicable for other partners to reasonably carry on the business in partnership with him. Thus, embezzlement, fraudulent breach of trust, or keeping erroneous aocounts may be sufficient ground for the court to order dissolution of the firm.

5 **Transfer of interest** : The court, at the instance of any other partner, may dissolve the firm when a partner has in any way

i) transferred the whole of his interest in a firm to a third party, or

ii) allowed his share to be charged on account of a decree passed by a court towards payment of liabilities of that partner, or

iii) allowed his share to be sold in the rccovcry of arrears of land revenue.

*6* **Perpetual losses** : When the firm is continuously suffering losses and it is apparent that in future also the businccss cannot be carried on except at a loss, the court may order for the dissolution of the firm at the instance of any partner.

7 **Any other just and equitable ground** : If. on any other ground, it can be proved to the satisfaction of the court that it is just and equitable to dissolve the firm, the

court may order dissolution of the firm. Examples of such ground are continued quarrelling between the partners, refusal to meet on matters of business.

Check Your Progress A

1 Given below are some parts of statements, only one sentence in each pair is true. Indicate the correct statement by ticking in the bracket.

a) i) A firm may be dissolved by the consent of all the partners. ( )

ii) The agreement of parties to dissolve the firm must be put in writing. ( )

b) i) Insolvency of all partners except one, can be a ground for dissolution. ( )

ii) If the firm is carrying on several businesses and if even one of the businesses becomes illegal, it would become a ground for dissolution of firm. ( )

c) i) A partnership at will can be dissolved by a notice to all partners. ( )

ii) A partnership for a fixed term cannot be continued after the expiry of that term. ( )

d) i) If the partnership is for a particular venture, it is compulsorily dissolved on the completion of such venture. ( )

ii) If two partners belong to different countries and there is an outbreak of war between the two countries, the partnership is automatically dissolved. ( )

2 Fill in the blanks.

i) When a partner has transferred the whole of his ..... to a third party, the other partners can sue for dissolution.

ii) When the share of a partner is sold to pay arrears of .....the court may dissolve the firm.

iii) The court may order dissolution of a firm on any just and ..... ground.

iv) The court may order dissolution of the firm, if a partner becomes ..... incapable of carrying on his duties.

v) In the event of continued losses, the court may dissolve cvcn a partnership for .....

vi) When a firm is dissolved it necessarily involves the dissolution of .....

## 15.4 CONSEQUENCES OF DISSOLUTION OF FIRM

Consequent to the dissolution of a partnership firm, the partners have certain rights and liabilities. These rights and liabilities are discussed below.

### 15.4.1 Rights of a Partner on Dissolution

1 Right of equitable distribution of firm's property : According to Section 46 of the Act, cvcry partner is entitled to have the property of the firm applied in payment of debts to the third parties and the other liabilities of the firm and have the surplus distributed amongst the partners or their representatives according to their rights. This right is also described as partner's general lien.

2 Right to return of premium on premature winding-up : If a partner joined a firm for a fixed term, and had paid a premium (goodwill), and the firm is dissolved before that fixed time, he has a right to the return of the whole or part of the premium. The amount of premium will depend upon (i) the terms upon which he became a partncr, and (ii) the length ot the time during which he was a partner. For example. Ram entered into partnership of a firm for a period ol' 10 years and paid Rs. 1,000 as premium. The firm was dissolved after expiration ol' two years because of the insolvency of a partncr. Ram shall be entitled to Rs. 800 as return of the premium. However, such a partner will not be entitled to claim any return of the premium when the premature dissolution is (i) due to death of a partner, (ii) due to the misconduct of the partncr who paid the premium, and (iii) where

the firm has been dissolved according to an agreement which had no provision for the return of premium or any part thereof.

3 **Right in the event of dissolution on account of fraud or misrepresentation** : Like any other contract, the partnership contract can also be rescinded on grounds of fraud or misrepresentation and the agrieved partners, besides other rights, will have the right to claim damages. Section 52 of the Act gives the following rights to partners where the partnership is rescinded on grounds of fraud or misrepresentation.

i) **Lien of surplus assets :** For any sums paid by him for purchase of a share in the firm or for the capital contributed by him, the partner rescinding the partnership contract has right of lien on the surplus 'assets left after the debts of the firm have been paid.

ii) **Right of subrogation** : For all payments made by him towards the debts of the firm, the partner rescinding the partnership ranks as a creditor of the firm. In other words, if he has used his personal assets to pay off the debts of the firm, he becomes a creditor of the firm for that amount.

iii) **Right to be indemnified** : **The** partner rescinding the partnership contract has the right to be indemnified by the partner or partners guilty of fraud or misrepresentation against all the debts of the firm.

4 **Rights to restrain any partner or his representativesfrom use of firm name or firm property** : Subject to contract between the partners, a partner during the continuance of winding up has the right to restrain every other partner or his representative from carrying on a similar business in the firm name or making use of any of the property of the firm for his own benefit till the accounts of the firm are completely settled and the affairs of the firm have been completely wound up. Of course, where a partner has bought the goodwill of the firm, he can carry on the business in the firm's name and cannot be restrained by other partner or his representative from using the firm's name even during the pendency of winding up.

## 15.4.2 Liabilities of a Partner on Dissolution

1 **Liability fur acts of partners done after dissolution** : For third parties, partnership continues till a public notice is given of its dissolution. Therefore, each partner of the dissolved firm continues to be liable to third parties for any act done by any of them even after the dissolution and such acts are deemed to be acts done before dissolution. For example, A, B and C are partners in a firm trading in rice, They decide to dissolve the firm from August 1,1989 but fail to give a public notice of its dissolution and continue the business of the firm even after that date. On August 10, A enters into 3 contract with D in firm's name to deliver 5 quintals of rice to D. The firm is liable for the consequences of the contract.

It should be noted that the following shall not be liable for acts done after the clissolution of the firm even though no public notice has been given.

i) the estate of a partner who died
ii) the estate of a partner who is adjudicated as insolvent, and
iii) a sleeping or dormant partner who has retired from the firm.

2 **Liability for winding up the affairs of the firm and completing unfinished transactions** : According to Section 47, after dissolution of a firm, the authority of partners to bind the firm as well as their mutual rights and obligations continue to operate, as far as may be necessary for the following purposes.

i) to complete the winding up of the affairs of the firm. For example to realise the dues from the debtors, to pay off the creditors, and dispose off the partnership property, etc.

ii) to complete all unfinished transactions that had begun before dissolution. For example, supplying goods for orders received by the firm before dissolution. Thus, the partner's liability in respect of the above matters continue even after the dissolution of the firm.

Check Your Progress B

State whether the following statements are True or False.

i) If a public notice of dissolution is not given the partner continues to be liable even after dissolution of the firm. .....

ii) If the partnership is for a fixed term and the firm is dissolved on account of the death of a partner, the partner who had paid a premium to join the firm, is entitled to return of premium proportionately. .....

iii) If the firm has been dissolved on account of fraud, only the third parties have the right to be indemnified. .....

iv) In order to complete transactions begun before dissolution, partners may continue to have the authority to bind the firm, even after dissolution. .....

v) An insolvent partner is also liable for acts of the other partners done after the dissolution of the firm. .....

vi) The sleeping partner is not liable for the acts of the other partners done after the dissolution of the firm. .....

## 15.5 SETTLEMENT OF ACCOUNTS

The manner for settling partnership accoubts after dissolution of the firm, is usually provided in the partnership contract itself. If, however, the partnership contract is silent on the matter, the accounts of the dissolved firm shall be settled according to the rules given is sections 48, 49 and 55 of the Act. These rules are as follows :

1 Sharing of deficiency : According to Section 48(a) the losses including deficiencies of capital, shall be paid first out of profits next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits.

This implies that if the assets of the firm are insufficient to discharge the liabilities of the firm, the partners shall bear the deficiency in their profit sharing ratio and pay them out of their private assets, if necessary.

Example : A, B, C and D are partners in a business sharing profits and losses equally. A dies and the firm is dissolved. On the date of dissolution it was found that the capitals of A and B were Rs. 20,000 each and that of C and D Rs. 10,000 and Rs. 5,000 respectively. The outside liabilities stood at Rs. 6,000 and the total value of assets at Rs. 41,000. Thus, the deficiency works out at Rs. 20,000 (61,000 — 41,000). This would be equally shared by B, C and D and the legal heir of A i.e., Rs. 5,000 each.

2 Application of assets : The assets of the firm including any sums paid by the partners to make up deficiencies of capital shall be applied in the following order :

i) in paying off the debts of third parties,

ii) in paying to each partner ratably what is due to him from the firm for advances as distinguished from capital,

iii) in paying to each partner ratably what is due to him on account of capital, and

iv) the surplus, if any shall be divided among the partners in the proportion in which they were entitled to share profits. [Section 48(b)]

Let us understand this with the help of an example. A, B and C were partners in a firm sharing profits and losses equally. The accounts show that, on the date of dissolution, partners' capital was A–Rs. 20,000, B–Rs. 10,000 and C – Rs. 2,000. A had advanced Rs. 2,000 as loan to the firm, the outside liabilities were Rs. 13,000. The asset could realise Rs. 50,000. This amount shall be utilised first to pay Rs. 13,000 of outside liability, next Rs, 2,000 to A for repayment of his loan then Rs. 32,000 to A, B and C for their capital (Rs. 20,000 to A. Rs. 10,000 to B and Rs. 2,000 to C), and the remaining amount of Rs. 3,000 shall be shared equally (profit sharing ratio) by A, B and C.

Suppose. the assets realised Rs. 42.500 only resulting in a loss of Rs. 4,500 (Rs. 47,000 – Rs. 42,500). This loss shall be shared by A, B and C equally reducing their capital balances to Rs. 18,500, Rs. 8,500 and Rs. 500 respectively. So, the

amount of Rs. 42,500 shall be used as follows :

i) Rs. 13,000 to pay outside liabilities
ii) Rs. 2,000 to pay A's loan, and
iii) Rs. 27,500 to pay the capital balances of A, B and C.

3 Payment of firm's debts and separate debts of partners : You know that the partners are jointly and severally liable to pay the debts of the firm. This means that even the private assets of the partners can be utilised for payment of firm's debts, if necessary. Not only that, the third party has the right to realise the whole amount from any partner. This however is subject to the provision of Section 49 which states that the private assets of any partner shall be applied first, to pay his private debts, and then, if there is any surplus, it can be applied to pay the debts of the firm, if necessary. Thus, partner's private assets can bc used for payment of firm's debts only after his private liabilities have been paid off and that too if firm's assets are insufficient to pay firm's debts.

It should be noted that firm's assets are also used first for payment of firm's liabilities and then the surplus, if any, can be used for payment of the private debts of a partner only to the extent of his share in the property of the firm.

4 Loss arising from insolvency of a partner : If, on distribution of the final amount of loss on dissolution, a partner's capital account shows some deficiency, he shall bring in the amount of deficiency in cash so that the other partners can be paid their amounts of capital. But, if the partner whose capital account shows deficiency is insolvent, he may not be able to bring in the necessary amount (fully or in part) resulting in additional loss to other partners. In such a situation, the question arises about the ratio in which the other partners are to share such loss. This is done in the light of a prominent English case of ***Garner v. Murray*** which states that the loss arising from the deficiency of an insolvent partner's capital should be borne by the solvent partners in proportion to their respective capitals as they stood on the date of dissolution. To continue with the same example of A, B and C who share profits equally, if the assets realise Rs. 35,000 only this would result in a loss of Rs. 12,000 (Rs. 47,000 – Rs. 35,000). When this amount of loss is shared by A, B and C their capital balances will reduce to : A – Rs. 16,000, B – Rs. 6,000 and C – Rs. (–)2,000. After paying Rs. 13,000 for outside debts and Rs. 2,000 for A's loan, we are left with Rs. 20,000 as against Rs. 22,000 to be paid to A – Rs. 16,000 and B – Rs. 6,000. There is no problem if C can bring in Rs. 2,000 due from him. But if he becomes insolvent and only Rs. 500 can be realised from him, then there will be a deficiency of Rs. 1,500 which will be shared by A and B in the ratio of their capitals i.e., 2:1 (not equally as per their profit sharing ratio). Thus their capitals will stand reduced to A – Rs.15,000 (Rs. 16,000 – Rs. 1,000) and B – Rs. 5,500 (Rs. 6,000 – Rs. 500) which can now be paid to them with the help of the amount (Rs. 20,000) left after paying outside debts and A's loan plus Rs. 500 realised from C's estate.

5 Sale of goodwill : According to Section 55, in settling the accounts of a firm after dissolution, goodwill shall, subject to contract between the partners, be included in theasscts, and it may be sold either separately or along with other property of the firm.

When, after dissolution of the firm, the goodwill of the firm has been sold, a partner may (i) carry on a business competing with that of the buyer i.e., the partner of the dissolved firm can carry on the same business as that of the dissolved firm, and (ii) advertise such business.

But, subject to agreement between him and the buyer, he may not
a) use the firm's name
b) represent himself as carrying on the business of the old firm, or
c) solicit the business from the customers of dissolved firm.

However, any partner may enter into an agreement with the buyer of goodwill that such partner will not carry on any business similar to that of the dissolved firm within a specified period or within the specified local limits. Such agreement shall be valid if restrictions imposed are reasonable as it would not be barred by Section 27 of the Indian Contract Act, which deals with the agreements in restraint of trade.

**Check Your Progress C**

1 **A,** B and C were partners in a firm. Their profit sharing ratio was 4:3:3. After working together for five years, they agreed to dissolve the firm. After paying off the debts of third parties and repaying the capital of the partners, there was a residual balance of Rs. 50,000. What shall each partner get?

2 A, B, C and D are four partners in a firm sharing profits equally. On March 31, 1990, D becomes insolvent and the partners decide to dissolve the firm. On that date their capital balances were Rs. 30,000, Rs. 20,000, Rs. 20,000 and Rs. 5,000 respectively. The outside liabilities were Rs. 40,000. The assets realised Rs. 81,000. Calculate how much will be paid to A, B and C assuming nothing is realised from D's estate.

3 State whether the following statements are True or False.

i) The private property of a partner has to be used first for the payment of his private debts. .....

ii) Any surplus left after payment of firm's debts is divided equally among all partners. .....

iii) Losses,of the firm have to be paid first out of partner's private property and then out of the firm's property. .....

iv) Any deficiency of partner's capital arising on the insolvency of a partner is shared by other solvent partners in the light of *Garner* v. *Murray* rule. .....

v) When, after dissolution of the firm, goodwill of the firm has been sold, a partner may carry on business competing with that of the buyer. .....

## 15.6 LET US SUM UP

When there is a change in the relation of partners such as on admission of a new partner or on retirement of a partner, it is called dissolution of partnership and not the dissolution of firm; The dissolution of firm involves the dissolution of partnership between all the partners. This may happen with or without the intervention of the court. The court can order dissolution on a petition by a partner in case of (i) insanity of a partner, (ii) permanent incapacity of a partner, (iii) misconduct by a partner, (iv) persistent breach of agreement by a partner, (v) transfer of the whole of his interest to a third party, or (vi) perpetual losses in the firm's business. The dissolution without the order of the court takes place (i) by mutual agreement among partners, (ii) on the happening of certain contingencies, (iii) by notice from a partner when partnership is at will, or (iv) by compulsory dissolution if all (or all but one) partners become insolvent or if the business of the firm becomes unlawful.

Consequent to dissolution of the firm, the partners are entitled to (i) equitable distribution of firm's property, (ii) return of premium on premature dissolution, (iii) restrain the use of firm's name and property, and (iv) certain rights where partnership is rescinded for fraud, etc. The partners continue to remain liable to third parties for any acts done after dissolution if public notice is not given. In any case, the partner's authority to bind the firm, and mutual rights and obligations of the partners continue so far may be necessary to wind up the affair of the firm, and to complete transactions begun but unfinished at the time of the dissolution.

Section 48, 49 and 55 of the Act lay down detailed rules regarding settlement of accounts between the partners. In the absence of any contract to the contrary, all losses including deficiencies of capital must be paid first out of profits, next out of capital, and lastly, if necessary, by contribution by all partners in their profit sharing ratio. The assets of the firm, including sums contributed by partners to make up the deficiency of capital, shall be applied (i) in paying debts of the firm, (ii) in paying each partner, rateably, for advances by him to the firm, (iii) in paying each partner, rateably amount due for his capital contribution, and (iv) the surplus in paying each partner according to his share in profits. If, however, a partner becomes insolvent and is unable to pay the amount due from him, the solvent partners will share such deficiency in the ratio of their capitals as on the date of dissolution as per *Garner* v. *Murray* rule,

The partner's liability is unlimited. Hence, his private assets can also be used for payment of firm's debts. But, the private assets of a partner will be first used for the payment of his private liabilities and the surplus, if any, shall be used for payment of firm's liabilities if necessary. In settling the accounts of a firm after dissolution, goodwill shall, in the absence of a contract to the contrary, be included in the assets of the firm and it can be sold either separately or alongwith other assets of the firm.

## 15.7 KEY WORDS

**Dissolution** : Breaking up of any constituted body of persons.

**Dissolution of Partnership** : A change in relation of partners caused by events like admission of a new partner, etc.

**Dissolution of a Firm** : Dissolution of partnership between all the partners of a firm.

## 15.8 ANSWERS TO CHECK YOUR PROGRESS

A 1 a) i b) i c) i d) ii

2 i) interest ii) land revenue iii) equitable iv) permanently v) fixed term vi) partnership

B i) True ii) True iii) False iv) True v) False vi) True

C 1 In proportion to their share in profit. Thus, A will get Rs. 20,000; B – Rs. 15,000; and C – Rs. 15,000

2 After Rs. 34,000 as loss on realisation of assets (Rs. 1,15,000 – Rs. 81,000) is adjusted equally in partner's capitals, D's capital will show a deficiency of Rs. 3,500. This amount will be borne by A, B and C in the ratio of 3:2:2 (ratio of capitals). Thus, A will finally get Rs. 20,000; B – Rs. 10,500; and C – Rs. 10,500.

3 i) True ii) False iii) False iv) True v) True

## 15.9 TERMINAL QUESTIONS

1 What do you understand by dissolution of firm'! How can a firm be dissolved?

2 Under what circumstances the court can order dissolution of the firm on a suit by a partner?

3 Describe the rights and liabilities of partners on dissolution of a firm.

4 What are the rules regarding settlement of accounts of a firm after dissolution? Explain fully.

5 Where goodwill has been sold after dissolution of the firm, what are the rights of a partner in relation to the business of the firm?

6 If a firm has been dissolved on account of insolvency of a partner and the assets of the firm are not sufficient to repay the capital of the partners, how would this deficiency be settled? Discuss.

7 Describe the rights of a partner when the firm has been dissolved on the grounds of fraud or misrepresentation of a partner.

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

## SOME USEFUL BOOKS

Gulshan, S.S. and G.K. Kapoor. 1989, *Business Law,* Wilay Eastern Limited, New Delhi (Chapter **3)**

Kapoor, N.D. 1988. *Mercantile Law,* Sultan Chand & Sons, New Delhi (Chapter 5 Part 1, 2 and 3)

Kuchhal, M.C. 1989. *Mercantile Law,* Vikas Publishing House Private Limited, New Delhi (Chapters 21–24).

Maheshwari, R.P. and Maheshwari, S.N. 1989. *Business Law,* National Publishing House, New Delhi (Block 3 Chapters 1–4).

Shukla, M.C. 1987. *A Manual* of *Mercantile Law,* S. Chand & Co., New Delhi (Chapter 2).

# ECO-05 MERCANTILE LAW
## Course Components-1

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|---|---|---|
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| | 1 | Essentials of a Contract |
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| 2 | | **General Law of Contracts-II** |
| | 5 | Consideration Legality of Object |
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| | 13 | Definition and registration |
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| 5 | | **Sale of Goods** |
| | 16 | Nature of Contract of Sale |
| | 17 | Conditions of Warranties |
| | 18 | Transfer of Ownership and Delivery |
| | 19 | Rights and an Unpaid Seller |

# UNIT 16 NATURE OF CONTRACT OF SALE

**Structure**



## 16.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of a contract of sale and describe its essential features
- distinguish sale from an agreement to sell and hire-purchase agreement
- explain the meaning of the term goods and identify different types of goods describe the effect of destruction of goods.

