BBA-15

# Vardhaman Mahaveer Open University, Kota

# Legal Aspects of Business

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CONTENTS

## Legal Aspects of Business

# Unit - 1 : Meaning and Essential of Contract

**Structure of Unit:**



## 1.0 Objectives

After studying this unit you will learn

- Meaning and Importance of law
- Meaning and sources of Mercantile law
- Important facts about Indian Contract Act
- Formation of Indian Contract Act
- Definition and essentials of Contract
- Different types of agreement & contraDistinguish between various types of agreement

## 1.1 Introduction

"**Ignorantia juris non excusat**" or **"ignorantia legis neminem excusat**" this maxima stands for "ignorance of the law does not excuse" or "ignorance of the law excuses no one" is a legal principle holding that a person who is unaware of a law may not escape liability for violating that law merely because he or she was unaware of its content. Therefore, every person must be aware about the laws in which he deals with.

Law is a system of rules and guidelines which are enforced through social institutions to govern behavior. Laws are made by governments, specifically by their legislatures. The formation of laws themselves may be influenced by a constitution (written or unwritten) and the rights encoded therein. The law shapes politics, economics and society in countless ways and serves as a social mediator of relations between people.

Thus, the term law refers to the rules of conduct recognized and enforced by the state of control and regulate the conduct of people, to protect their property and contractual rights in order to secure justice and equality in the society.

**According to Salmond** "Law is the body of principles recognized and applied by the state in administration of justice."

**According to Austin**"A Law is a rule of conduct imposed and enforced by sovereign."

Mercantile law may be defined as a set of rules enforced to govern and regulate business. It is a branch of civil law which deals with the mercantile transactions. It includes law relating to contracts, sale of goods, companies, partnership, insurance, negotiable instruments, arbitration etc.

**According Prof.M.C.Shukla**"Mercantile law may be defined as the branch of law which deals with the rights and obligations of mercantile persons,"

## 1.2 Sources of Mercantile Law

The major source of mercantile law in India is English Common Law. The provisions of English law has adapted with required modification as per the conditions prevailing in India.

1. **English Common Law** :It is the foundation on which the super structure of the of the Indian Contract Act has been built.
2. **Indian Statute Law**: the various act passed by Indian legislatures such as The Negotiable Instruments Act,1881, The Indian Partnership Act,1932, the Sale of Goods Act,1930, are the main source of the law of contract in India.
3. **Judicial Decisions:** It usually referred to as precedents and are binding on all course. Whenever an act is silent on a particular point or there is ambiguity, The judges have to decide the case on the basis of principle of justice, equity and good conscience.
4. **Customs and Usage**: The customary in a trade govern the merchants of that trade while dealing with each other . These are providing guidelines to the courts in deciding the disputes arises .Some of them have been recognize by the law of the contract.

The main sources of Indian mercantile law shown in Fig 1.1

## 1.3 Introduction of Indian Contract Act

The Law of Contract constitutes the most important branch of mercantile or commercial law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world.

The law relating to contracts in India is contained in **Indian Contract Act, 1872**. It came into force from September, 1872. It is applicable to All the States of India except the State of Jammu & Kashmir.1 It determines the circumstances in which promise made by the parties to a contract shall be legally binding on them. All of us enter into a number of contracts everyday knowingly or unknowingly. Each contract creates some right and duties upon the contracting parties. Indian Contract deals with the enforcement of these rights and duties upon the parties in India.

1. The State of Jammu & Kashmir enjoys a special status under Article – 370 of Indian Constitution.

The Act as enacted originally had 266 Sections, it had wide scope and included.

**Table – 1.1**

| Provisions | Section |
|---|---|
| General Principles of Law of Contract | 1 to 75 |
| Contract relating to Sale of Goods | 76 to 129 |
| Special kinds of Contracts (includes indemnity, guarantee, bailment & pledge) | 125 to 238 |
| Contracts relating to Partnership | 239 to 266 |

Indian Contract Act embodied the simple and elementary rules relating to Sale of goods and partnership. The developments of modern business world found the provisions contained in the Indian Contract Act inadequate to deal with the new regulations or give effect to the new principles. Subsequently the provisions relating to the sale of goods and partnership contained in the Indian Contract Act were repealed respectively in the year 1930 and 1932 and new enactments namely Sale of Goods and Movables Act 1930 and Indian Partnership act 1932 were re-enacted.