## 16.1 INTRODUCTION

Sale of goods is the most common transaction in business as well as in day-to-day life of individuals. In law, it is regarded as a specific contract for which the Contract Act had made special provisions. But, looking at the importance and the complexities of such contracts a separate Act entitled 'Sale of Goods Act' has been enacted which contains all rules and regulations relating to various types of contracts for the sale of goods. To be more specific, it provides definitions of various terms and covers detailed rules relating to the effect of destruction of goods, the conditions and warranties implied in such contracts, the transfer of ownership and delivery, and the position of an unpaid seller. In this preliminary unit, you will learn about the nature of a contract of sale, the essentials of a valid contract of sale, the distinction between sale and an agreement to sell, and the difference between sale and hire-purchase agreement. In this unit, you will also learn about the exact connotation of the term 'goods', the various types of goods as well as the effect of the destruction of goods.

## 16.2 MEANING OF A CONTRACT OF SALE

According to Section 4 of the Sale of Goods Act, ***"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" (Section 4).*** A Contract of sale may be absolute or conditional according to the desire of the contracting parties. The term 'contract of sale' is a generic term and, therefore, broader than 'sale'. It includes 'sale proper' and 'an agreement to sell'. Where under a contract of sale, the property in goods has passed from the seller to the buyer, it is called a 'sale', but where the transfer of property in goods is to take place at a future time or subject to some conditions thereafter to be fulfilled, it is an 'agreement to sell'. You should remember that an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the ownership in the goods, is to be transferred (Sec.4(4)).

**Examples**

i) A enters into a contract with B to buy 100 quintals of potatoes, from B's cold storage for 8s. 2,000. It shall amount to a sale if the seller authorises A to come to his cold storage and take away the potatoes whenever A desires.

ii) A agrees to sell his scooter to B after ten days for Rs. 5,000. B agrees to buy it after ten days, for Rs. 5,000. It is an 'agreement to sell' and it will become sale after ten-days. The specific points of distinction between 'sale: and 'agreement to sell' shall be discussed a little later in this unit.

**Formalities sf a Contract sf Sale (Section 5)**

A contract of sale is regulated by the general law of contract. Accordingly, there must be an offer to buy or sell goods and an acceptance of that offer, parties must be competent to contract and there should be free consent. The subject matter of such contract is goods the property in which is transferred or is to be transferred for a money consideration called the price-paid or promised to be paid. As per Section 5 of the Sale of Goods Act, a contract of sale may be made in any of the following modes:

i) There may be immediate delivery of the goods;

ii) There may be immediate payment of the price but the delivery to be made at some future date;

iii) There may be immediate delivery of goods and also immediate payment of price;

iv) It may be agreed that the delivery or payment or both are to be made in instalments; or

v) The delivery or payment or both may be made at some future date.

Except where specially provided by some law for the time being in force, no specific, formalities are required to constitute a valid contract of sale of goods. However, the buyer and the seller should mutually agree for the transfer of property in goods. A contract of sale may be express or implied from the conduct of the parties and in the case of express contract, it may be oral or in writing or partly in writing and partly by wards of mouth.

A written offer to sell goods may be accepted verbally or by writing, similarly, a verbal offer may be accepted in writing. In case of a contract made with a company, the contract may have to be in writing.

## 16.3 ESSENTIALS OF A VALID CONTRACT OF SALE

A contract of sale is a special type of contract, therefore all the essentials of a valid contract must be fulfilled. If any of the essential element of a valid contract is missing, then the contract of sale will not be valid. For example, A agreed to sell his scooter to B without any consideration. This contract of sale is not valid since there is no consideration.

From the definition of Contract of Sale as per Section 4 of the Sale of Goods Act, the following essential features may be noted.

1 **There must be two parties:** There must be two parties, one seller and the other buyer. A person cannot be a seller as well as a buyer. A person cannot buy his own goods. For example, X is the owner of certain goods, but he is not aware of this fact. A pretends to be the owner of the goods and sells them to X. There is no sale, for X cannot buy goods which are already his own. (Bell v. Lever Bros. Ltd.) However, a .part-owner may sell to another part-owner (Section 4). Partners are not regarded as separate persons for the purpose of sale of the partnership property. They are the joint owners of the goods and as such they cannot be both seller and buyer. But a partner may buy goods from the firm or sell goods to the firm.

2 **Subject matter of sale must be 'goods':** The subject matter of a contract of sale must be goods and the goods must be movable. Sale and purchase of immovable property is not covered by this Act, but is regulated by the Transfer of Property Act. Similarly, contracts relating to services are not treated as contract of sale. The meaning of the term 'goods' is explained in detail in 16.6.

3 **Transfer of Property in the goods:** In every contract of sale, it is the ownership that is transferred and in an agreement to sell the ownership is agreed to be transferred as in case of pledge. According to Section 2 (II) of the Act, property means the general property in the goods and not merely a special property. In a contract of sale the general property is transferred from seller to the buyer. On the other hand, when the goods are pledged, it is only the special property which is transferred i.e., possession of the goods is transferred to the pledgee while the ownership rights remain with the pledger. You should note that for transferring the ownership of goods, the physical delivery of the goods is not essential.

4 **Consideration in Price:** Consideration in a contract of sale has necessarily to be money. Thus, if for instance, goods arc offered as consideration for goods, it will not amount to sale, but it will be called a 'barter'. Similarly, in case there is no consideration, it amounts to gift and not sale. However the consideration may be partly in money and partly in goods.

**Sale and Contract for Work and Labour**

A contract of sale of goods has to be distinguished from a contract for work and labour, involving the exercise of skill or labour on some material. The dividing line between the two is very minute. The distinction essentially rests on whether the rendering of the service and exercise of skill is the essence of the contract or the delivery of the goods is the essence of the contract, although some labour on the part of the seller might also have been out. In case of the former, it is a contract of work while in the later case it will be a contract of sale of goods. The distinction between the two may be understood by referring to the case of ***Robinson v. Graves.*** In this case A engaged an artist to paint a portrait. Canvas, paint and other necessary articles were to be supplied by A to the painter. Applying the above-mentioned test that whether application of the skill and labour in the production of the portrait is the substance of the contract, it was held that it is a contract for work and labour and not a contract of sale. On the other hand, a contract for providing and fixing four different types of windows of certain size according to specifications, designs, drawings and instructions set out in the contract and a contract for making and supplying of wagons or coaches on the underframe supplied by Railways have been held by the Supreme Court to be contracts for work and labour and not a contract of sale.

From the above it should become clear to you that in a contract of gale ownership and possession of goods is transferred, while in a contract for work and labour though there may be delivery of goods, yet the emphasis is on the exercise of skill and labour upon the goods.

Does providing food in a restaurant amount to sale of goods? The Punjab High Court while delivering judgement in ***Northern India Caterers (India) Ltd., v. Lt. Governor*** of ***Delhi*** observed that the supply of meals, whether to residents or stray customers is esentially in the nature of service and not a transaction of sale. The customers come there not to buy food and drinks bur to find bodily satisfaction that service of food in the setting of a restaurant can afford to give.

**Check Your Progress A**

1 What is a Contract of Sale?

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2 What is meant by the term 'property' as used in Sale of Goods Act?

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.....

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3 What is the salient feature of a contract for work and labour?

.....

.....

.....

4 State whether the following statements are True or False:

i) In a sale the property in goods is transferred when the buyer pays the price.

ii) The consideration for the contract of sale can be partly in money and partly in goods.

iii) A contract of sale must be made in a particular form.

iv) In an agreement to sell the ownership of goods passes to the buyer when the stipulated condition is fulfilled.

v) The subject matter of a contract of sale must be movable goods.

vi) A sale by a partner of a firm to his firm is valid.

## 1164 SALE AND AGREEMENT TO SELL

As noted earlier in this unit itself, contract of sale is a generic term and includes both sale and an agreement to sell. The two, however, have different legal ramifications. The rights and obligations of the parties vary with the fact whether the transaction is a sale or an agreement to sell. Distinction between the two is, therefore, of prime importance. The vital point of distinction between the two is that in a sale the buyer becomes the owner of the goods as soon as the contract of sale is made, whereas in an agreement to sell, the seller continues to be the owner of the goods agreed to be sold, till it becomes a sale and as you have already read an agreement to sell becomes a sale on the expiry of the stipulated time or when the cunditions arc fulfilled subject to which the property in goods is to be transferred. Other points of distinction between the two may be noted as under :

1 A 'sale' is an executed contract whereas an agreement to sell is always an executory contract. Executed means that the ownership of the goods has been transferred to the buyer, while executory means that something remains to be done i.e., ownership shall pass on some future date.

2 An agreement to sell is a contract, pure and simple, and creates merely *jus* in personam, i.e., gives a right to either buyer or seller against the other for any default in fulfilling his part of the agreement. A 'sale' is a contract plus conveyance, and creates *jus* in rem, i.e., gives right to the buyer to enjoy the goods as against the whole world including the seller.

3 In a sale, if the buyer wrongfully refuses to accept the goods, and pay the price, the seller can sue for the price, even if the g o d s are in his possession and he can exercise the right 'of lien, stoppage of goods in transit and of resale. But in an agreement to sell only remedy available to the seller is to sue for damages if buyer fails to accept and pay for the goods. For example, A sells ten bags of rice to B for Rs. 3,000. If B refuses to accept the goods, A can file a suit against B for price even though the goods are in A's possession. But instead if it was an agreement to sell, then A's only remedy is to claim damages from B because the ownership has not yet passed tb B.

4 In an agreement to sell, the seller being still the owner, he can dispose of the goods as he likes and the buyer's remedy against the seller's breach is a suit for damages. For example, A agreed to sell a particular horse to B for Rs. 5,000. Subsequently A sells the same horse to C for Rs. 6,000. B's remedy is to claim. damages from A. B cannot recover the horse from C. In a 'sale' breach by the seller gives the buyer a double remedy; a suit for damages against the seller, and the right to follow property in the hands of the subsequent buyer. Thus in sale if the goods are resold, the buyer can recover them as the owner from the subsequent purchaser. If, in the above example where A sells a particular horse to B for Rs. 5,000 and subsequently it is sold to C for Rs, 6,000, B shall have the

right to recover the horse from C, because at the time of sale A was no longer the owner of the said horse. B can also claim damages from A for wrongful conversion.

5 'Risk follows ownership' is the golden rule i.e., whosoever is the owner of the goods at the time of loss, will bear the loss.

In case of 'sale', if there is any loss to the goods, the loss will fall on the buyer, even though the goods are in the possession of the seller. On the other hand in case of 'an agreement to sell', the loss shall be borne by the seller, even though the goods are in the possession of the buyer. It is because, ownership in case of agreement to sell continues to vest in the seller.

6 **Insolvency of the seller:** If in a sale the seller becomes insolvent while the goods are still in his possession, the buyer shall have a right to claim the goods from the official Receiver or Assignee because the ownership of poods has passed to the buyer. However, in case of an agreement to sell, the buyer cannot claim the goods even when he has paid the price. Buyer's only remedy in this case is to claim rateable dividend for the money paid from the estate of the insolvent seller.

7 **Insolvency of the Buyer:** In case of sale, if the buyer becomes insolvent before paying the price, the ownership having passed to the buyer, the seller shall have to deliver the goods to the Official Assignee or Receiver. For the unpaid price, the seller will rank as an unsecured creditor and thereby entitled to rateable dividend out of the estate of the insolvent buyer.

In case of an agreement to sell, where the seller continues to be the owner of the goods, the seller can refuse to deliver the goods to the Official Assignee or Receiver unless he is paid full price of the goods.

## 16.5 SALE AND HIRE-PURCHASE AGREEMENTS

A transaction of sale has to be distinguished from another apparently similar but different transaction, called 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' and the hirer has the option to buy the goods by paying the agreed amount in specified instalments.

The hirer, under this agreement, is required to pay every month a particular sum of money, and if he pays in that way for an agreed number of months, the hirer will become the owner of the goods on the payment of the last instalment. But if the hirer fails to pay any particular instalment, the owner can terminate the contract and take away the goods because the ownership continues to remain with him. The hirer has two option: i) he may buy the goods after paying all the agreed instalments or ii) he may return the goods at any time. In case he decides to return the goods he shall not be liable for further payment of instalments, the amount already paid is treated as hirk charges for the use of goods.

A hire-purchase agreement, therefore, entitles the hirer only to possession of the goods. He cannot accordingly pass a good title to any buyer from him. A hire purchase agreement is distinct from 'sale' in which price may be payable by instalments. In case of sale, the property in goods passes as soon as the contract is made, though price may not yet have been paid. A hire-purchase agreement, on the other hand, does not result in passing of the property unless the option to purchase is exercised, usually by payment of all the instalments. Till such time, it continues to be a bailment. Thus, it is primarily the option on the part of the hirer to buy or to terminate the hiring that marks the distinction. In ***K.L. Johar & Co. v. Dy. Commercial Tax Officer,*** the Supreme Court observed as follows:

***The essence of a sale is that the property is transferred from the seller to the buyer for a price, whether paid at once or paid later in instalments. On the other hand, a hire-purchase agreement has two aspects. There is first an aspect of bailment of goods subject to the hire-purchase agreement, and there is next, an element of sale which fructifies when the option to purchase is exercised by the intending purchaser.***

You should note that in a contract in which the person taking the goods does not have the option to return the goods. it will bc an 'agreement to buy' and not an agreement of hire-purchase, even though the price is payable in instalments and the seller has the power to take the goods back in case of default. In *Les v.* Butler, a lady hired certain furniture from the plaintiff. The contract provided that the hirer has no option to return the goods and owner can take the furniture back if any instalment was not paid. Before the last instalment was paid, the lady sold the furniture to the defendant. It was held, that the defendant had acquired a good title, the lady being in possession of the furniture under an 'agreement to buy' and not under an agreement of 'hire-purchase', because the lady did not have the option to return, but was under compulsion to buy.

Thus, in case of sale by instalment, the buyer cannot terminate the contract and as such is bound to pay the price of the goods. The hire-purchaser, on the other hand. has an option to terminate the contract at any stage and cannot be forced to pay the further instalments. Further, if the agreement is an agreement to sell and under it if the buyer obtains possession of the goods, with the consent of the seller, he can validly sell or pledge the goods and thereby give the transferee or pledgee a good title on the goods provided they have acted in good faith. However, in a contract of hire purchase, the hirer cannot transfer ownership to such buyer even if the latter acts ih good faith, because the position of the hirer is that of a bailee only. He becomes the owner when all the instalments are paid.

In this connection the following points should also be noted:

i) A hirer cannot claim the benefit of implied conditions and warranties (you will read about these in the next unit) unless it becomes a sale. However, conditions implied under Hire-Purchase Act, 1972 do apply.

ii) Sales-Tax is not leviable on a hire-purchase until it becomes a sale,

iii) A contract of sale may be made orally or in writing, but the hire-purchase agreement must be in writing.

## 16.6 MEANING AND TYPES OF GOODS

You have already learnt that the Sale of Goods Act does riot extend to the sale and purchase of immovable property;. The subject-matter of a contract of sale is goods. Let us, therefore, understand the meaning of the term 'goods' and explain its various types relevant, to the contract of sale.

### 16.6.1 Meaning of Goods

Goods are defined to mean every kind of movable property other than actionable claims and money. The term 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 [Section 2(7)].

Stock and shares have been expressly included in the definition of goods primarily to avoid any misunderstanding because they are excluded from the term 'goods' under English Law.

You will have noticed that 'money' and 'gctionable claims' have been expressly excluded from the term 'goods'. 'Money' means the legal tender, it excludes old coins and foreign currency, as they can be sold or bought as goods. Sale and purchase of foreign currency is, however, regulated by the Foreign Exchange Regulation Act. 'Actionable claims' like debts arc things which a person cannot make use of, but which can be claimed by him by means of a legal action. Actionable claims cannot be sold or purchased like goods, they can only be assigned.

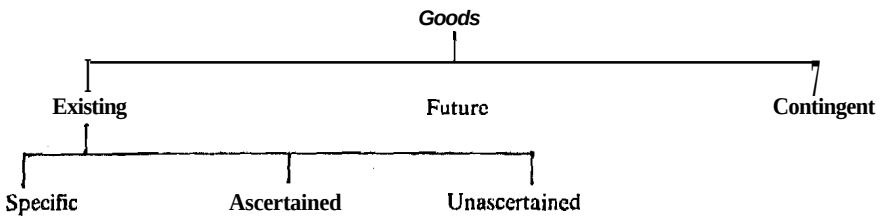
Thus, you should note the goods include every kind of movable property, i.e., things which can be carried from one place to another. However, all such things which form part of the Iand itself but are agreed to be served from the land under the contract of sale, are considered as goods. Thus, grass, growing crops, trees to be cut and their log

.vood to be delivered are goods as per the above definition, similarly things like goodwill, copyright, trade mark, patents, water, gas, electricity are all goods and may be the subject-matter of a contract of sale.

## 16.6.2 Types of Goods

The goods forming subject-matter of the contracl of sale may be classified into following types as shown in Figure 16.1.

**Figure 16.1: Types of Goods**




Existing Goods

As per Section 6 of the Act, *existing goods are those goods which are owned or possessed by the seller at the time of contract of sale,* The seller is either the owner of goods or he is in possession of goods. For example A, a manufacturer of fans, sells a fan to B. It is a contract of sale of existing goods because A owns the fan. Similarly when a person sells goods possessed buy not owned by him such as sale by an agent, it is a sale of existing goods. For instance in the above example, if the manufacturer sends the fans to his agent in Delhi and sells them through the agent it is a sale of existing goods because the dealer possesses the goods, although he is not the owner of them, at the time of the contract of sale. The existing goods may be '

i) **Specific goods:** These are the goods which are identified and agreed upon by the parties at the time a contract of sale is made [Section 2(14)], for example, a specified watch, ring or a car.

ii) **Ascertained goods:** Though normally used as synonym for specific goods, ascertained goods are intended to include goods which have become ascertained subsequently to the formation of the contract. In *re Wait,* Lord Atkin observed that ascertained probably means "identified in accordance with the agreement after the time a contract of sale is made." When the 'unascertained goods' are identified and agreed upon by the parties, the goods are called 'ascertained'. You should note that ascertainment involves unconditional appropriation of the goods as the subject-matter of a particular contract. Thus when out of a mass of unascertained goods, the quantity contracted for is identified and set aside for a given contract, the goods arc said to be ascertained.

iii) **Unascertained** goods: These are the goods which are not identified and agreed upon at the time when the contract is made. They are identified only by description. For example, A, who owns and Ambassador car show room, has 50 cars and agrees to sell any one of them to B. The contract is for unascertained goods, because which particular car shall be sold to B has not been identified at the time of the contract af sale.

**Future Gouds**

As per [Section 2(6)] of the Act *'futuregoods' means* **goods** *to be manufactured or produced or acquired by the seller after making the contract of sale.* Thus, future goods are goods which either are not in existence at the time of Contract of sale or hey may be in existence when the agreement of their sale is entered upon but have ot yet been acquired by the seller by that time. For example, S agrees to buy the ntire crop of wheat that would yield in B's farm, at the rate of rupees 200 per uintal. This is an agreement of sale of future goods. As future goods are not in the ossession of the seller at the time of contract, they can become the subject-matter of n agreement to sell only and not the contract of sale.

**Contingent** Goods

ontingent Goods are the goods the acquisition of which by the seller depends upon contingency which may or may not happen [Section 6(2)]. For example, A agrees sell to B a certain painting only if C, its present owner, sells it to him. Here the ntract is for the sale of contingent goods as the availability of the painting depends its sale by C.

## 16.7 EFFECT OF DESTRUCTION OF GOODS

You have learnt in Block 1 that a contract becomes void on the destruction of the subject-matter. Similarly a contract of sale becomes void on the destruction of goods We can study the effect of destruction of goods under following two heads.

1 **Goods perishing** before **making of the contract:** Sometimes, the goods might have perished before making of the contract of sale. In such a situation the contract of sale is void. Section 7 of the Act provides that a contract for the sale of specific goods is void, if at the time when the contract was made, the goods have without the knowledge of the seller, perished or become so damaged as no longer answer to their description in the contract. This is based on the principle of impossibility of performance of the contract. Thus, the contract of sale shall b void on the destruction of goods, if the following conditions are satisfied:

a) It must be a contract of sale for specific goods;
b) The goods must have perished before making of the contract; and
c) The seller must not be aware about the destruction of goods.

**Examples**

i) A agrees to sell a horse to B. Unknown to both the parties, the horse was dead a the time of making the contract. This contract of 'sale is void.

ii) A agrees to sell 1,000 bags of sugar coming on a particular ship. On arrival of the ship, it is discovered that because of sea water entering the cabin the sugar had become syrup (sharbat). The contract is void as the goods no longer answer to their description.

Sometimes, only part of the goods may be destroyed. In such a situation, the decidin factor would be whether the contract is divisible or indivisible. If the contract is divisible and only a part of the goods are lost, then the contract remains valid for tha part which is in good condition. In *Barrow* Lane *& Ballard* v. *Philips,* A agreed to sell to B a parcel of 700 bags of groundnuts lying in his godown. Unknown to A, 10 bags had been stolen at the time of the contract. A, therefore, tendered delivery of the parcel containing 591 bags. It was held that the contract had become void and B cannot be compelled to accept 591 bags because the contract was indivisible.

**Goods perishing** before **sale but after agreement to sell:** It is also possible that the goods might perish after an agreement to sell is made but before it becomes a sale. In this connection Section 8 of the Act provides that in an agreement to sell specific goods, the agreement becomes void if the goods are destroyed without any fault of the seller or the buyer. This rule is based on the fact that it was only an agreement tc sell and the goods were lost before the passing of the risk.

In *Eliphic v.* Barnes, a horse was delivered on trial for eight days. However, the hors died on the third day, without any fault of either the seller or buyer. It was held that this agreementis void and the seller could not recover the price from the buyer.

You should note that Section 7 and 8 are applicable only in case of specific goods. Therefore, if unascertained goods are destroyed either before or after making the agreement, the contract shall not become void. Thus, in an agreement to sell unascertained goods, even if the entire stock of goods is destroyed, the contract shall not become void and the seller will have to perform his promise. For example, A agreed to sell to B 100 bags of wheat from his stock of 1,000 bags in his godown. The entire stock was destroyed by fire. A is bound to deliver 100 bags of wheat or else he will be liable for damages.

**Check Your Progress B**

1 Define the term ''Goods'.

.....

.....

2 What do you mean by specific goods?

.....

.....

.....

3 What is the main feature of hire-purchase agreement?

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.....

.....

4 What is the effect of destruction of specific goods on a contract of sale?

.....

.....

.....

5 State whether the following statements are True or False:

i) A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a price.

ii) In case of sale 'on instalments', the seller has a right to take possession of the goods if the buyer fails to pay any instalments.

iii) When **A** buys certain goods from B and the payment is to be made partly for the goods and partly for a service, it is a contract of sale.

iv) In a .'sale', insolvency of the buyer entitles the seller to withhold the possession of the goods if price remains unpaid.

v) Goods in return for goods is an acceptable mode of sale of goods.

vi) In case of hire-purchase agreement, the hirer has an option to buy or refuse to buy.

vii) In a sale, if the goods are destroyed, the loss falls on the seller.

viii) A rare coin can be the subject-matter of a contract of sale.

ix) Future goodscannot be the subject-matter of a sale.

## 16.8 LET US SUM UP

A contract of sale of goods is a specie of contracts but since a distinct legislation, viz., Sale of Goods Act regulates it, the transactions relating to sale and purchase of goods fall within the purview of the Sale of Goods Act. However, where 'specific provisions are not available in this Act, the provisions of Indian Contract Act shall apply.

Contract of sale of goods may take the shape of sale or an agreement to sell. The two have different legal implications. Sale should also be distinguished from contracts for work and labour and the hire-purchase agreements.

The subject-matter of a contract of sale, is 'goods'. Goods, generally, mean movables other than actionable claims and money. Certain items have, however, been specifically included in goods. These are stock and shares, growing crops, grass and things attached to or the land which are agreed to be severed before sale or under the agreement of sale. Goods may be existing goods, future goods or contingent goods. A contract of sale of goods becomes void on the destruction of goods provided certain conditions are satisfied

## 16.9 KEY WORDS

***Sale*** **:** ***A*** contract of sale where the property in goods passes from the seller to the buyer when the contract is made.

***Price*** *:* It means the money consideration for sale of goods.
***Agreement to Sell:*** When the property in goods is to transfer at a future time or subject to some condition being fulfilled.

***Jus in personam*** **:** Rights against a particular person.

***Jus in rem*** **:** Rights against the whole world.

***Property :*** It means the general property in the goods and not merely a special property.

## 16.10 ANSWERS TO CHECK YOUR PROGRESS

**A4** i) False; ii) True; iii) False; iv) True, v) True; vi) True.
A5 i) True; ii) False; iii) True; iv) True; v) False; vi) True; vii) False; viii) True; ix) True.

## 16.11 TERMINAL QUESTIONS/EXERCISES

1 Define a contract of sale. How is a contract of sale different from an agreement to sell?

2 Explain the essentials of valid contract of sale.

3 How is a contract of sale made? State briefly with illustrations the necessary formalities of such a contract.

4 What is meant by goods? What are the various types of goods?

5 Distinguish between sale and hire-purchase agreement.

6 What is the effect of destruction of specific goods on a contract of sale?

7 What is a 'Contract for work and labour'? Distinguish it from sale.

8 Answer the following, giving reasons for your answer:

i) A agreed to sell his radio set to B for 20 kg of rice. Is it a contract of sale?

ii) A delivered a manuscript to B for printing. B agreed to use his own ink and paper for printing the book. Is it a contract of sale?

iii) A gave a piece of cloth to a tailor to make a suit for him. The tailor agreed to supply the lining material and buttons. Is it a contract of sale?

iv) A purchased certain books from a book-seller and agreed to take them with him on his way home. As a result of accidental fire in the shop, the books were lost. Who will bear the loss and why?

v) A sold a piano on hire-purchase basis to B. After paying five instalrnents, B refused to pay the remaining instalments and sold the piano to C. Can A recover the piano from C?

vi) X sold to Y 100 bags of cement lying in his godown. As a result of heavy rainfall the cement has become stone on the date of making the contract, but this fact was not known to either party, Advice Y.

vii) A agreed to sell to B all the wheat that will be grown in his farm, Before the crop was ready for harvesting as a result of flood, it was totally destroyed. Is A bound to deliver the goods?

*Hints*

i) No. It is barter and not sale.

ii) No. It is a contract for work and material.

iii) It is a contract for work and material and not a contract for sale of goods.

iv) A will bear the loss because it is a contract of sale and at the time of loss A was the owner of books.

v) Yes. A can recover piano from C because it was a hire-purchase agreement and the hirer has no title to it.

vi) The contract is void (Sec. 7)

vii) The contract is void (Sec. 8).

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

# UNIT 17 CONDITIONS AND WARRANTIES

## Structure



## 17.0 OBJECTNES

After studying this unit you should be able to :

- describe the meaning of the terms 'Condition' and 'Warranty' in relation to sale and purchase of goods.
- distinguish between a 'Condition' and a 'Warranty'
- list the conditions and warranties implied under the Sale of Goods Act.
- discuss as to when a condition may be treated as a warranty
- explain the fundamental principle of sale of goods, viz., Doctrine of Caveat Emptor.

## 17.1 INTRODUCTION

We are all consumers in one way or another. We may purchase goods for our own consumptions or for producing other goods. Many a times, we are attracted by certain claims made by the sellers in respect of their goods. Sometimes, it may be only because of such claims about the quality, usefulness or suitability of these goods that we decline to buy a brand of goods as against other competing brands.

At other times, we may decide to buy a particular brand because it carries certain assurances as to its fitness, etc. Such claims are called conditions and warranties. Such assurances or representations may either be a condition or a warranty.' In this Unit we shall study the meaning of conditions and warranty, the distinction between them and their effect on the contract of sale.

Besides, as a measure of consumer protection, Sale of Goods Act, 1930, assumes every contract of sale of goods (unless agreed to between the parties) to be subject to certain stipulation. These stipulations are called as implied conditions and warranties. In this unit, we shall also study these 'implied conditions and warranties.'

## 17.2 MEANING AND DEFINITION OF CONDITION AND WARRANTY

Many a times a seller of goods makes certain claims about the goods he offers for sale. These claims may relate to the quality, use, suitability, utility, etc., of those

subject-matter of the contract. These assurances may be a mere expression of opinion of the seller and may not form part of the contract. But, sometimes they may form part of the contract and the buyer buys the goods on the faith of such assurances. In such a case they have legal effect on the contract. An assurance or representation which forms part of the contract of sale is tenned as 'stipulation'. All such stipulations cannot be treated at the same footing. Some may be intended to be of a fundamental natare whereas others may be subsidiary or merely an expression of an opinion. Depending upon whether a representation is fundamental or subsidiary, it ranks as a 'condition' and 'warranty'. If a stipulation forms the very basis of the contract, it is a 'condition'. On the other hand, if the stipulation is collateral to the main purpose of the contract, i.e., is of a lesser importance, then it is known as a 'warranty'.

### 17.2.1 Definition of Condition

The term 'Condition' is defined under Section 12(2) of the Sale of Goods Act, 1930. According to this Section, a *condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.*

Thus, a condition is that stipulation which goes to the root of the contract and thus forms the basis of the contract. It is essential to the main purpose of the contract. It is that obligation the non-fulfilment of which may fairly be considered as a substantial failure to perform the contract at all. Therefore, if a condition is not fulfilled, the buyer has a right to put an end to the contract and also recover damages for the breach of contract.

The aforesaid description of condition is well illustrated by the case of *Baldry* v. *Marshall.* In this case 'B' consulted 'M', a motor car dealer, for a car suitable for touring purposes. M suggested a 'Bugatti' car and B accordingly bought it. The car turned out to be unfit for the touring purpose. It was held that the term that 'car should be suitable for touring purposes was a condition of the contract. It was so vital that its non-fiilfilment defeated the very purpose fur which B bought the car. He was, therefore, entitled to reject the car and have refund of the price.

### 17.2.2 Definition sf Warranty

According to Section 12(3) of the Sale of Goods Act, 1930, a *warranty, is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.* In other words, warranty is a stipulation which is not essential to the main purpose of the contract i.e., it is of a subsidiary or collateral nature. If there is a breach of warraniy, the buyer cannot repudiate the contract, but he can only claim damages from the seller. In the case discussed above if the buyer had asked for a good car and while selling the car the dealer said that it could run for 15 kms per litre of petrol. But it was discovered that it could run only 12 kms per litre of petrol. Here, the statement made by the seller would amount to a warranty and the buyer could not terminate the contract and he was cntitlcd to claim damages only.

## 17.3 DISTINCTION BETWEEN CONDITION AND WARRANTY

From the aforesaid discussion, you must have noted that the difference between the two terms viz., 'Condition' and 'Warranty' is not that of a degree and not that of kind. The crux of the decision shall lie on the fact as to whether a stipulation forms the basis of the contract or is only a collateral promise. Thus, where the buyer wouldn't have purchased those goods but for that stipulation, it shall be construed as a condition. On the other hand, if the buyer would have so purchased and the stipulation is only designed to provide an assurance as to the quality or suitability of the goods, it shall be a warranty. The distinction between the two stipulations is to be measured from the point of view that if the stipulation is such that its breach would make the rights of the aggrieved party nugatory, then such a stipulation is condition

and where the stipulation is only auxillary, it is a warranty. One may, therefore, say that whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract as a whole. The court is not to be guided by the terminology used by the parties to the contract, but is to be guided by the intention of the parties which can be gathered from the terms of the contract and circumstances. Section 12 (4) endorses this view and provides that *a stipulation* may *be a condition, though called a warranty in the contract.*

The above mentioned point may be clarified with the help of the following example:

'A', who desires to purchase a horse, goes to a horse dealer and asks the horse dealer to give him a quiet and non-vicious horse. The horse which the dealer supplies him turns out to be a hostile horse and on the very first ride throws him down resulting in broken limbs. In this case, the statement made by the buyer that he wants a quiet horse was a condition essential to the main purpose of the contract. Therefore, A can reject the horse and get back the price. The buyer can also claim damage for the injuries suffered by him.

But, if 'A', himself selects a particular horse and then seeks the seller's assurance as to its being quiet and non-vicious, the stipulation shall be a 'warranty' and the only remedy of the buyer shall be a claim for damages, he cannot return the horse and claim the price.

On the basis of the above discussion, the points of distinction between the two can be summarised as follows :

| | Condition | | Warranty |
|---|---|---|---|
| 1 | A condition is a stipulation (in a contract), which is essential to the main purpose of the contract. | 1 | A warranty is a stipulation which is only collateral to the main purpose of the contract. |
| 2 | A breach of condition gives the aggrieved party a right to sue for damages as well as the right to terminate the contract. | 2 | A breach of warranty gives only the right to claim damages. The contract cannot be terminated. |
| 3 | In the event of the breach of a condition, the aggrieved party may choose to treat the breach of condition as a breach of warranty. A buyer may for instance, like to retain the goods and claim only damages. | 3 | A breach of warranty cannot be treated as a breach of condition. |

## 17.4 KINDS OF CONDITIONS AND WARRANTIES

Condition and warranties may either be express or implied.

### 17.4.1 Express Condition and Warranties

They are said to be express when the terms of the contract expressly provide for them. Thus, where a buyer desires to buy 'While Maruti Car', the colour of the car becomes an express condition. If the two contracting parties desire they may put the contents of any specific statement or promise which has taken place between them at par as the description of the thing contracted for. This then shall be treated as express condition. The parties are at liberty to impose any condition or warranty by an express agreement in a contract of sale.

Similarly, you must have noticed companies advertising their products carrying guarantee for a certain period, for instance, 'Orient Fans — Guaranteed for Two Years'. 'Binatone TVs — Three Years Guarantee on Picture Tube'. All these are example of express warranties.

### 17.4.2 Implied Conditions

Conditions and Warranties are said to be implied when the law infers their existence as implict in the contract even without their actually having been put in the contract. Hence, unless otherwise is agreed upon between the parties, every contract of sale of goods shall be subject to these implied conditions and warranties. But the parties do have the right to exclude any of the implied conditions or warranties by specifically

and expressly providing otherwise. The implied conditions and warranties are enforced because the law deem: that in the circumstance of the contract the parties desired to add these stipulations to their contract but did not put them expressly. These implied conditions and warranties are contained in Sections 14 to 17 of the Act and are as follows :

1 **Conditions as to title (ownership):** Sale involve transfer; of ownership and possession. Therefore, Section 14 (a) provides that 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 he has a right to sell the goods, and that in the case of an agreement to sell, he will have a right to sell the goods at the time when the property (ownership) is to pass.

The aforesaid provision, you should note, is based upon a simple logic that only an owner has the right to effect a valid sale of goods, since only he (subject, however, to certain exceptions which you will study later under 'Sale by Non-owners') can confer ownership. The rule of law is *Nemo dat quod non-habat,* i.e., one cannot give what one does not have'. In every contract of sale there is an implied condition that the seller has a valid title to the goods. This condition is very essential to protect the interest of innocent buyers.

The following example will clarify the point further :

A purchased a car from B who had no title to it. A used the car for several months. After that, *C,* the true owner, spotted the car and demanded it from A. Held, that A was bound to hand over the car to its true owner. A's remedy is to sue B, the seller without title, for the recovery of the price and damages even though several months had passed *(Rowland v. Divall).*

However, this condition like other implied conditions, may be negatived by an express terms. Thus, where a thief goes to a *'Chor Bazar'* to sell the stolen goods to the knowledge of the buyer thereof, the buyer may not get the refund of sale price if those goods are to be restored to its real owner. Similarly, when the custom authorities, sell any confiscated items they are absolved from any responsibility with respect to the owners title. It should further be noted that the seller should have the right to sell the goods. The term 'light to sell' is wider than 'right to pass ownership'. Thus, a seller has no right to sell, if he infringes the trade mark of another person.

Therefore if the seller sells the goods in contravention of trade mark laws, it is regarded as a breach of implied condition as to title. In such a case the buyer will have a right to terminate the contract of sale. In ***Niblett Ltd. v. Confectioner's Materials Co.*** certain tins of condensed milk bearing the label "Nissly Brand" were sold by A to B. In order to save themselves from any liability under the trade mark laws, B had to remove the labels and sold the naked tins at loss. A was held liable for breach of implied conditions that they had a right to sell.

2 **Sale by description:** Sometimes, the goods arc sold by description. In such a case, Section 15 lays down that there *where there* ***is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with description.*** The term 'correspond with 'description' means that the goods supplied must be same as were described by theseller. If it is found that the goods supplied do not correspond with the desqiption, the buyer has a right to reject the goods and claim damages. The term 'sale of goods by description' is wide and shall include many situations.

i) It will include a case where the buyer has never seen the goods and buys them only on the basis of the description given by the seller. For example, in a sale of a reaping machine, the seller described it to be only one year old and used only to cut 50 to 60 acres. On delivery, the buyer found that the machine was extremely old. The buyer was entitled to reject the machine as it did not correspond with the description given by the seller *(Varley* v. *Whipp).*

Similarly, where a person orders for a 'Philips Juicer-made in Japan' it will not be a sufficient compliance if a 'Philips Juicer-made in Hongkong' is supplied to him.

ii) Even where the buyer has seen the goods, it may be treated a sale by description, if he purchases those goods not on what he has seen but what was stated to him. Thus, where a person orders 100 bags of a particular variety of 'Punjab Wheat' and the wheat supplied to him is found to be 'Gujarat Wheat', condition as to description shall be deemed to have been violated inspite of the fact that buyer was shown the wheat to be delivered. Similarly, in an auction sale, a set of linen napkins and table cloths were described as "dating from seventeenth century". The buyer, who was a dealer in antiques, purchased the same after seeing it, but later found it to be an "eighteenth century set". It was held that they having relied on the description, the buyer had a right to return the same for not conforming to the description. *(Nicholson* and *Venn. v. Smith Marriott).*

iii) The methods of packing may also form part of the description, For example, where a seller agrees to deliver 5,000 tins of canned fruit to be packed in cases each containing 50 tins, the buyer shall have a right to reject the goods if the cases contain 'more' or 'less' than 50 tins.

**3** Sale by sample: Sale by sample means that the seller has shown a sample of the goods to the buyer and has agreed to supply the goods according to the sample. It cannot be assumed that in all cases, where sample is shown, the sale shall be a sale by sample. In cases where there is no term to that effect, it is assumed that the sample is not shown as a warranty, but only to enable the buyer to form a reasonable judgement about the gcods to be bought. The goods supplied may marginally differ. They may be inferior or superior to the sample shown,

In case of a contract of sale by sample, law assumes the sale to be subject to the following three implied conditons:

i) The goods must correspond in quality with the sample, i.e., the buyer shall have a right to reject goods inferior or superior to the sample.

ii) The buyer shall have a reasonable opportunity of comparing the goods with the sample. Thus, the seller will have to take the goods back, if they are not found to be according to the sample. In fact, depending upon the nature and volume of the goods involved, opportunity to compare the goods with the sample shall be available to the buyer. For example, in a sale of 100 bags of wheat, the buyer is given an opportunity to examine the contents of three bags only. The buyer can terminate the contract.

iii) The goods shall be free from any defects rendering them unmerchantable, which would not be apparent on reasonable examination of the sample, i.e., Iatent defects. Such defects are discovered when the goods are put to use. However, seller will not be liable for apparent or visible defects which could be easily discovered by an ordinary prudent person. For example, A sold to B certain quantity of worsted coating equal to sample. The coating was equal to sample but had a latent defect as a result of which the cloth was found lo be unfit for making coats. It was held that the buyer could reject the goods. The reason for this was that though the sample also contained the defect was not apparent on an examination of sample *(Drummond & Sons v. Van Ingen).*

4 Sale by sample as well as by description: If the sale is by sample as well as by description, Section 15 requires that the goods must not only correspond with the sample but should also correspond with the description. The following examples explain the point :

i) *In Wallis* v. *Pratt* Case the agreement was for the sale of 'English Sainfoin Seeds', exhibited by sample and described as common English Sainfoin. However seller did not give any warranty regarding the growth description or any other matter. The seeds supplied did correspond to the sample but both the sample and the seeds supplied were found to be 'Gaint Sainfoin', in altogether different variety. Held, there was a breach of condition as to description and therefore the buyer may recover damages from the seller.

ii) 'Foreign refined rape-seed oil' was sold which was warranted to be equal to sample. The oil which was supplied by the seller was according to the

sample. The sample was actually not 'foreign rape-seed oil' but contained a mixture of rape oil and hemp oil . Held, the buyer could reject the oil *(Nichol v. Godts).*

5 **Condition as to quality or fitness:** The general rule in respect of the sale of goods is that a buyer is supposed to satisfy himself about the quality as well as the suitability of the goods. Thus, later on, if the goods turn out to be unsuitable or unfit for the purpose he purchased them for, he shall not be entitled to return or exchange them or seek compensation. There are, however, certain exceptions to this rule. It is in these exceptional circumstances that implied condition as to fitness applies.

Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer 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 (whether he is the manufacturer or producer or not) there is an implied condition that the goods shall be reasonably fit for such purpose [Section 16(1)]. Thus, to avail of the condition as to fitness, all the three conditions must be satisfied, viz.,

i) the exact purpose for which the goods are being bought must have been disclosed (expressly or impliedly) by the buyer to the seller,

ii) the buyer must have relied upon the seller's skill or judgement with respect to the fitness of the goods for any particular purpose,and

iii) the seller's business must be to sell such goods (the condition cannot be invoked against a casual seller).

Thus, in *Priest v. Last, a* draper went to a chemist shop and asked him to give a hot water bottle. He told him the purpose also for which it was required. The Chemist gave the hot water bottle but told him only to use hot water because the bottle would not stand the boiling water. While the bottle was being used, it burst and injured her. *Held,* breach of condition as to fitness was committed and the Chemist was liable for refund of price as well as damages because the bottle was unfit for being used as a hot water bottle.

When the goods can be used only for one particular purpose, the buyer need not tell the seller the purpose which the goods are being bought. Thus, a refrigerator that failed to make ice would be rejected on grounds of breach of this condition *(Evens v. Stelle Benjamin).* A set of false teeth bought from a dentist may be rejected if they do not fit the buyer's mouth *(Dr. Baretto v. T.R. Price).*

The problem may arise where the goods are capable of being put to multiple uses. In such a case, to avail the relief under the aforesaid condition, the buyer must show that he had explained to the seller the exact purpose for which the goods were purchased. *For example, in Re : Andrew Yule & Co.,* hessian cloth, which is generally used for packing purposes, was supplied to buyer in accordance with his order. The buyer found it unfit for his purpose of packing foodstuffs because this cloth has a peculiar smell, although it was good as a packing cloth. *Held,* the buyer cannot reject it because hc had not disclosed to the seller, the particular purpose for which he required the cloth. The buyer need not disclose the exact purpose for which he is buying the goods when the goods are fit only for a specific purpose or where the nature of the goods itself by implication tells the purpose for which they are being bought. In those conditions the purpose is deemed to have been impliedly told. For example, if the buyer demands a cold drink from the seller, it is implied that the buyer needs it for consumption and subsequently, if it is found to contain BVO or some other unhealthy contents, it is a breach of implied condition as to fitness and makes the seller liable to pay damages.

***However,*** *condition as to fitness shall not be applicable in the following cases :*

i) *Where the buyer fails to disclose to the seller any abnormal circumstances.* In *Griffith v. Peter Conway Ltd.,* a woman with abnormally sensitive skin asked for a warm tweed coat and was supplied a 'Harris Tweed Coat'. She got rashes on

wearing the coat. Her claim for return of price and damages was struck down because there was nothing in the Harris tweed which would have affected the skin of a normal person and she had failed to inform the seller about her abnormally sensitive skin.

ii) When the buyer buys the goods by a patent or other trade name. Thus, where a person goes to a chemist and purchases 'Bournvita' as a health drink, hc cannot claim any compensation if he finds no improvement in his health in spite of its prolonged use.

6 **Condition as to merchantable quality:** Section 16(2) of the Act provides that where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. The expression 'merchantable quality' in simple words means that the quality of the goods shall be such that they are capable of being used as the goods of that description and should be free from any latent or hidden defects. If the goods are purchased for resale, then they should be resaleablc in the market under the description by which they arc ordinarily known in the market. There should be no defect in the goods which renders them unfit for sale. For example, if sugar becomes syrup (Sharbat) it is no longer merchantable. The term 'merchantability' also means that the goods must be properly packed. For example, A purchased wine from B. While opening its cork in the normal manner, the bottle broke off and injured A's hand. It was held that the bottle was not of merchantable quality and A could recover damages from B.

**Examples**

a) A person purchases a 3 metre suit length to make it into a three-piece suit and gives it to the tailor for stitching. The tailor after stitching coat and waist-coat finds that the balance of the cloth is sufficient to make only half-pants instead of full pants—the cloth having a texture defect, i.e., it is not uniform throughout its width. The buyer shall have a right to claim compensation.

b) 'A' purchases Black Yarn from 'B' and finds it to be damaged by white ants, the condition as to merchantability shall be said to have been breached.

c) A sold a plastic catapult to B. While B's son was using it in the usual manner, the catapult broke due to the fact that the material used in its manufacture was unsuitable. As a result, the boy was blinded in one eye. It was held that A, the seller was liable as the catapult was not of merchantable quality *(Godley* v. ***Perry).***

It should be noted here that when the buyer buys the goods after examining them, the implied condition as to merchantability shall not be applicable as regards those defects which the buyer by an ordinary examination could have discovered. For example, A purchased glue from B, which was packed in barrels. A was given every facility to examine the goods, but the buyer **A** did not bother to examine the contents. Here A cannot reject the goods by saying that they are not merchantable. Had he taken the trouble of examining the goods, he would have easily discovered the defect *(Thornett v. **Beers).***

7 **Condition as to wholesomeness:** In case of items which are supposed to be physically consumed, e.g. provisions or foodstuffs, condition as to merchantability assumes another form, viz., condition as to wholesomeness. Condition as to wholesomeness means that the goods shall be fit for human consumption, that is, they shall not be stale or contaminated. In ***Frost*** v. *Aylesbury Dairy Co. **Ltd.*** F bought milk from A's dairy. The milk containea typoid germs.: F's wife consumed the milk, became infected and died. A was held liable for damages because the milk was not fit for human consumption. Thus, an action shall lie if a 'house fly' is found in a bottle of cold drink or a 'lizard' in a bottle or pack of milk and the consumer, therefore, suffers thereby.

## 17.4.3 Implied Warranties

There are only two implied warranties under the Act and both of them are in fact necessary corrollories to the 'implied condition as to title'. These are:

1 Warranty as to quiet possession: In every contract of sale, unless contrary intention appears from the circumstances of the contract, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. Thus, if the right of enjoyment or possession of the buyer is disturbed by the seller or any other person, the buyer shall be entitled to sue the seller for damages. Breach of this warranty shall arise where the title of the seller is not exclusive and he has not been conferred a clear right to effect the sale or where his title is defective.

This implied warranty can be understood by referring to the case of *Niblett Ltd. v. Confectioner's Materials Co. Ltd.* which you have already read in this unit. In that case the seller were held rcsponsiblc for two things. Firstly that they had committed a breach of implied condition as to their title and secondly, for committing breach of implied warrantly that the buyers would have quiet possession of the goods sold.

2 Warranty of freedom from encumbrances: Under his warranty, the buyer is entitled to assume that the goods are free from any charge or encumbrance in favour of any third person, not declared to or known to him before or at the time when the contract is made. Thus, this clause will not be applicable where the buyer has been informed of the encumbrances or has notice of the same. Further, it was held in *Collinge. v. Heywood* case that the claim under this warranty shall be available only when the buyer discharges the amount of encumbrance. If the possession of the buyer is disturbed due to such charge in favour of a third person, he can claim damages from the seller. For example, A sells certain goods to B. A had already taken a loan of Rs 500 from X on the security of those goods- B was not aware about this charge on the goods. B had to pay Rs 500 to X in order to enjoy the goods. Now B can claim this amount from A.

## 17.5 WHEN BREACH OF A CONDITION IS TO BE TREATED AS A BREACH OF A WARRANTY?

Section 13 provides for certain circumstances where a condition may be reduced to the status of a warranty. Consequently, the buyer loses his right to reject the goods. His only remedy in such case shall be to claim damages. This shall happen in the following cases:

1 Waiver by buyer: Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may: (i) waive the condition; or (ii) elect to treat the breach of condition as a breach of warranty. You know that the conditions, express or implied, are for the benefit of the buyer. He has, therefore, the option to waive the breach of a condition and accept the performance short of it. In that case, he remains liable for the price but may only recover damages if there is any breach. Once the buyer exercises his option, he cannot later on compel the seller for its fulfilment.

2 Compulsory treatment of breach of condition as breach of warranty: When the contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty. As per Section 42 of the Act, a 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 (a) he does any act in relation to them which is inconsistent with ownership of the seller (say, pledges the same), or (b) when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them,

But if the contract is severable, and the buyer has accepted part of the goods, he can still exercise his right to reject the remaining goods.

## 17.6 DOCTRINE OF CAVEAT EMPTOR

'Coveat Emptor' is a fundamental principle of the law relating to sale of goods. It means 'Caution Buyer', i.e., Let the buyer beware'. In other words, it is no part of the seller's duty to point out defects of the goods he offers for sale. The buyer must examine the goods and find out their suitability for the purpose he buys them for.

**Examples**

a) A person buys a readymade shirt for his son, he will not have a right to return or exchange the same if the shirt doesn't exactly fit his son, i.e., too tight or loose.

b) Pigs were sold 'subject to all faults', and these pigs, being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. (*Goddard Hobbs*)

**Exceptions**

The doctrine of 'Caveat Emptor' is. however, subject to the following exceptions:

1 Where the seller makes a misrepresentation and the buyer relies on that representation, the rule of 'Caveat Emptor' will not only apply and the contract entered between the parties would be a contract voidable at the option of the buyer.

2 Where the seller actively conceals a defect in the goods, so that on a reasonable examination the same could not be discovered, or where the seller malces a false representation amounting to fraud, and the buyer, relying upon the false representation, enters into a contract with the buyer, in both these circumstances the resulting contract would be a voidable contract. The buyer's remedy in that is that he can put the contract to an end and can also claim damages from the seller for fraud.

3 Where the buyer makes known to the seller the purpose for which he is buying the goods, so as to show that the buyer relies on the seller's skill or judgement and the seller happens to be a person whose business is to sell goods of that description, then there is an implied condition that the goods shall be reasonably fit for such purpose. The rule of 'Caveat Emptor' will not apply in such cases.

4 In case of sale by description where the goods are bought from a seller who deals in such goods there is an implied condition as to their being of a merchantable quality, i.e.,they should be capable of being used as such goods. For example, a cricket bat should be fit enough to play cricket with a 'cricket ball'. If the goods are not found to be of merchantable quality, the seller cannot take the defence of the doctrine of Caveat Emptor. But, if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed, i.e., in such cases the rule of Caveat Emptor will be applicable.

5 An implied warranty or condition as to quality or fitness for a particular purpose may be annexed (attached) by the usage of trade Section 16(3). This exception may be explained by the facts of Jones *v. Bowden's* case as follows:

It was usual in the sale of drugs by auction that if the goods were sea damaged, it should be declared.

This usage in effect created an implied condition that when the drug were sold without such declaration, they were free from sea damage. In this case the seller exhibited the sample without disclosing that the drugs were sea damaged, The rule of Caveat Emptor would, therefore, not apply here.

6 Where the goods are sold by description and the goods supplied by the seller do not correspond to the description, this doctrine would not apply.

7 If the goods are sold by sample and the bulk of the goods supplied do not correspond with the sample, this doctrine would not apply. In addition to it, when the goods are delivered and the buyer is not provided an opportunity to compare the goods with the sample or where there is any latent defect in the goods, the doctrine will not apply.

8 In a sale by sample as well as by description, if the bulk of the goods supplied does not correspond to the sample as well as with description, this doctrine will not apply.

## Check Your Progress A

1 Define 'Condition' in a contract of sale.

.....

.....

.....

2 What is a 'Warranty' in a contract of sale?

.....

.....

.....

3 What is a sale by sample?

.....

.....

.....

4 When can a breach of condition be treated as a breach of warranty?

.....

.....

.....

5 Fill in the blanks

i) A condition is a stipulation ..... to the main purpose of the contract of sale of goods.

ii) A warranty is a stipulation ..... to the main purpose of the contract of sale of goods.

iii) A contract of sale involves transfer of .....

iv) An implied condition as to quality or fitness for a particular purpose may be annexed by the ..... of trade

v) In a contract of sale of eatables, there is an implied condition that the goods shall be ..... and ..... for human consumption.

6 State whether the following statements are True or False

i) Breach of condition gives rise to a claim for return of price as well as damages.

ii) Breach of warranty entitles the buyer to only claim return of price.

iii) A breach of condition can be treated as a breach of warranty.

iv) 'Sale' and a 'Contract of Sale' are interchangeable expressions.

v) In case of sale by sample the bulk must correspond to sample as well as be merchantable.

vi) When the goods are sold by trade mark, there is no implied condition as to their fitness.

7 Fill in the blanks.

ii) To avail relief under condition as to fitness, the condition to be satisfied are:

a) .....

b) .....

c) .....

8 Deepak purchased a Colour TV from M/s Paul Brothers for a sum of Rs 12,000. The TV set was defective from the beginning and it did not work in spite of repairs by the expert mechanics. Deepak wants to return the TV set to M/s Paul Bros, and claim refund. Advise.

## 17.7 LET US SUM UP

The seller sometimes makes certain claims, statements or representation about the goods which he intends to sell. These representations are called 'stipulations'. A stipulation in a contract of sale with reference to the goods which are the subject thereof may be a condition or a warranty.

A condition, is a stipulation essential to the main purpose of the contract. The breach of a condition gives the buyer the right to repudiate the contract and claim damages.

A warranty, is a stipulation collateral to the main purpose of the contract. The breach of warranty gives the buyer the right to claim damages only. He does not have a right to put an end to the contract. A breach of condition may be treated as a breach of warranty by the aggrieved party whereas a breach of warranty cannot be treated as a breach of condition.

In a contract of sale, condition and warranties may be express or implied. The express conditions and warranties are those which are agreed upon between the contracting parties at the time of contract. Implied condition and warranties are those which are implied by law, unless otherwise agreed upon by the parties. Implied conditions are (1) condition as to title, (2) sale by description (3) sale by sample, it includes that the bulk should correspond with the sample, goods should be free from any defect rendering them unmerchantable, the buyer should have the opportunity to compare the bulk with the sample (4) sale by sample as well as description (5) condition as to quality or fitness (6) condition as to merchantable quality (7) condition as to wholesomeness. Implied warranties are (1) warranty as to quiet possession, and (2) warranty of freedom from encumbrances.

Caveat Emptor means let the buyer beware. However this doctrine does not apply: (1) where the seller makes a misrepresentation, or fraud (2) where the seller conceals a defect in the goods, which cannot be found out on reasonable examination, (3) in case of sale by description (4) when there is usage of trade (5) In case of implied conditions and warranties.

## 17.8 KEY WORDS

***Caveat Emptor: Let*** the buyer beware

Encumbrance: A charge over goods

***Wholesomeness:*** Worthy of ***human*** consumption

Title: Ownership

***Stipulation:*** Representation or claims about goods

## 17.9 ANSWERS TO CHECK YOUR PROGRESS

5 i) essential, ii) collateral, iii) ownership, iv) usage, v) wholesome, fit

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

7 i) that the goods are capable of being used as the goods of that description.
ii) a) the exact purpose must have been disclosed.
b) the seller must be a dealer in such goods.
c) the buyer must have relied upon the seller's skill or judgement.

8 There is a breach of implied condition as to merchantability (i.e., the goods should be capable of being used as the goods of that description). A TV set, therefore, must function as a TV set. The dealer shall have to either replace the set or refund the price.

## 17.10 TERMINAL QUESTIONS/EXERCISES

1 Define and distinguish 'condition' and 'warranty'.

2 What is the doctrine of 'Caveat Ernptor'? What are the exceptions to this doctrine?

3 Discuss the provisions of Sale of Goods Act relating to the implied conditions in a contract of 'Sale by sample'.

4 In case of 'Sale by sample as well as by description', the goods must not only correspond to the sample but also to the description. Comment.

5 Under what circumstances does a 'Condition' descend to the level of a 'Warranty'?

6 State the two implied warranties in a contract of sale of goods.

7 Where a buyer has examined the goods, the condition as to merchantability extends only to the latent defects. Comment.

8 Answer the following problems giving suitable reasons:

i) A Railway company purchased timber for railway sleepers, the timber was unfit for the purpose. Advise the railway company.

ii) A contracts to sell B a saree which B believes to he a pure silk saree. A does not tell anything to B. Can B terminate the contract'?

iii) X sold a Campa Cola bottle to Y. While opening the bottle it bursts and injures Y. Can Y claim damages from X?

iv) Certain goods were sold by sample by A to B, who in turn sold them by sample to C. 'fie goods were not according to sample. Therefore, C rejected the goods and gave notice to B. B sued A. Advise B.

v) A contracts to sell to B timber of $\frac{1}{2}$" thickness. The timber actually supplied varied in thickness from $\frac{1}{2}$" to 5/8" and was fit for the purpose. Can B reject the timber?

vi) A desi ghee dealer while selling ghee described it as pure ghee. The ghee was adulterated. What is the remedy to the buyer?

***Hints***

i) Railway company can reject the timber, there is a breach of implied condition as to quality and fitness,

ii) No. The rule of Caveat Emptor will apply.

iii) Yes. The bottle was not merchantable.

iv) B is liable to C, and B cannot take action against A because B has accepted the goods. B can claim damages only from A.

v) Yes. The goods must correspond to the description.

vi) There is a breach of implied condition. The buyer can reject the goods.

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

# UNIT 18 TRANSFER OF OWNERSHIP AND DELIVERY

## Structure



## 18.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of transfer of ownership
- describe the significance of transfer of ownership
- state the rules regarding transfer of ownership,
- explain the cases where a non-owner can pass on a better title
- outline the meaning and types of delivery of goods
- describe the rules regarding delivery of goods and liability of the buyer.

## 18.1 INTRODUCTION

You have learnt in Unit 16 the meaning of the contract of sale of goods. From the meaning it should be clear to you that the main purpose of the contract of sale is transfer of ownership, the seller ceases to be the owner of the goods. There are various rights and liabilities of the parties which are linked with the transfer of ownership. It is, therefore, very important for us to know the exact time of transfer of ownership of goods from seller to the buyer.

In this unit, you will study in detail the various rules regarding the transfer of ownership of goods from seller to the buyer. You will further study the circumstances where even a non-owner can pass on a better title to the buyer. You will also learn the rules relating to the delivery of goods.

## 18.2 MEANING OF TRANSFER OF OWNERSHIP

In the Sale of Goods Act, the word property is used for the 'ownership'. When the goods are sold, it is the property in the goods which is transferred to the buyer. The term 'property in the goods' should not be confused with the physical 'possession of goods'. A person may be in possession of goods but he may not be the owner of

those goods. For example, an agent, or servant or a bailee may be in possession of goods, but is not the owner because the properly in the goods does not vest in him, he is holding the goods for his principal master or the bailor. Similarly, a person may be the owner of the goods but he may not be in possession of goods, for example, the principal, master or bailor may not be in possession of the goods but the property in goods vests in him. Thus, the transfer of possession of goods is not the same thing as the transfer of ownership, You will notice that the, ownership of the goads may pass with or without the transfer of possession.

In a, contract of sale of goods when the goods are sold to the buyer, the buyer becomes the owner of the goods irrespective of the fact whether the buyer has taken the delivery of goods or not. Thus, it should be clear to you that transfer of property or ownership means the legal ownership and not the physical possession of goods.

## 18.3 SIGNIFICANCE OF TRANSFER OF OWNERSHIP

In a contract of sale of goods, one of the most important question is 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. In business, the goods are generally bought for resale and it is only the owner of goods who can sell them. Therefore, a buyer who has become the owner of the goods can sell those goods. Thus, it becomes very important for us to know the exact moment as to when the ownership passes from the seller to the buyer for the following reasons:

1 **Risk passes with the ownership:** It is the rule of law that 'risk prima facie passes with the property' (Section 26). It implies that if the goods are lost or suffer any damage then whosoever is the owner of the goods at the time of loss or damage, he shall bear the loss. Therefore, if the property in goods is transferred to the buyer, the buyer becomes the owner of goods and in case the goods are lost or damaged, the buyer will have to bear the loss. Hence it is important to know whether the property in the goods has passed to the buyer or is still with the: seller. It is the owner of the goods who runs the risk of loss and not the person who may be in possession of goods.

**Examples,**

i) A sold certain books to B. B left the books in A's shop. The books were damaged as a result of fire in the shop: The loss is to be borne by B because at the time of loss of books he had become the owner of the books.

ii) A lends his book to B. As a result of an accidental fire the book is totally damaged. The loss will be borne by A because at the time of loss he was the owner of the book.

2 **Action against third party:** In the case of loss or damage to the goods caused by a third party, it is the owner who alone can take action and not the person who was in possession of the goods. The buyer gets proprietory rights over the goods i.e., he gets all the rights over the goods as their owner.

3 **Suit for price:** The seller becomes entitled to recover the price of the goods from the buyer only when the property in the goods has passed to the latter.

4 **Insolvency of seller or buyer:** If the seller or buyer becomes insolvent, the question arises as to whether or not the Official Receiver or the Assignee can take over the goods. The answer depends upon whether the property in the goods has passed to the buyer or not. If the property in goods has passed to the buyer and the buyer is adjudged insolvent, the buyer's Official Receiver of Assignee shall take the possession of the goods even though the goods have not been delivered by the seller.

## 18.4 RULES REGARDING TRANSFER OF OWNERSHIP

You learnt the importance of knowing the time of transfer of ownership from seller to buyer. Now the next important thing is to determine the time of transfer of

ownership. The rules regarding the transfer of ownership are contained in Sections 18 to 24 of the Sale of Goods Act, 1930. The general rule is that the 'property in goods is transferred to the buyer at such time as the parties intend it to be transferred' [Section 19(i)]. Thus the whole question of transfer of ownership is left to the intention of the parties. The parties are free to fix any time for the, transfer of ownership from seller to the buyer. But sometimes the intention of the parties may not be clear from the contract itself. In such cases, the intention could be ascertained according to the rules laid down in Section 20 to 24 of the Sale of Goods Act.

For the purposes of knowing the time of passing of ownership from seller to the buyer, the goods have been classified into three classes, viz.,

i) Specific or ascertained goods,
ii) Generic or unascertained goods; and
iii) Goods send 'on approval' or 'on sale or return' basis,

Let us now discuss the rules for each of the class separately.

## 18.4.1 In Case of Specific or Ascertained Goods

Specific goods means goods identified and agreed upon at the time a contract of sale is made. According to Section 19(1) of the Act *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.* It further provides that *for the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties* and *the circumstances of the case.*

For knowing the intention of the parties with respect to the time when the properly in the goods is to pass to the buyer, the following rules are applicable:

1 **Specific goods in** a deliverable **state:** Where there is an unconditional contract for the sale of specific goods and the goods are in a deliverable state, the property in the goods passes to the buyer when the contract is made, you should note that it is immaterial whether the time of payment of the price or the time of delivery of goods or both, is postponed (Section 20). On analysing this section you find that the ownership shall pass at the time of making the contract if the goods are specific, the contract is an unconditional one and the goods are in a deliverable state. By an unconditional contract we mean that there is no condition regarding the transfer of ownership of goods. For example, A sells some specific goods in a deliverable state to B on the condition that the property in the goods shall pass only when B accepts the bills of exchange. This is a conditional contract and the property in goods shall be transferred only when the condition is fulfilled.

Another important point in this section is that the goods must be in a deliverable state. Now the question arises as to when goods can be said to be in a deliverable state. According to Section 2(3) of the Act, *goods are said to be in a deliverable state when they are in such state that the buyer would, under the contract, be bound to take delivery of them.* In simple words it means that the goods are in such a condition that the buyer can take away the goods then and there. It is possible when the goods are ready and the seller is not required to do anything with the goods.

**Examples**

i) A offers to sell his car to B for Rs 60,000 the price to be paid after 20 days. B accepts the offer and a contract is made. The property in the car passes to B immediately when the contract is made, the payment of the price is immaterial.

ii) A selects some books from B's book-shop and agrees to pay the price on the first day of the next month and the books are to be delivered at A's house on the following day. As a result of an accidential fire in the shop, the books selected by A were destroyed. A shall be liable to pay the price, as the property in the books has passed from B to A on making the contract. You should note that in this case neither the price has been paid nor the goods have been delivered, even then the ownership has passed from seller to the buyer.

You should further note that if any of the conditions stated in Section 20 is not fulfilled, the property in the goods shall not pass to the buyer at the time of making the contract.

**Specific goods not in a deliverable state:** Another situation may be where goods are not in a deliverable state at the time of making the contract. In simple words, the seller has to do something to the goods to put them in a deliverable state. For example, cutting the goods, or packing or sealing, or loading or filling them in containers etc. In such a case as per Section 21 of the Sale of Goods Act. ***Where. there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof:*** According to this rule the property in goods will not pass to the buyer unless "something" is done in order to put them in a deliverable state.

In ***Rugg v. Minett,*** the whole of contents of a cistern of oil were sold, and the seller had to put the oil in casks to deliver it to the buyer. The seller filled some casks in the presence of the buyer, but, before the remainder could be filled a fire broke out and the entire quantity of oil was destroyed. It was held that the buyer must bear the loss of the oil which was put into casks and the seller will bear the lpss of the remainder, the reason being that the oil that was put in a deliverable State became the property of the buyer. You should note that here the ownership did not pass to the buyer at the time of the contract but it passed only when the goods were put into a deliverable state and the buyer has notice thereof.

3 **Specific goods in a deliverable state, when the seller has to do something to ascertain the price:** Sometimes the goods may be in a deliverable state, but the seller is bound to do something for the purpose of ascertaining the price. In such a case the property in goods shall not pass to the buyer unless the seller has done that thing for ascertaining the price. In this regard Section 22 of the Act provides, "***where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof".*** For example, ***A*** sells to B a heap of wheat at the rate of Rs 250 per quintal. A had to weigh the wheat in order to ascertain the price of the entire wheat sold to B. The property in the goods will pass when A has weighed the . wheat and a notice of it is given to the buyer.

***In Zagury v. Furmell, 289*** specified bales of goat skins, containing 60 pieces in each sale were sold. It was the duty of the seller to count them before sale. Before counting was completed, the bales were destroyed by fire. It was held that since the seller has not done that thing (counting of bales) for ascertaining the price, the ownership had not passed to the buyer, so this loss had to be borne by the seller.

You should notice that this rulc is only an extension of the rule given in Section 21. However, it should be noted that if the buyer does something (weighing, measuring or counting etc.) for his own satisfaction, this Section will not apply.

## 18.4.2 In Case of Unascertained Goods and Future Goods

The general rule is that no property in goods is transferred to the buyet unless and until the goods are ascertained (Section 18). For example, A agreed to sell to B 100 bags of wheat out of 1,000 bags of wheat lying in his godown. The property in goods shall not pass to B until and unless 100 bags of wheat are separated from the rest. Thus, for transferring the property of unascertained goods the first step is to identify or ascertain the goods. Ascertainment is the process of identifying the goods to be sold to the buyer. After the goods have been ascertained, the next step is their unconditional appropriation to the buyer.

Section 23(i) provides that in a contract for the sale of unascertained or future goods by description, the property in goods passes to the buyer when the goods are

unconditionally appropriated to the contract. The term 'appropriation' has not been defined in the Act. It means an overt act showing an intention to identify and determine the specific goods as those to which the bargain of the parties shall apply. Appropriation is done with the mutual consent of the seller and the buyer. Appropriation may be done either by the seller or by the buyer with the consent of the other, The consent of the seller or the buyer, may be express or implied and may be given before or after the appropriation is made, Once the goods are appropriated with the mutual consent of the parties, they become the property of the buyer.

Here you should note the difference between ascertainment and appropriation. Ascertainment is an unilateral act and is usually done by the seller alone, while in case of appropriation the mutual consent of the parties is required. The goods are appropriated by putting them in suitable receptacles i.e. by putting the goods in bags or boxes or putting the oil in bottles or casks. Sometimes, when the seller delivers the goods to the carrier or other bailee for transmission to the buyer without reserving the right of disposal, the property in goods passes.

Appropriation of goods may be done either by the seller or by the buyer with the consent of the other party.

Appropriation by the seller with the buyer's assent: Goods are generally in the possession of the seller, so he appropriates the goods with the consent of the buyer in such a case the property in goods shall pass to the buyer only when he agrees to such appropriation. For example, A agreed to sell 10 bags of rice to B out of his stock of 500 bags. A separates 10 bags with B's assent; the ownership of 10 bags would pass to B as soon as this is done.

Section 23(2) of the Act provides that "*where, in persuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or nor;)for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract,* Whether or not the seller has reserved the right of disposal over the goods even after delivering them to the carrier, is a question of fact depending on the circumstances of the case.

Where the seller takes out the railway receipt or bill of lading in his own name, the presumption is that the seller has reserved the right of disposal and in such a case the ownership of goods shall hot pass. Similarly, if the railway receipt or bill of lading is in the name of the buyer but is sent through the bank with the instructions that the same are to be delivered to the buyer on payment of the price or acceptance of the bill, the property in the goods will not pass to the buyer until and unless he makes the payment or accepts the bill of exchange.

Appropriation by the buyer with the seller's assent: Where the goods are already in the possession of the buyer, as in the case where he is the warehouseman for the seller, the goods can be appropriated by the buyer with the consent of the seller. For example, 500 bags of wheat belonging to A are stored in B's warehouse. A sells 100 bags of wheat to B, Since B is in possession of the goods, he may with A's consent appropriate 100 bags. Here the property in goods will pass from A to B as soon as the appropriation is done.

Now it should be clear to you that property in goods cannot pass in unascertained goods. It is, in fact, an agreement to sell. It becomes sale only when the goods are ascertained and unconditionally appropriated to the contract.

### 18.4.3 In Case when Goods are Sent 'on Approval' or 'on Sale or Return' Basis

When goods are sent on approval or 'on sale or return' basis, it means that the buyer has the option to return the goods to the seller, if he is not satisfied with the goods. According to Section 24 of the Act, when goods are delivered to the buyer on approval or 'on sale or return' or other similar terms, the property therein passes to the buyer (a) when he signifies his approval or acceptance to the seller or (b) does any other act adopting the transactions or (c) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice: of rejection. Let us now discuss these points in detail.

i) **When he signifies his** approval or acceptance: When the buyer accepts the goods and the seller is informed about it, the property in goods passes to the buyer. For example, A delivered a scooter to B on approval for seven days. B informs A that he has accepted to buy the scooter. The ownership shall pass to B on his approval. This is a case of express approval.

ii) **When he** adopts the transaction: Sometimes the buyer does not send his express approval but does some act in regard to the goods which shows that he has accepted the goods, there the ownership shall pass to the buyer on the act of adoption. This is implied acceptance or approval. For **Example,** A delivered some jewellery to B 'on sale or return' basis. B pledged the jewellery with P. It was held that B has adopted the transaction by pledging the jewellery with P, the property has passed to B. A can recover the price from B but has no right against P.

iii) **When he fails to return the goods:** When the buyer does not signifies his approval or rejection, but retains the goods without giving notice of rejection, the ownership passes to the buyer. We can take up this point under the following two sub-heads.

a) **If time is fixed for the return of the goods:** In case the goods are sent on approval or 'sale or return' basis and a time has been fixed for the return of the goods, the ownership passes to the buyer on the expiry of such fixed time. For example, A delivered a horse to B on 'sale or return' basis for seven days. B retains the horse even after the expiry of seven days, B shall be deemed to have become the owner. But if the horse dies on the third day itself without any fault of B, B shall not be liable for the price because the ownership has not yet passed to the buyer.

b) **If no time** is **fixed for the return of the goods:** When the goods are delivered on approval or 'sale or return' basis and no time is fixed for the return of the goods, if the buyer fails to return the goods within reasonable time, the ownership passes to the buyer on the expiry of reasonable time. The question as to what is a reasonable time is a question of fact depending on circumstances of each case. For example A delivered his scooter to B on approval. B kept the scooter with him for three months. B shall be liable to pay the price to A because B has become the owner of the scooter on the expiry of a reasonable time.

However, you must remember that in case the goods are sold on sale or return basis upon the condition that the property in goods will pass only on payment, then the property will not pass until payment has been made. For example, A delivered a scooter to B on approval on the condition that the ownership will not pass until the price of the scooter is paid to the seller. B pledges the scooter with P without making the payment of the price. Here, since B has not yet become the owner of the scooter, A can recover his scooter from P.

**Check Your** Progress A

1 Define the term 'property' as used in the Sale of Goods Act.

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2 State the reasons of knowing the exact moment when property in goods passes to the buyer.

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3 What are the rules relating to transfer of property of specific goods from seller to the buyer?

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4 When goods are delivered on approval or on sale or return basis, when does property therein pass to the buyer?

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5 State whether the followingstatements are True of False

i) The term 'property in goods' and 'possession of goods' mean the same thing.

ii) Risk follows ownership only when goods have been delivered.

iii) Property in goods can pass only in case of ascertained goods.

iv) Seller can file a suit for the price against the buyer only when the property in goods has passed to him.

v) In an unconditional contract for the sale of specific goods in deliverable state, the property in the goods passes to the buyer when the buyer accepts the goods.

vi) In a contract for the sale of unascertained goods, the property in goods passes when the contract is entered into.

vii) When goods are sent on sale or return basis, the property in goods passes when the buyer retains the goods beyond a reasonable time.

viii) In case of unascertained goods, the goods can be appropriated either by the seller or the buyer.

## 18.5 DELIVERY TO A CARRIER

The term 'carrier' means an agency to whom the goods are delivered for the purpose of transmission to the buyer. The carrier may be railways, shipping company, road transport agency or airways. Delivery of goods to a carrier, whether named by the buyer or not, operates prime facie as a delivery of goods to the buyer. You have learnt in Section 23(2) that in case of sale of unascertained goods, when the goods are delivered to the carrier, it amounts to appropriation of goods. When goods are unconditionally delivered to the carrier, it amounts to the delivery to the buyer.

Section 39(1) of the Sale of Goods Act provides that where, in persuance of a contract of sale, the seller is authorised or required to send the goods to the buyer, delivery of goods to a carrier for the purpose of transmission to the buyer or to a wharfinger for safe custody, is prima facie, deemed to be a delivery of the goods to the buyer. If we read this Section along with Section 25(i), we can state that where the seller without reserving the right of disposal, delivers the goods to the carrier, the property in goods passes to the buyer. Here the canier is treated as the agent of the buyer. For example, A of Delhi sells certain goods to B of Calcutta. A sends the goods by railway and the railway receipt is taken in the name of B. Here the property in goods passes when the goods were delivered to the railway.

But it must be noted that where it is agreed, that the goods are to be delivered at a particular place, for example, at the buyer's godown, then the delivery of goods to a carrier does not amount to a delivery of the goods to the buyer.

It should further be noted that merely by delivering the goods to the carrier, the seller's duty is not over. Section 30(2) provides that unless otherwise authorised by the buyer, the seller must make a reasonable contract with the carrier or wharfinger, for the safe carriage of goods. It should be noted that this contract, shall be made on behalf of the buyer. If the seller fails to take such precautions (as are necessary and reasonable) and the goods are lost or daniaged in course of transit or whilst in the custody of the wharfinger, the buyer may decline to treat the delivery to the carrier or wharfinger as a delivery to himself, or may hold the seller responsible for damages.

Sometimes, the goods are sent by sea transit wherein it is quite usual to insure the goods. In such cases the seller should give to the buyer such notice as shall enable

him to insure the goods. If the seller fails to give such notice and the goods are not insured, the goods will be deemed to be at the risk of the seller. The duty of giving notice to the buyer arises only where the goods are to be insured by the buyer. In CIF (cost, insurance and freight) contracts, the sale price includes insurance, here the seller is required to insure the goods. But in FOB (free on board) contracts when goods are delivered on board the ship, the liability of the seller comes to an end. In such cases, the buyer must be given a notice so that he can get the goods insured.

## 18.6 RESERVATION OF RIGHT OF DISPOSAL

Reservation of right of disposal—this is a right vested in the seller by which he reserves to himself the right to dispose of goods until certain conditions are fulfilled. Therefore, when the goods are delivered to a carrier certain conditions are fulfilled. Therefore, when the goods arc delivered to a carrier or other bailee, the seller can reserve the right of disposal of the goods and in such cases the property in goods will not pass to the buyer until the conditions imposed by the seller are fulfilled. For example, A sells certain goods to B upon the condition that B must pay the price before delivery of the goods. Here the seller has reserved his right of disposal by making the delivery of the goods conditional upon the payment of the price. The property in goods will not pass to B until the price is paid by him.

From the above it should be clear to you that the delivery of goods to the carrier does not mean transfer of property if the seller has reserved the right of disposal to himself. The seller may reserve the right of disposal of goods either expressly or by implication. When the seller exercises this right expressly he may do so at the time of entering into the contract or at the time of making appropriation of unascertained goods.

In the following two cases, the seller is deemed to have reserved the right of disposal to himself.

Where the goods are shipped or delivered to a railway administration for carriage and by the bill of lading or railway receipt, as the case may be, they are deliverable to the order of the seller or his agent Section 23(2). In such a case the seller keeps to himself the right of dealing with the goods and also the right of demanding possession of the goods from the carrier. For example, A sold some goods to B with the terms that the goods shall be sent by railway. The railway receipt is taken in the name of B, but it was sent by A to his agent. The goods were damaged in the course of journey. A will have to bear the loss because the property in goods has not got passed to the buyer. However, if the bill of lading or railway receipt are endorsed in the name of the buyer and sent to him, the properly in goods passes to the buyer because then the buyer becomes entitled to take possession of the goods'from the carrier.

Where the seller of goods draws a bill of exchange on the buyer for the price of the goods and sends the bill of exchange along with the bill of lading or the railway receipt, to the buyer to secure acceptance or payment of the bill of exchange, the property in goods will not pass to the buyer until the buyer accepts the bill of exchange. If the buyer does not accept the bill of exchange, he must return the bill of lading or railway receipt to the seller. If he wrongfully retains the bill of lading or railway receipt, the property in the goods does not pass to the buyer [Section 25(3)]. In such a case, as soon as the bill of exchange is accepted, the ownership is transferred to the buyer.

Passing of risk: The general rule is that 'the risk prima facie passes with the ownership' i.e., the goods are at the risk of the party who has the ownership of the goods. According to Section 26 unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not. Far example, A bids Rs 5,000 for a costly flower case at a Bale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the case which was destroyed. The loss will have to be borne by the seller, because the ownership of goods has not yet passed from the seller to the buyer.

The general rule that the risk passes with the ownership is only a prima facie rule and is subject to the following exceptions:

i) the rule is not applicable where the parties have made some agreement to the contrary. For example, if the parties have agreed that during the transit the goods shall be the property of the seller but they shall be at the risk of the buyer.

ii) The rule is not applicable, where delivery has been delayed through the fault of either buyer or seller. In such a case the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault. For example, A contracted to sell 100 casks of apple juice to B to be delivered in February. B took the delivery of part of the juice but made a default to accept the remaining casks. Consequently the juice became unfit for consumption. The loss will have to be borne by the buyer. It should however be remembered that the general rule shall not affect the duties or liabilities of either seller or buyer as a bailee of goods for the other even when the risk has passed.

## 18.7 SALE BY NON-OWNERS

You learnt the rules regarding the transfer of ownership from the seller to the buyer, wherein you have noted that once the goods are sold, the buyer becomes the owner of such goods. Here we have presumed that the seller is the owner of the goods. Now what will happen if it turns out that the seller was not the owner of the goods? Our answer will be that since the seller was not the owner, therefore, the buyer does not become the owner thereof.

The general rule as to transfer of property is that it is only the owner of the goods who can transfer the ownership in the goods to the buyer. In simple words, a person who is not the owner of the goods can not sell them and transfer the ownership to the buyer even though the buyer has purchased them in good faith and for value. No one can sell the goods and give a good title thereof unless he is the owner of such goods. This general rule is expressed by the maxim: "Nemo dat quid non habet", which means that "no one can give what he himself has not got". Therefore, if a person deals with the goods of another person and without the owner's authority, such transaction is of no value in the eyes of law. If the seller's title is defective, the buyer's title will also be defective. This is so because the buyer acquires his title to the goods from the seller. For example, A finds a ring of B and sells it to C who buys it in good faith and for value. The true owner (B) can recover the ring from C, since A had no title to the ring.

This general rule is contained in Section 27 of the Act which lays down that. ***Subject to the provisions of this Act and of any other law for the time being in force, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority as, with the consent of the owner, the buyer acquires no better title to the goods than what the seller had.*** Thus, it can be stated that a person who is not the owner of the goods cannot make a third person owner of the goods.

But the above rule is subject to some exceptions where seller may confer a better title than what he himself possess. These exceptions are as follows:

1 **Title by estoppel:** You are already familar with the principle of estoppel. Applying this principle to a contract of sale of goods, when the owner of the goods, by his statement or conduct, leads the buyer to believe that the seller has the authority to sell later on he may be estopped from denying the seller's authority to sell. For example: A says to B, in the presence of C that he (A) is the owner of the goods and ***C,*** who is the real owner of the goods does not contradict the statement. B buys the goods from A. Here, B will get a better title. In this example if the real owner C wishes to deny A's authority to sell the goods he (C) may be estopped from doing so.

2 **Sale by a mercantile agent:** Where a mercantile agent is, with the consent of the owner, in possession of the goods or of a document of title to the goods, and he sells those goods in the ordinary course of business as a mercantile agent the buyer will get a good title to the goods provided he (the buyer) buys them in good faith and for value. Section 2(9) defines a mercantile agent as an ***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.* In a sale by mercantile agent the buyer will acquire a good title to the goods only if the following conditions are satisfied:

a) the goods are sold by a mercantile agent who is in possession of goods or of a documents of title to the goods with the consent of the owner;

b) the agent sells the goods in the ordinary course of his business as a mercantile agent;

c) the buyer must have acted in good faith i.e., the buyer must have no knowledge that the agent had no authority to sell.

In *Folkes* v. *King,* F, the owner of the car, instructed an agent A to sell the car at a stipulated price and not below that. But A sold the car to B at a price lower than the stipulated price and misappropriated the money. B bought the car in good faith. It was held that B got a good title to the car and the real owner F cannot recover the car from B.

From the above, it should be clear that where the buyer does not act in good faith or has the knowledge that the agent has no authority to sell, this rule shall not apply. This rule has been framed to protect the interest of innocent buyers.

3 **Sale by one of joint-owners:** According to Section 28 of the Act, if one of several joint owners of goods has the sole possession of them by permission of the other co-owners, and he sells them to a person who buys them in good faith, and has, at the time of the contract of sale, notice of the fact the seller has no authority to sell, the buyer will get a good title to goods. As a rule a joint owner can transfer his share only. However, if he is in sole possession of the goods with the consent of other joint-owners and the buyer buys them in good faith, the buyer get a good title to the goods. For example, A, B and C are the joint-owners of some furniture and with the consent of B and C, the furniture was kept in possession of A. A sells the furniture to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to the goods.

You should note that this exception is applicable only in such cases where the joint-owner is in possession of goods with the consent of other co-owners.

4 **Sale by person in possession under voidable contract:** According to Section 29 of the Act, where a seller is in possession of goods under a voidable contract, and he sells the goods to a bonafide buyer before the contract is rescinded the buyer gets a good title to the goods. This exception is limited to contract of sale of goods obtained under a contract voidable under Section 19 or 19A of the Contract Act, i.e., voidable on the ground of coercion, undue influence misrepresentation or fraud. For the application of this exception it is necessary that:

a) the seller must be in possession of goods under a voidable contract;

b) the goods must be sold before the contract is rescinded; and

c) the buyer must buy in good faith and without notice of the seller's defect of title.

Thus, if the seller is in possession of goods under a contract which is void, even an innocent buyer will not get a good title to the goods.

**Example:** A obtains a necklace from B, a jeweller, by playing fraud upon him. This contract is voidable at the option of B. But before B could terminate the contract, A sells the necklace to C who buys it in good faith and without notice of A's defective title. *C* gets a good title.

5 **Sale by seller in possession after sale:** Sometimes, the buyer after buying the goods, leave them with the seller. Section 30(1) of the Act provides that where a person having sold the goods continues or is in possession of the goods or of the documents of the title of the goods, after sale and lie resells the same goods to another buyer, the buyer shall get a good title to the goods provided the buyer buys them in good faith and without notice of the previous sale. For example, A buys some goods from B, but leaves them with B for the time-being. In the

meanwhile, B sells the same goods to C who buys them in good faith and without knowledge about the previous sale. C gets a good title to the goods.

For the application of this aclion it is necessary that the seller must be in possession of goods as seller and not in any other capacity. Thus, if the first sale was completed and the seller again gets possession of the goods for same specific purpose and he resells those goods, then the buyer shall not get a good title to the goods even though he buys them in good faith.

Example: A sold a wrist watch to B and it was delivered to B. Later on, B delivered the watch to A for some repair. A resells that watch to C, who buys in good faith. Here C will not get any title to the goods because A was in possession of the watch not in the capacity as a seller but in the capacity of a bailee.

Thus, it is necessary that the seller must be in possession of goods as a seller and plot as a bailee or a hirer.

6 **Sale** by a buyer in possession **after sale:** Section 30(2) deals with cases where goods are sold or agreed to be sold and the goods are in the possession of the buyer but the ownership has not yet passed to the buyer. If such a buyer resells the same goods to a new buyer who buys them in good faith and without any knowledge about the first seller's rights over the goods, the second buyer gets good title to the goods. For the application of this rule it is necessary that the first buyer must have obtained the possession of the goods or doc tnents of title to the goods with the consent of the original seller. For example, A buys a scooter on instalment basis from B. It is agreed that B will remain the owner of the scooter till the last instalment is paid. **A** sold the scoolcr to C even before the payment of the last instalment. C buys in good faith and has no knowledge about the arrangement herwccn **A** and B. C gets a good title to the scooter.

You should note that this exception will apply only in such cases where the buyer is in possession of goods or the documents of title to the goods.

7 **Sale by** an unpaid seller: Section 54(3) provides that where an unpaid seller exercises his right of lien or stoppage in transit and is in possession of the goods, if he resells such goods, the subsequent buyar gets a good title to the goods as against the original buyer (discussed in detail in Unit 19).

8 Sale by a finder **of goods:** According to Section 169 of the Contract **Act,** a finder of goods has the power to sell the goods under certain circumstances and **the** buyer will get a better title. **A** finder of goods can sell such goads:

a) if the owner cannot be found with reasonable deligence, or

b) if found, he refuses to pay lawful charges of the finder, or

c) if the goods are in danger of perishing or of losing the greater part of its value, or

d) if the lawful charges of the finder, in respect of the thing found, amount to two thirds of its value.

9 Sale by a **pawnee or** pledgee: If the pawner or pledger makes a default in payment of the debt or the performance of the promise at the stipulated time, the pawnee has the right to sell the goods pledged after giving a reasonable notice to the powner. In such a case, even though the **pawnee** is not the owner of the goods but still he **can** convey a good title to the buyer.

10 Sale by Official Receiver or Official Assignee: The official receiver or the official assignee are appointed by the court to sell **the property** of the insolvent person. Though they are not the owners of the property, they can pass on a better title to the buyer.

**Check Your Progress B**

1 Does delivery of goods to a carrier amount to transfer of ownership?

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2 What is meant by reservation of right of disposal?

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3 State the circumstances when a Non-Owner can sell goods?

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4 State whether the following statements are True or False.

i) Delivery of the goods to the carrier amounts to transfer of ownership to the buyer.

ii) Property in goods passes to the buyer where the seller has reserved the right of disposal.

iii) When the seller takes a railway receipt in his own name, he is said to have reserved the right of disposal.

iv) Property in goods passes to the buyer when documents of title are endorsed in the name of the buyer.

v) Risk follows ownership whether the goods have been delivered or not and whether price has been paid or not.

vi) Sale by a non-owner does not make the buyer an absolute owner of the goods.

vii) A seller in possession of goods under a void contract can pass on a good title to a bonafide buyer.

viii) A joint owner in possession of goods with the consent of other joint-owners, can make a valid contract of sale,

## 18.8 WHAT IS DELIVERY?

You learnt the process of making the contract of sale and the transfer of ownership from seller to the buyer. Apart from transferring the ownership to the buyer, it is the duty of the seller to deliver the goods. Let us now study the meaning and types of delivery of goods.

Delivery is defined in the Act as a ***voluntary transfer of possession from one peron to another*** [Section 2(2)]. If the transfer of possession of goods is not voluntary i.e. if the possession of goods is taken by force or by fraud or by theft, there is no delivery in the strict legal sense. If B steals goods from A, there is no delivery from A to B though possession is transferred.

Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf (Section 33).

## 18.8.1 Types of Delivery

Delivery of goods may be of three kinds, viz., (1) actual, (2) symbolic, (3) constructive.

1 **Actual Delivery:** In this case the goods are physically handed over to the buyer or his authorised agent. For example, A sells a scooter to B and delivers it to B, it amounts to actual delivery of the goods.

2 **Symbolic Delivery: In** cases where the goods are bulky and heavy and it is not possible to physically hand them over to the buyer, some symbol which carries with it the real possession or control over the goods is handed over to the buyer. For example, delivery of the keys of godown where goods are lying or transferring the bill of lading or railway receipt to the buyer, amount to symbolic delivery of the goods. In this case even though there is no change in possession of goods, but it amounts to delivery.

3 **Constructive Delivery:** In this case neither actual nor symbolic delivery is made. When a person who is in possession of the goods, acknowledges to hold the goods on behalf of the buyer, it amounts to constructive delivery. For example, A sells to B 100 bugs of wheat lying in C's warehouse. A orders C to deliver the wheat to B. C agrees to hold the 100 bugs on behalf of B and makes the necessary entry in his books. In this case, there is constructive delivery of goods from A to B.

## 18.8.2 Rules Regarding Delivery of Goods

After learning the meaning and types of delivery, let us now study the rules regarding the delivery of the goods. These rules are as follows:

1 Delivery of the goods may be made in any of the types discussed above. The important point to remember is that it should have the effect of putting the goods in the possession of the buyer or his authorised agent.

2 **Delivery and payment are concurrent conditions:** Unless otherwise agreed, the delivery of goods and payment of price are concurrent conditions. The seller should be ready and willing to give possession of the goods to the buyer, and the buyer should be ready and willing to pay the price (Section 32).

3 **Effect of part delivery:** Sometimes when goods in large quantity are to be delivered, then during the process of delivery when part of the goods are delivered, it is treated as the delivery of the whole, for the purpose of passing the property in the goods. But where part delivery is made with the intention of separating it from the whole lot, then it does not amount to the delivery of the whole of the goods (Section 34).

You should, however, note that part delivery should not be confused with instalment delivery.

4 **Buyer to apply for delivery:** Unless some contract exists the seller of goods is not bound to deliver them until the buyer applies for delivery (Section 35). In case the goods are to be subsequently obtained or procured by the seller, then the duty of the seller is to intimate the buyer that the goods have been obtained by him, even then, the buyer should apply for delivery. The buyer can have no cause of action against the seller, if he fails to apply for delivery.

5 **Place of delivery:** The place where goods are to be delivered is generally agreed betweemthe parties. Where the place of delivery is agreed upon, the goods must be delivered at that place during business hours on a working day. But if nothing specific is agreed upon them.

a) the goods sold are to be delivered at the place at which they are at the time of the sale, and

b) goods agreed to be sold are to be delivered at the place at which they are at the time of the agreement to sell, or

c) if the goods are not in existence at the time of the agreement to sell, they are to be delivered at the place at which they are manufactured or produced Section 36(1).

6 **Time of delivery:** Where under the contract of sale the seller is bound to send the goods to the buyer; but no time for sending them is fixed, tlie seller is bound to send them within a reasonable time [Section 36(2)]. What is a reasonable time is a question of fact depending upon the facts and circumstances of each case.

7 **Manner of delivery:** Where the goods at the time of 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 (Section 36(3)).

8 **Expenses of delivery:** Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state shall be borne by the seller (Section 36(3)).

9 **Delivery of wrong quantity:** Wrong quantity may be either 'short delivery', 'excess delivery' or 'mixed delivery'. Following are the rules, but they are subject to any usage of trade, special agreement or course of dealing between the parties.

a) **Short delivery:** Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them. But if the buyer accepts the goods so delivered, he shall pay for them at the contract rate [Section 37(1)]. By accepting a lesser quantity, the buyer is not debarred from suing for damages on the ground of short delivery.

b) **Excess delivery:** Where the seller delivers to the buyer a quantity of goods larger than contracted for, the buyer has the option:-
   (i) to accept the contracted quantity and reject the excess; or
   (ii) to accept the whole, in this case, he shall become liable Io pay for all the goods at the contract rate; or
   (iii) to reject the whole quantity. [Section 37(2)].

**Example:** A agrees to sell 100 quintals of rice to B at Rs 1,000 per quintal. A delivers 1,050 quintals. B may reject the whole lot, or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract rate.

c) **Mired Delivery:** Where the seller delivers to the buyer the goods hc 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 reject the whole [Section 37(3)]. For example: A agrees to sell 10 quintals of wheat to B. A sends 100 quintals of wheat and 10 quintals of rice. B may reject the whole or may accept 100 quintals of wheat and reject the rice.

You have noted that when goods in wrong quantity are delivered, the buyer has the option to reject the whole lot. If the buyer does so, it does not amount to cancellation of the contract. The seller still has the right to deliver the goods contracted for, and the buyer shall be bound to accept the same.

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). For example, A agrees to deliver to B 100 quintals of wheat in April. But A delivers only 80 quintals in April and tlie remaining 20 quintals in the first week of May. B is entitled to reject the whole100 quintals.

Sometimes, thcrc may be a contract for the supply of goods in instalments which are to be separately paid for. In such a case a problem arises when there is a breach either by the seller or the buyer. In such a situation it is a question of fact whether the whole contract is to be treated as repudiated or only one instalment is repudiated for which the party may claim damages and the remaining instalments are to be duly delivered and accepted.

11) **Delivery to a carrier or wharfinger:** According to Section 39(1), where the seller is authorised or required to send the goods to the buyer, delivery of the goods to a carrier for the purpose of transmission to the buyer or the delivery of the goods to a wharfinger for safe custody, is prima facie deemed to be a delivery of goods to the buyer.

The seller must make a reasonable contact with the carrier or wharfinger for the safe transmission or custody of tlie goods, and if he fails to do so, and the goods are lost or damaged, the buyer may either decline to treat the delivery to the

carrier or wharfinger as a delivery to himself, or hold the seller liable for damages [Section 39(2)].

### 18.8.3 Acceptance of Delivery

You have learnt that it is the duty of the buyer to accept the delivery of the goods. Now the question arises as to when the buyer can be said to have accepted the delivery of the goods. It should be noted that when buyer receives the goods, it does not mean that he has accepted them. Acceptance is something more than this. Following are the rules in this regard:

i) When goods are delivered to the buyer which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract [Section 41(1)].

ii) The buyer is deemed to have accepted the goods:

   a) When he intimates to the seller that he has accepted the goods, or

   b) When the goods are delivered to the buyer and he does any act in relation to them which shows that he has accepted them, for example, he resells them or pledges them, or

   c) When the buyer retains the goods beyond a reasonable time without intimating the seller that he has rejected them.

iii) Unless otherwise agreed, when goods are delivered to the buyer and he refuses to accept them, he is not bound to return them to the seller. But the buyer must inform the seller that he refuses to accept the goods.

### 18.8.4 Liability of the Buyer

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not within a reasonable time after such request, take delivery of the goods, he is liable to the seller for

a) any loss caused by his neglect or refusal to take delivery; and also

b) a reasonable charge for the care and custody of the goods.

It is further provided in Section 44 that where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract, the seller may sue for the price or for damages.

**Check Your Progress C**

1 What is meant by delivery of goods?

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2 What is constructive delivery?

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3 Delivery of goods to the carrier amounts to delivery to the buyer. Do you agree?

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4 What happens if wrong quantity of goods are delivered?

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5 When the buyer is said to have accepted the goods?

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6 State whether the following statements are True or False

i) When the keys of the warehouse where goods are lying are delivered to the buyer, it amounts to symbolic delivery.

ii) Unless otherwise agreed, delivery of goods and payment of the price art concurrent conditions.

iii) Buyer must apply for delivery in all cases.

iv) If no place is agreed upon, the goods are to be delivered at the place of the buyer.

v) Where the seller delivers to the buyer goods larger in quantity than contracted for, the buyer may reject the whole lot.

vi) When goods are rejected by the buyer, he is bound to return them to the seller.

vii) Unless otherwise agreed, the buyer is not bound to accept the goods in instalments.

viii) When the buyer refuses or neglects to take delivery of the goods and it amounts to termination of the contract, the seller has a right to sue for price and damages.

## 18.9 LET US SUM UP

The main object of a contract of sale of goods is to transfer the property in goods to the buyer. Property in goods means the ownership of the goods and not the possession of goods. The ownership of goods can pass to the buyer even though the goods have not been delivered or the buyer has not paid the price.

It is very significant to know the exact time as to when the ownership passes to the buyer owing to these reasons: (i) risk passes with the ownership; (ii) right to taking action against third parties, (iii) suit for the price; and (iv) in the event of insolvency of seller or buyer.

In case of specific goods, the ownership passes to the buyer when the parties intend it to pass. When the intention is not clear, following rules shall apply:

i) In case of specific goods in a deliverable state, the property passes immediately when the contract is made.

ii) In case the goods are specific but not in a deliverable state, the ownership passes when they are put in a deliverable condition and the buyer has notice for the same.

iii) When the seller has to do something to the goods to be sold for ascertaining the price, the ownership passes when the seller has done that and the buyer is informed

In case of unascertained goods, the ownership passes only when the goods are unconditionally appropriated by the seller or the buyer with the consent of the other.

When goods are sent on approval or on sale of return basis, the nwnership passes when the buyer signifies his approval or acceptance to the a seller or when the buyer does any act which shows that he has accepted the goods or when the buyer retains the goods without rejecting them beyond a reasonable time.

Where the seller, without reserving the right of disposal, delivers the goods to a carrier for the purpose of transmission to the buyer, the ownership passes to the buyer.

As a general rule, only the owner of the goods can transfer the ownership, i.e., a seller cannot pass on a better title than what he himself possesses. There are some exceptions to this rule. A seller can give a better title to the buyer in the following cases:

i) title by estoppel, ii) sale by a mercantile agent, iii) sale by a joint-owner, iv) sale by a person in possession of goods under a viodable contract, v) sale by a seller in possession after sale, vi) sale by a buyer in possession of goods before buying them, vii) sale by an unpaid seller, viii) sale by a finder of goods, ix) sale by a pawnee or pledgee, x) sale by official receiver or assignee.

Delivery means voluntary transfer of possession of goods from one person to another. Delivery may be made by doing anything which has the effect of putting the goods in possession of the buyer. Delivery may be actual. symbolic or constructive.

Unless otherwise agreed, delivery and payment are concurrent conditions. Delivery has to be made at the request of the buyer. The goods are to be delivered at the agreed place, and if no place is agreed upon, then at the place at which they were at the time of making the contract. The goods should be delivered within the time stipulated, and if no time is fixed, then within a reasonable time. The expenses of delivery are normally borne by the seller.

## 18.16 KEY WORDS

*Carrier:* The'person or system who is engaged to carry the goods to the buyer.

***Delivery:*** Voluntary transfer of possession from one person to another.

***Deliverable state:*** When the goods are in a state in which they can be delivered to the buyer and as such are in accordance with the terms of the contract.

*Documents* of ***title:*** Documents which establish the ownership of the goods such as a railway receipt, bill of lading,etc.

***Mercantile agent: A*** person who is in possession of the goods with the consent of the owner and has the authority to deal with them in the normal course of business.

***Property in goods:*** Ownership rights over the goods.

*Specific goods:* Goods which are identified and agreed upon at the time of a contract of sale.

## 18.11 ANSWERS TO CHECK YOUR PROGRESS

A 5 (i) False, (ii) False, (iii) True, (iv) True, (v) False, (vi) False, (vii) True, (viii) True.

B 4 (i) False, (ii) False, (iii) True, (iv) True, (v) True, (vi) True, (vii) False, (viii) True.

C 6 (i) True, (ii) True, (iii) False, (iv) False, (v) True, (vi) False, (vii) True, (viii) True.

## 18.12 TERMINAL QUESTIONS/EXERCISES

1 Why is it important to know the exact time when the ownership passes to the buyer?

2 State briefly the rules regarding the transfer of ownership from seller to the buyer.

3 What is meant by reservation of the right of disposal in a contract of sale of goods'?

4 "No seller of goods can give to the buyer a better title". Explain this rule. Are there any exceptions to this rule?

5 Explain in brief the rules relating to the delivery of goods.

6 What are the remedies available to the buyer when goods in wrong quantity are delivered to him?

7 "Delivery does not amount to acceptance of goods." Comment.

8 Answer the following problems, giving reasons:

i) Ramesh buys a radio set from a dealer. He neither makes the payment nor takes the delivery of the radio set. He asks the dealer to deliver the set next day and receive the payment. As a result of accidental fire, the radio set is destroyed. Can the dealer recover the price?
*(Hint:* Yes, since the property in goods has passed, the seller can sue for the price.)

ii) Mohan sells to Suresh a particular horse to be delivered to Suresh the next week. Mohan asks his servant to keep the horse separate from other horses. The horse dies before it is delivered, who shall bear the loss?
*(Hint:* Suresh will bear the loss because the horse was in a deliverable state, the ownership has passed to him at the time of making the contract.)

iii) Surendra agreed to sell 100 quintals of wheat to Harish out of his stock of 1,000 quintals. The price was to be paid on a later date. When will the property in goods pass to Harish?
*(Hint:* The property in goods will pass to Harish when 100 quintals of wheat is appropriated i.e., set aside.)

iv) Karim delivers a horse to John on trial for a week. Without any negligence on the part of John, the horse dies on the third day. Is John liable to pay the price?
*(Hint:* No, he is not liable for the price because the ownership has not yet transferred to him.)

v) Goods are delivered by A to B on 'Sale or return' basis. They are further delivered by B to C and then by C to D on similar terms. The goods are stolen while in the custody of D. Who is to bear the loss and why?
*(Hint:* C will bear the loss because property in goods has passed from A to B and from B to C but not from C to D.)

vi) Motilal entrusted his car to a mercantile agent for sale at a stated price and not below that. The agent sold it to Rarnesh, a bona fide buyer, below the stated price and misappropriated the proceeds. Discuss the position of Ramesh.
*(Hint:* Ramesh got a good title to the car from the mercantile agent.)

vii) A hirer, who obtains possession of a car from its owner under a hire purchase agreement, sells the car to a buyer who buys in goods faith and without notice of the right of the owner. Does the buyer get a good title to the car?
*(Hint:* The buyer will not get good title to the car because in a hire-purchase agreement the ownership does not pass. The hirer is the bailee, he has no right to sell.)

viii) A, by fraud obtains the possession of a diamond ring from B. B sells the ring to C before A rescinds the contract. C purchases the ring in good faith and for value. Examine the position of C.

(*Hint:* C is the owner of the ring because he bought the ring from A, who is in possession of goods under a voidable contract and before the contract is rescinded.)

ix) Rajesh purchased certain specified goods from Trehan & Co. Trehan & Co. delivered the goods along with some other goods. What is the position of Rajesh?
*(Hint:* Rajesh may accept the whole or reject the whole or accept the goods ordered by him and reject the rest.)

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

# UNIT 19 RIGHTS OF AN UNPAID SELLER

## Structure



## 19.0 OBJECTIVES

After studying this unit you should be able to

- define an unpaid seller
- state the rights of an unpaid seller
- explain the right of lien and when it comes to an end
- discuss the right of stoppage-in-transit
- describe the procedure of stopping the goods in transit
- distinguish between right of lien and stoppage in transit
- explain the rules of an auction sale.

## 19.1 INTRODUCTION

In the previous units you have learnt the meaning of a contract of sale and rules regarding ascertaining the time of transfer of ownership of goods from seller to the buyer. You have also learnt that the consideration in a contract of sale is the price. You know that the payment of the price is immaterial for transferring the ownership i.e. ownership may change even without the payment of the price. But sooner or later, the price has to be paid. In this unit, you will learn who an unpaid seller is, what are his rights against the goods and against the buyer personally. You will also learn when and how goods are stopped-in-transit and when this right comes to an end. You will also learn the rules regarding auction sales.

## 19.2 MEANING OF AN UNPAID SELLER

In simple words, a seller who has not received the full price of goods sold is termed as an unpaid seller. Section 45 of the Sale of Goods Act, 1930 has defined an unpaid seller as follows:

The seller of goods is deemed to be an unpaid seller

i) when the whole of the price has not been paid or tendered; or
ii) when a bill of exchange or other negotiable instrument has been received as conditional payment and it has been dishonoured.

Thus, to be called an unpaid seller, the following conditions must be satisfied:

a) the goods have been sold and the price must be due;
b) the full price has not yet been paid;
c) a bill of exchange or other negotiable instrument, such as cheque, was received as payment of the price, but the same has been dishonoured.

From the above, you should note that where a major part of the price has been paid and only a small portion remains to be paid, even then the seller shall be called an unpaid seller. But you should remember that it is only for the non-payment of the price that a seller is termed as an unpaid seller. Thus, if the price has been paid but some other expenses remain to be paid, the seller is not an unpaid seller. Similarly, where the seller has sold the goods on credit, he cannot be terined as an unpaid seller. If the seller does not receive the price in full after the expiry of the credit period, then he will become an "unpaid seller". Where whoie of the price has been tendered by the buyer, and the seller has refused to accept it, the seller cannot be called an unpaid seller.

**Examples**

i) **A** sold certain goods to B for Rs. 5,000; B paid Rs. 4,500 but fails to pay the balance. **A** is an unpaid seller.

ii) **A** sold some goods to B for Rs. 5,000 and received a cheque for the full price. On presentment, the cheque was dishonoured by the bank. **A** is an unpaid seller.

iii) **A** sold some goods to B for Rs. 5,000 and allowed him a period of one month for payment of the price. **A** is not an unpaid seller during this period of one month. On the expiry of one month, if the price remains unpaid, then only **A** shall become an unpaid seller.

If before the expiry of one month's time the buyer becomes insolvent, then the seller becomes an unpaid seller.

The term 'seller' in this case means not only the actual seller but includes any person who is 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 , or is directly responsible for, the price [Section 45 (2)].

## 19.3 RIGHTS OF AN UNPAID SELLER

The rights of an unpaid seller can broadly be discussed under the two heads:(1) rights against the goods; and (2) rights against the buyer personally.

1 *The rights against the goods are as follows:*

a) Where the property in goods has passed to the buyer:
   i) Right of lien;
   ii) Right of stoppage of goods-in-transit; and
   iii) Right of resale.

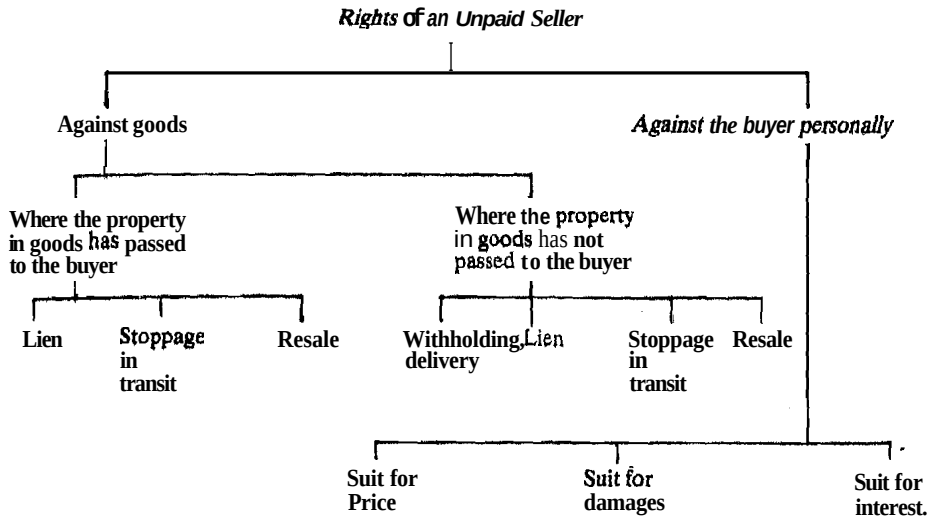
b) Where the property in goods has not yet passed to the buyer, he has an additional right of withholding delivery.

2 *The rights against the buyer personally as follows:*

i) Right to file a suit for price;
ii) Right to file a suit for damages; and
iii) Right to file a suit for interest.

Look at Figure 19.1. It gives a complete picture of the various rights of an unpaid seller.

Figure 19.1




Let us now discuss these rights in detail.

# 19.4 RIGHTS AGAINST THE GOODS

## 19.4.1 Where the Property in the Goods has Passed to the Buyer

As stated earlier the rights of an unpaid seller when the property in the goods has passed to buyer are as follows:

### 19.4.1.1 Right of Lien

You have learnt in Unit 10 that the term 'lien' means to 'retain possession' of the goods until charges due in respect of the goods are paid or tendered. The right of lien is a possessory right and can be exercised by the unpaid seller only when the goods are in his possession. An unpaid seller has the right of lien over the goods until the full price is paid or tendered.

According to Section 47(1) of the Sale of Goods Act, "the unpaid seller of goods who is in possession of them, is entitled to retain possession of them until payment or tender of the price in the following cases, namely:

a) where the goods have been sold without any stipulation as to credit;

b) where the goods have been sold on credit, but the term of credit has expired;

c) where the buyer becomes insolvent."

Thus, it is clear that the unpaid seller can exercise his right of lien on goods only when the goods are in his actual possession. For exercising this right of lien, transfer of property, title or ownership is immaterial. The unpaid seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer [Section 47(2)]. Right of lien is not affected even where the seller has delivered to the buyer, the documents of title to the goods such as bill of lading or any other type of delivery: order provided the goods are in his possession. For example; A sold certain goods to B for Rs. 5,000 and allowed him to pay the price within one month, B becomes insolvent during this period of credit. A, the unpaid seller can exercise his right of lien.

You should note that the term 'insolvent' in the Sale of Goods Act means "a person *who* has ***ceased to pay his debts in the ordinary course of business, or cannot pay his debts*** as ***they became due, whether he*** has ***committed, an*** act ***of insolvency or not [Section 2 (8)].***"

*Rules regarding right of lien* : The important legal provisions' in connection with the exercise of right of lien are as following:

i) The goods must be in actual possession of the seller. Once the possession is lost, the lien is also lost.

ii) When the goods have not been sold on credit and the buyer fails to pay the full price, right of lien can be exercised.

iii) When the goods have been sold on credit and the credit period has expired, lien can be exercised.

iv) When the buyer becomes insolvent, the seller can retain possession over the goods.

v) The right of lien can be exercised even if the goods are in the possession of the seller in any other capacity, such as a bailee or agent.

vi) 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.

vii) The right of lien can be exercised only for the price and not for any other expenses, e.g., godown charges, interest, etc.

viii) The right of lien is indivisible in nature. The seller may refuse to deliver a part of the goods on payment of a proportionate part of the price by the buyer.

xi) 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 an agreement to waive the lien (Section 48). In simple words, where part delivery is intended as delivery of the whole, right of lien is lost.

x) The right of lien can be exercised even though the seller has obtained a decree for the price of the goods [Section 49 (2)].

*Termination* of *lien:* You know that the right of lien depends upon the actual possession of the goods. The unpaid seller's right of lien is lost in the following cases:

i) When the goods are delivered to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods [Section 49(1)(a)]. It is so because, the delivery to the carrier amounts to the delivery to the buyer himself. For example; A sold machine to B for Rs. 20,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now, A cannot exercise the right of lien.

ii) When the buyer or his agent lawfully obtains possession of the goods [Section 49(1)(b)]. The possession by the buyer or his agent must be lawful.

iii) When the seller waives his right of lien. This waiver may be express or implied. Thus, when the seller extends the period of credit or when the seller agrees to a sub-sale by the buyer, there is an implied waiver.

iv) When the buyer tenders the price, but the seller refuses to accept it, 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 there to Section 53(1).

vi) Where a document of title to goods has been lawfully issued to the buyer and he transfers the documents to an innocent purchaser, who takes them for consideration and in good faith and the seller has assented to it Section 53(1), right of lien is not lost by obtaining a decree,

Where, however, the property in goods has not passed to the buyer, the question of exercising the right of lien does not arise. In such a situation the unpaid seller has the right to withhold the delivery of the goods.

**Check Your Progress A**

1 Define an unpaid seller.

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2 State the rights of an unpaid seller against goods.

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3 When is the right of lien lost?

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4 State whether the following statements are True or False.

i) The right if lien of an unpaid seller depends solely on the possession of goods.

ii) The right of lien can be exercised for the non-payment of the price of goods and other charges.

iii) The right of lien can be exercised when goods have been sold on credit and the period of credit has expired.

iv) An unpaid seller can refuse to deliver the goods even where the documents of title have been delivered but the goods are still in his possession.

v) The right of lien is lost when the unpaid seller obtains a decree for the price of the goods.

vi) The lien is not lost even when the buyer or his agent lawfully obtains possession of the goods.

vii) The right of lien cannot be exercised on the goods repossessed after sale.

viii) In case of part delivery, the unpaid seller can exercise his right of lien over the remainder.

ix) The rights of an unpaid seller arise by implication of law.

19.4.1.2 Right of Stoppage of Goods in Transit

You learnt that when the unpaid seller parts with the possession of the goods, the right of lien is iost. If after delivering the goods to the carrier, the buyer becomes insolvent, the seller has got another right i.e. to stop the goods-in-transit. He can prevent the goods from being delivered lo the buyer or to his agent. The right of stoppage in transit simply means the right of stopping the goods while they are in transit. This right arises only when the lien is lost. In this sense it is said that the tight of stoppage in transit is an extension of the right of lien. By exercising this right, the unpaid seller regains possession over the goods.

According to Section 50 of the Act, *"Subject to the provisions of this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods, has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may retain them until payment or tender of the price."*

On analysing the above provision, you will notice that the right of stoppage-in-transit can only be exercised in the following cases:

i) The seller must be unpaid;

ii) The property in goods must have passed to the buvcr;

iii) The goods must be in the course of transit i.e., the goods are neither in the possession of the seller nor in the possession of the buyer or his agent;

iv) The buyer of the goods has become insolvent; and

v) The goods-in-transit can be stopped only for the payment of the price of the goods.

Duration of transit: As you have learnt that the goods can be stopped only when they are in the course of transit. Now the question arises as to how long and up to what

time the goods can be said to be in transit? In simple words, it can be said that the goods are deemed to be in transit when they are neither in the possession of the seller nor in the possession of the buyer, but they are in the possession of a carrier who is holding them in his own name for the purpose of transmission to the buyer.

If the carrier is holding the goods as an agent for the seller, there is no question of exercising the right of stoppage-in-transit because the seller can exercise lien over them. In case the carrier is holding the goods as an agent of the buyer, the seller cannot exercise the right of stoppage in transit, because the delivery to the carrier amounts to delivery to the buyer.

Section 51(1) of the Sale of Goods Act, explains the duration of transit, It provides that "goods are deemed to be in the 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" From this provision it becomes very clear that 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.

Sometimes, the buyer asks the seller to deliver the goods at a different place other than the agreed one, the goods are in transit until they are received by the buyer or his agent at that place. Similarly if the goods are rejected by the buyer and they are in the possession of the carrier, the transit is not deemed to be at an end, even if the seller had refused to receive them back [Section 51(4)].

Termination of transit: You know that the unpaid seller can stop the goods while they are in transit. In other words, this right will be lost when transit ends. Let us now study the cases when the transit comes to an end. Transit comes to an end in the following circumstances:

i) Buyer taking the delivery: Once the goods reach the hands of the buyer or his agent the transit comes to an end. Sometimes, the buyer or his agent obtains delivery of goods before their arrival at the appointed destination, the transit is at an end [Section 51 (2)]. For example, A of Delhi sold certain goods to B of Bombay. The goods reach Bombay and the buyer, after taking the delivery of the goods, was loading them in his truck. Though the truck was still in the premises of station, the transit has ended because B has taken the delivery.

ii) Carrier's acknowledgement to the buyer: If, after the arrival of the goods at the appointed destination, the carrier or bailee acknowledges to the buyer or his agent, that he holds the goods on his behalf, the transit ends. It should be noted that this acknowledgement must be in clear terms. It is immaterial that a further destination of the goods was indicated by the buyer. Thus, in the above example, B ,went to the railway authorities and after presenting the railway receipt, told them that he would collect the goods within a week. In the meanwhile, B becomes insolvent and A wants to stop the goods. A will not succeed since the transit came to an end when the railway authorities agreed to keep the goods on behalf of B.

iii) Carriers wrongful refusal to deliver the goods to the buyer: Where the carrier or bailee wrongfully refuses to deliver the goods to the buyer or his agent, the transit is deemed to be at an end [Sec. 51(6)]. Here, it should be noted that the transit will come to an end only when the carriers refusal is wrongful.

iv) Delivery to the ship: When the goods are delivered to a ship, the question arises whether the transit ends or not. The answer to this question depends on the circumstances of each case. If the ship is chartered by the buyer, i.e., the buyer is the owner of the ship, the transit ends as soon as the goods are loaded on the ship. On the other hand, if the carrier is acting independently, the transit continues.

v) Part delivery of goods: Where part delivery of the goods has been made to the buyer or his agent, the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods [Section 51(7)].

vi) How stoppage in transit is effected: The unpaid seller may exercise his right of stoppage in transit either: (a) by taking actual possession of the goods; or (b) by

giving notice of his claim to the carrier in whose possession the goods are [Section 52(1)]. 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, to be effective, it must be given at such time and in such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer [Section 52(1)]. In other words, the notice to the principal shall be effective only, if there is sufficient reasonable time with him to further pass on the information to his agent. The notice need not necessarily be in writing and no particular form for it is laid down. All that is required is to give a clear notice to the principal or carrier not to deliver the goods to the buyer and it must reach the carrier before he delivers the goods to the buyer.

When the carrier or the bailee who is in possession of goods receives such a notice from the seller, it becomes his duty to re-deliver the goods to, or according to the directions of the seller. The expenses of such re-delivery shall be borne by the seller [Sec.52(2)]. If the carrier, after receiving notice, delivers the goods to the buyer or his agent, he shall be liable to the seller for conversion.

**Distinction Between Lien and Stoppage-in-Transit**

You have learnt that both these rights can be exercised when the property in goods has passed to the buyer and the buyer has not yet paid the price in full. Though the two rights are similar in these respects, there are some important differenes between the two, they are as follows:

| | Lien | | Stoppage-in-Transit |
|---|---|---|---|
| 1 | The goods must be in actual possession of the seller. | 1 | The goods must be in possession of an independent carrier or bailee. The goods are neither in the possession of the seller nor in the possession of the buyer. |
| 2 | This right can be exercised even when the buyer is solvent but refuses to pay the price. | 2 | This right can be exercised only when the buyer becomes insolvent. |
| 3 | This right comes to an end when the seller parts with the goods | 3 | This right commences only when the seller delivers the goods to a carrier. |
| 4 | This is a right to retain possession over the goods. | 4 | This is a right to regain possession of the goods. |
| 5 | This right can be exercised by the seller himself. | 5 | This right can be exercised by the seller through the carrier or the bailee in whose possession the goods are. |

From the above you must have noted that the right of stoppage in transit commences from the time when the seller delivers the goods to an independent carrier or bailee, in this sense the right of stoppage in transit begins when the right of lien ends. It is because of this it is said that the right of lien ends. It is because of this it is said that the right of stoppage in transit is an extension of the right of lien.

**Effect of Sub-Sale or Pledge by Buyer**

You have earlier read the general rule of law is that the right of lien or stoppage in transit of the unpaid seller is not affected by a sub-sale, pledge or other disposition of the goods by the buyer unless the seller had agreed to such a sale, etc.[Section 53(1)]. For example, A sold certain goods to B of Bombay and the goods are handed over to railways for transmission to B. In the meantime B sold these goods to C for consideration. B becomes insolvent A can still exercise his right of stoppage in transit.

But there are two exceptions to this general 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:

i) Seller's consent: 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. In a case of ***Knights v.*** *Wiffen,* A sold'to B, 80 mounds of grain out of his granary. B then sold (out of these 80 mounds) 60 mounds to C. A told C that the grain would be delivered to him in due course. B then became insolvent. A's right against 60 mounds is lost since A recognised the title of C, the sub-buyer.

ii) **Transfer of documents of title:** Where a document of title to goods (bill of lading or railway receipt) has been issued or lawfully transferred to any person as a buyer, and the buyer transfers the document to a purchaser who buys them in good faith and for valuable consideration, then the unpaid seller's right of lien or stoppage in transit would come to an end, if the transfer by buyer to the purchaser is by way of sale. For example, A sold certain goods to B and set the railway receipt to B. B, before making the payment of the goods transferred the railway receipt to C for valuable consideration. C buys the goods in good faith. B becomes insolvent. A's right to stop the goods in transit is defeated and C shall get a good title.

Section 53(2) further provides that if ***such transfer of documents of title is by way of pledge, then the unpaid seller's rights are not completely defeated but he can exercise these rights subject to the rights of the pledge.*** For example, A sold certain goods to B and sent the railway receipt to B. Without paying for the goods, B pledged the railway receipt with C as a security for a loan of Rs 10,000. Thereafter, B became insolvent. Here, A can get back the railway receipt after paying Rs 10,000 to C.

## Check Your Progress B

1 When can the goods be stopped-in-transit?

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2 When are the goods deemed to be in transit?

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3 How is stoppage in transit effected?

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4 Fill in the blanks

i) An unpaid seller can exercise the right of lien only when he is in actual possession of .....

ii) The right of lien is lost when ..... over the goods is lost.

iii) An unpaid seller can stop the goods in transit when .....

iv) Transit comes to an end when .....

v) Notice of stoppage in transit can be given either to .....

vi) If after receiving the notice to stop the goods in transit, the carrier delivers them to the buyer, the carrier shall be liable to .....

5 State whether the following statements are True or False.

i) The right of stoppage in transit commences only when the right of lien is lost.

ii) An unpaid seller can exercise the right of stoppage in transit when the carrier holds the goods as seller's agent.

iii) Transit comes to an end where the carrier wrongfully refuses to deliver the goods to the buyer or his agent.

iv) Transit does not come to an end when goods are delivered to a ship chattered by the buyer.

v) When the unpaid seller gives his consent to the sale by the buyer, the right of stoppage in transit is lost.

vi) Where part delivery has been made, the seller may stop the remainder unless the part delivery shows an intention to give up the possession of the whole.

19.4.1.3 Right of Resale

You have learnt the two important rights of an unpaid seller against the goods, namely, the right of lien and the right of stoppage in transit. After exercising any of these rights, the seller again gets the possession of the goods which have already been sold by him. Now a question arises as to how long the unpaid seller should wait for the buyer to pay the price and take the delivery of the goods. This question becomes more important in case where the goods are of a perishable nature. Therefore, the unpaid seller has been given another right, and that is, the right to resell the goods. You should note that without this right, the first two rights would become meaningless or burdensome for the seller, for without this right the seller shall have to keep the goods with him.

An unpaid seller who is in possession of the goods can resell them under the following circumstances:

a) Where the goods are perishable: The unpaid seller can in such a cases sell the goods without any notice to the buyer. The word 'perishable' does not only mean physical deterioration, it also includes commercially perishable goods. The unpaid seller can resell such goods after the expiry of reasonable time. What is reasonable time is a question of fact depending on the facts of such case.

b) Where the seller expressly reserves a right of resale: In case where the seller expressly reserves right of resale if the buyer commits a default in making the payment, the unpaid seller may resell the goods. The consequence of this resale will be that the original contract of sale will be rescinded but without defeating unpaid seller's right to claim damages Section 54(4).

c) Where the unpaid seller has given a notice to the buyer about his intention to resell and the buyer does not pay or tender the price within a reasonable time.

If on such resale, the unpaid seller fails to realise the amount which he would have otherwise recovered as price from the original buyer i.e. If there is some loss to the seller, he is entitled to recover this loss from the original buyer. But if there is some profit or surplus on resale, the seller is entitled to keep it with himself, because the buyer cannot be allowed to take advantage of his own wrong i.e., breach of contract.

Notice of Resale: Except in cases of perishable goods and where the seller expressly reserves the right of resale, a reasonable notice to the buyer must be given that he (unpaid-seller) intends to resell the goods. This notice is necessary because of the following two reasons:

i) The buyer is given another opportunity to perform the contract, i.e., pay the price and take the delivery of the goods.

ii) If the buyer is still unable to pay, he can at least supervise the sale and see to it that the goods are sold at a proper price. In this way the buyer can minimise his liability to the seller.

If the unpaid seller fails to give such a notice and resells the goods he cannot claim the loss on such resale from the buyer and in case there is any surplus or profit on such-resale, he cannot keep it, he will have to give it to the original buyer. However, the buyer (who buys in case of resale) shall get good title to the goods against the original buyer, notwithstanding that no notice of resale has been given to the original buyer [Section 54(3)].

It should, however be noted that if the buyer had paid some money, by way of advance or deposit, then this amount can be claimed by him but subject to the seller's claim for damages.

## 19.4.2 Where the Property in the Goods has not Passed to the Buyer

Where the property in goods has not passed to the buyer then the unpaid seller has, in addition to other rights, right to withhold delivery of goods. This right is similar to

and is co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer [Section 46(2)].

## 19.5 RIGHTS AGAINST THE BUYER PERSONALLY

You have studied the rights of an unpaid seller against the goods. In addition to those rights, the seller has certain remedies against the buyer personally. These rights are as follows:

1 Suit for price: It is the legal duty of the buyer to pay the price of the goods, where, under a contract of sale, the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods [Section 55(1)].

Where the property in goods has not passed to the buyer, as a rule, the seller cannot file a suit for the price; his only remedy is to claim damages. But Section 55(2) provides that ***if the contract of sale stipulates the payment of the price 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 although the property in goods has not passed. Thus, you see that transfer of ownership is immaterial.*** For example, *A* sold certain goods to B for Rs 10,000 and the price was agreed to be paid after ten days of the contract. B fails to pay the price on the agreed day. A can file a suit for price against B even though the goods have not been delivered or the property in goods has not been transferred to B.

2 Suit for damages for **non-acceptance:** Sometimes, the seller is ready and willing to deliver the goods to the buyer but the buyer refuses to accept them. In such cases, if the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. What shall be the amount of damages is to be determined in accordance with the provisions laid down in Section 73 of the Indian Contract Act (Please refer to Unit 8 of Block 2).

3 Suit for interest: When under a contract of sale, the seller tenders the goods to the buyer and the buyer wrongfully refuses or neglects to accept and pay the price, the seller has a further right to claim interest on the amount of the price. The interest may be calculated from the date of the tender of the goods or from the date on which the price was payable. The unpaid seller can claim interest only when he can recover the price, i.e., if the seller's remedy is to claim damages, then he cannot claim interest. The rate of interest to be awarded is at the discretion of the court.

## 19.6 RIGHTS OF THE BUYER

So far we have discussed the rights of the seller. But there are certain rights of the buyer as well in case there is a breach of contract by the seller. The buyer has the following rights:

1 Suit for damages for **non-delivery:** When the buyer is ready and willing to take the delivery of the goods but the seller wrongfully neglects or refuse to deliver the goods to the buyer, in such cases the buyer may sue the seller for damages for non-delivery (Section 57).

2 Suit for specific **performance:** In a contract of sale of ascertained or specific goods, if the seller fails to deliver the goods, the buyer may file a suit for specific performance. The court may then order for the specific performance. The court shall pass such order in those cases only where the damages are not a suitable remedy or the goods are of a unique nature. For example, A agreed to sell a rare painting to B for Rs. 20,000. Later on A refused to perform his promise. B may ask the court for granting an order directing A to specifically perform his promise.

3 Suit for breach of warranty: Where there is a breach of warranty by the seller, or in case where the breach of condition on the part of the seller is to be treated as a breach of warranty, the buyer can claim damages from the seller for such breach. If the buyer has already paid the price, his only remedy is to sue for damages.

4 Repudiation of contract before due date: Just as the seller has a right against the buyer, the buyer also has a similar right against the seller. Thus, if the seller repudiates the contract, the buyer has the option to treat the contract as repudiated and claim damages or he may keep the contract open till the date of delivery of goods.

5 Suit for interest: If the price has already been paid by the buyer and the seller fails to deliver the goods on due date, the buyer has a right to sue for interest on the amount of the price. The interest will be calculated from the date on which the price was paid. But, you must remember that the buyer can claim interest only when he has a right to recover the price, i.e., he cannot claim interest when his only remedy is to claim damages.

## 19.7 AUCTION SALES

One of the method of selling the goods is to sell them by auction. Auction sale means a public sale where intending buyers assemble at one place and offer the price at which they are ready to buy the goods. The offer of the price is known as 'bid' and the person making the bid is known as the 'bidder'. The owner of the goods may himself sell them by auction or appoints an 'auctioneer' to sell the goods on his behalf. The relationship between the owner of the goods and the auctioneer is that of the principal and agent. In an auction, as a rule, the goods are sold to the highest bidder.

When goods are to be sold by auction, the auctioneer gives wide publicity regarding the time, date and place of sale. The bidders are also given an opportunity to inspect the goods. As you have already learnt in Unit 2 (offer and acceptance) an advertisement to sell goods by auction is not an offer to sell but it is simply an invitation to the public to make offers. The auctioneer is not bound to sell the goods on the date, time and place announced earlier, he can cancel or postpone the sale and the intending buyers have no right to sue the auctioneer since it was only an invitation and not an affer to the public.

The various rules regarding auction sales are given in Section 64 of the Sale of Goods Act, they are as follows:

i) Where the 'goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale [Section 64(1)].

ii) The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner, for example, by saying "one, two and three" or by shouting "going, going, gone': etc

iii) When the auctioneer announces the completion of the sale, the sale is complete and the property in goods passes immediately to the buyer.

iv) Since offers are invited from the public, before the sale is completed, the bidders have a right to withdraw their bid (offer). Until the announcement of the completion of sale is made, any bidder may retract his bid [Section 64(2)].

v) A right to bid may be reserved expressly by or on behalf of the seller, and where such tight is expressly reserved, the seller or any one person on his behalf, may bid at the auction [Section 64(3)]. This right is given to the seller so that he can protect his interests in case the buyers agree not to outbid each other. Here it should be noted that the seller can appoint only one person to bid on his behalf. If more than one person is appointed, then it amounts to fraud and sale is voidable at the option of the buyer.

vi) Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller himself to bid himself at such sale or to employ any such person on his behalf or for the auctioneer knowingly to accept the bid from such person. Any sale contravening this rule may be treated as fraudulent by the buyer [Section 64(4)].

vii) It is quite usual for the auctioneer to announce a 'reserve' price. It is the price below which the auctioneer will not sell. Such a reserve price is fixed by the seller to protect himself from selling the goods at a very low price. Thus, if the highest bid is below the reserve price, the auctioneer by mistake, accepts the bid which is below the reserve price, he can refuse to deliver the goods.

You may note that even where a reserve price is not notified, if the auctioneer feels that the price offered is not upto his expectation, he can refuse to accept the highest bid. This is possible because 'bid' is only an offer which may or may not be accepted by the auctioneer.

viii) If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Section 64(6)].

ix) An agreement between the bidders not to bid against each other is called the 'knock-out' agreement. Such an agreement is made to avoid competition among themselves. These bidders agree that only one of them will bid, and anything obtained by him shall be shared privately. Knock-out agreements are valid and not illegal. However, if the intention of the parties to the agreement is to defraud a third party, such an agreement shall be termed as 'illegal'.

x) Damping is an unlawful act intended to discourage the bidders from bidding. This is done by pointing out 'defects' in the goods or scaring them away so that may not participate in the auction. Damping is highly undesirable and is illegal.

xi) Puffers are persons employed by the seller for the purpose of raising the price. A puffer has no intention to buy the goods. The seller can appoint only one puffer and not more.

**Check Your Progress C**

1 When can an unpaid seller resell the goods?

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2 Why is it necessary to give a notice for resale to the buyer?

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3 Is the unpaid seller bound to return the surplus realised on resale of goods?

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4 What is an auction sale?

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5 What is a knock-out agreement?

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6 State whether the following statements are True or False.

i) An unpaid seller is bound to resell the goods.

ii) In case of perishable goods, the unpaid seller con resell them without giving any notice to the buyer.

iii) Where a notice of resale has been given to the buyer if there is loss on resale, the unpaid seller can recover it from the buyer.

iv) Where the seller has expressly reserved the right of resale, the unpaid seller need not give any notice of resale to the buyer.

v) If notice .of resale is not given, the title of the buyer shall be affected.

vi) Sale by auction is complete when the auctioneer announces its completion by the fall of hammer, or some other customary manner.

vii) A bidder cannot revoke his bid.

viii) In an auction sale, the seller has the right to fix a reserve price.

ix) Where the right to bid at an auction is expressly reserved by the seller, the seller or any one person on his behalf may bid at the auction.

## 19.8 LET US SUM UP

An unpaid seller is one who has not received the full price or if the price is received in the form of a negotiable instrument, it has been dishonoured. A seller who has been partly paid is also an unpaid seller.

An unpaid seller has two rights — against the goods and against the buyer personally.

**Against Good**

i) Lien: He has a right to retain the possession of the goods until the price is received. Even if part of the goods have been delivered, lien can be exercised on the remaining goods. Lien is lost when possession of goods is lost.

ii) **Stoppage-in-transit:** When the goods are delivered to a common carrier for transmission to the buyer, and in the meantime the buyer becomes insolvent then goods can be stopped in transit. Goods are said to be in transit from the moment they are delivered to the carrier and they continue to be in transit till they are delivered to the buyer or his agent. Transit is at an end when the goods are delivered to the buyer or his agent or the carrier acknowledges to the buyer that he is holding the goods on his behalf. For stopping the goods in transit, reasonable notice should bc given either to the carrier or to his principal.

iii) **Right of resale:** An unpaid seller can resell the perishable goods without giving any notice to the buyer, but in case of other goods a reasonable notice must be given to the buyer before resale. After giving such a notice, if on resale there is some loss or deficiency, the seller can claim it from the buyer. But if there is some surplus or profit on resale, the unpaid seller can retain it. If notice of resale is not given, these rights are lost.

**Against the buyer personally.**

i) **Suit for the price:** The unpaid seller can sue the buyer for the price where the property in goods has passed to the buyer. Where the property in goods has not yet passed, theseller can only claim damages.

ii) **Suit for damages:** Where the buyer wrongfully refuses to accept and pay for the goods, the seller may sue him for damages.

iii) Suit **for interest:** The seller can also claim interest on the price from the date of default.

In an auction sale the goods are put up for sale and bids are invited from the public, Auctioneer invites offers and intending buyers make the proposal for stating a price.

The goods are sold to the highest bidder. A bidder can revoke his bid before the completion of sale. Auction sale is complete when the auctioneer announces its completion, Once the sale is complete, the property in goods passes to the buyer immediately. Sometimes the seller reserves the right to bid, then the seller or any one person on his behalf can bid at the auction.

The auctioneer can notify the reserve price, below which the goods shall not be sold. In an auction sale the auctioneer is not bound to accept the highest bid.

## 19.9 KEY WORDS

Auction: It is a public sale, where goods are sold usually to the highest bidder.

***Bid:*** It is the price offered by the intended buyer.

*Carrier:* One to whom the goods are delivered for transportation to the buyer.

*Damping:* Any act by which the buyer is prevented from bidding or raising the price at an auction sale.

*Insolvent:* A person who has ceased to pay his debts or one who cannot pay his debts as they become due.

***Knock-out agreement: An*** agreement among the bidders not to bid against each other.

***Lien: A*** right to retain possession of the goods until the amount due from another is received.

***Puffer:*** A person who is employed by the seller to raise the price and who has no intention to buy the goods.

Reserve Price: The price below which the goods are not to be sold.

***Transit:*** Transit means when the goods are neither in the possession of the seller nor in the possession of the buyer but are with an independent carrier.

***Unpaid seller:*** A seller who has not received the price in full, or the bill of exchange or other negotiable instrument which was received has been dishonoured.

## 19.10 ANSWERS TO CHECK YOUR PROGRESS

A 4 i) True ii) False iii) True iv) True v) False vi) False vii) True viii) True ix) True

B 4 i) goods, ii) possession, iii) the buyer becomes insolvent, iv) goods are delivered to buyer or his agent, v) the carrier or his principal, vi) unpaid seller for conversion

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

C 6 i) False ii) True iii) True iv) True v) False vi) True vii) False viii) True ix) True

## 19.11 TERMINAL QUESTIONS / EXERCISES

1 Define an unpaid seller. What are his rights?

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 Distinguish between the right of lien and stoppage-in-transit.

5 What is the effect of sub-sale or pledge on unpaid seller's right of lien and stoppage in transit?

6 State the circumstances when the transit'ends.

7 When can a seller resell the goods? Explain.

Explain in brief the rules applicable to an auction sale.

Answer the following problems, giving reasons:

i) A sold some goods to B without any stipulation to deliver the goods until the price is paid. Advise B.

(Hint: A is an unpaid seller, he can exercise right of lien. B can take the delivery of goods only after making payment.)

ii) A sells goods to B. B pays to A through a cheque. Before B could obtain the delivery of goods, his cheque is dishonoured by the bank, A, therefore, refuses to deliver the goods until paid. Is A's action justified?

(Hint: Yes, A's action is justified. A is an unpaid seller and he'can exercise his rights of lien over the goods.)

iii) Suresh sold fifty bags of rice to Mohan of Calcutta and sent the goods by railways. The railway receipt duly endorsed in favour of Mohan was sent to Mohan. When the goods reached Calcutta, Mohan asked the railways to carry them to Durgapur. In the meantime Mohan became insolvent. Suresh asks the railways to stop the goods. Will he succeed?

(*Hint:* No, Goods cannot be stopped because the transit came to an end when the railways agreed to carry the goods to some other place at the request of Mohan (Sec. 51(3).)

iv) Avinash sells and consigns to Gopal goods worth Rs 20,000 on credit. Gopal assigns the railway receipt to Kumar to borrow Rs 10,000 on the security of railway receipt. Before the goods reach the destination Gopal becomes insolvent. Avinash gives notice to stop the goods in transit but Kumar claims them. Will Avinash succeed in stopping the goods?

(Hint: Yes, Avinash can stop the goods but subject to the pledge of Kumar (Sec. 53).)

v) Virender sells and consigns goods to Ashok. The price has not yet been paid. Ashok becomes insolvent and while the goods are still in transit, Ashok assigns the railway receipt for cash to Mohan who knows about the insolvency of Ashok. Can Virender stop the goods in transit?

(*Hint:* Yes, Virender can stop the goods because Mohan nas not acted in good faith.)

vi) Roshan sells to Rajesh a quantity of wheat lying in Roshan's warehouse. It is agreed that Rajesh shall get one month's credit. Rajesh allows the wheat to remain in Roshan's warehouse. Before the expiry of one month's credit Rajesh becomes insolvent. Can Roshan refuse to deliver the wheat to the official assignee?

(*Hint:* **Yes,** Roshan has the right of lien over the goods (Sec. 47.)

vii) Amar of Delhi orders Basant of Bombay to deliver certain goods to him at Delhi. Basant sent the goods by railways. When the goods reach Delhi, the railway officials inform Amar that the goods are lying at the station at Amar's risk. Amar became insolvent in the meantime. Can Basant stop the goods in transit?

***(Hint:*** No, Basant cannot stop the goods because the transit has come to an end when the railways acknowledge to the buyer that the goods are lying at Amar's risk (Sec. 51(3).)

viii) Kranti sold certain furniture by an auction to Manohar. Manohar gave a cheque for the price and took the delivery of furniture. One of the clauses of the agreement was that the property in goods will not pass to the buyer until the cheque was honoured. Manohar sold the furniture to Keshav, Kranti wants the furniture back from Keshav. Will he succeed?

(Hint: No, sale is complete as the ownership has passed to the buyer. Keshav gets a good title.)

ix) Ashok made a bid for a steel almirah in an auction but withdrew the bid before the fall of the hammer, one of the condition of the sale was "bid once

made cannot be withdrawn" and Ashok was aware of this condition. Auctioneer sued Ashok for the price. Will he succeed?

*(Hint:* No, Ashok is not liable for the price, because he can withdraw his bid before the completion of sale. (Sec. 64(2).)

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

## SOME USEFUL BOOKS

Chawla, R.C. and Garg K.C., Mercantile *Law,* Kalyani Publishers, Ludhiana (Chapters 1-6)

Gulshan, S.S. and Kapoor G.K., 1989. *Business Law,* Wiley Eastern Limited, New Delhi (Chapter 4)

Kapoor, N.D. 1988. Mercantile *Law,* Sultan Chand & Sons, New Delhi (Chapter 4)

Kuchhal, M.C. 1989. *Mercantile Law,* Vikas Publishing House, Private Limited, New Delhi (Chapters 16-20)

Maheshwari, R.P. and Makeshwari S.N., 1989. Mercantile *Law,* National Publishing House, New Delhi (Chapters 1-6 Book 2)