At present the Indian Contract Act includes:

**Table – 1.2**

| Provisions | Section |
|---|---|
| General Principles of Law of Contract | 1 to 75 |
| Special kinds of Contracts (includes indemnity, guarantee, bailment & pledge) | 125 to 238 |

## 1.4 Important Facts About Indian Contract Act

1. **Rights Available to Parties Under Indian Contract Act:** Generally the rights available to a person are:

   **a. Rights in Rem (Jus in Rem):** A right in rem is available against the world at large. This right protects interest against the world and there is a duty upon every person of the world not to interfere with other's rights. It is available against an open or indefinite class of persons. The freedoms given in article 19 of the Indian constitution with its restrictions are the rights in rem.

   Example: X has a house. The people of the world have a duty not to interfere with his ownership. Nobody has right to disturb his possession

   I have money in my pocket. I can use my money as like. The world at large has no right to interfere with my possession.

   **b. Rights in Personam (Jus in Personam):** A right in personam is available only against a particular person or party. This right protects an interest solely against determinate individuals and duty imposed upon determinate individuals. Indian Contract Act, 1872 provides right in personam to the parties who enters in to the contract thus, the parties to the contract can exercise their contractual rights against each other only.

Example: X let his house to Z-tenant. X has a right to receive rent from his tenant. This right to receive rent from his tenant. is a right in personam. The rest of the world is not concerned with this right.

2. **Assumptions:** a. There shall be freedom to the parties to the contract to determine their rights and obligations under contract and law shall enforce only what the parties have agreed to be bound subject to certain limited principles.

   b. Rights and obligations created by parties shall be performed and their non performance shall give rise to legal consequences .

3. **Law of Contract is Not the Whole Law of Agreements:** The law of contract is concerned only with only those agreements which contains all essentials under section10 and where the parties have intension to create legal obligation thus the law of contract does not covers all agreements such as social, political, religious and other agreements without legal intensions.

4. **The Law of Contract is Not the Whole Law of Obligation:** The Indian contract act shall not lay down absolute rights and obligations of the contracting parties. It enforce only those obligations which are agreed by the parties under a contract i.e. contractual obligation. Thus it is not concerned with obligations arises by the statutes, torts or judgment of courts.

5. **It Has No Retrospective Effect:** The law of the contract enacted as on 1 sep.1872, and applies only on those contracts which are formed as on 1sep.1872 or after it. It does not have retrospective effect therefore, does not enforce those contract which are formed prior to 1sep.1872.

## 1.5 Definition of Contract

**Salmon** defines contact as "An agreement creating and defining obligation between agreement as the parties"

**Sir Federick Pollock** defines it as "Every agreement and promise enforceable at law is a contract."

**Section 2(h)** of the Act defines the term contract as "an agreement enforceable by law is a contract". The definition resolves that a contract is fundamentally an agreement that binds the parties legally, thus,

Contract = Agreement + Enforceability

## 1.6 Related Terminology

1. **Agreement:** An agreement occurs when two minds meet upon a common purpose, i.e. they mean the same thing in the same sense at the same time. The meeting of the minds is called *consensus-ad-idem,* i.e., consent to the matter.

   **Section 2(e)** defines the term 'agreement' as "Every promise and every set of promise, forming the consideration for each other"

   In other words, an agreement consist of an offer by one party and its acceptance by the other party whom the offer was made

   Thus, Agreement = Offer + Acceptance

2. **Offer : Section 2 (a)** defines proposal (offer) as "When one person signifies to another his willingness to do or to abstain from doing something with a view to obtain the assent of that other to such act or abstinence, he is said to make a proposal."

3. **Promise: Section 2 (b)** defines "a proposal (offer) when accepted becomes a promise." Thus an accepted offer is a promise.

4. **Acceptance: Se ction 2(b)** "when the person to whom the offer is made signifies his assent there to, the proposal is said to be accepted."

5. **Enforceability:** Enforceability means creation of some legal obligations! An agreement is said to be enforceable only after complying all the requirements under section 10 of Indian contract act and only those agreements called contracts which have enforceability.

   However, there may be certain agreements which do not converts into contracts as there may be absence of one or more essentials as prescribed under section 10. Such agreement neither creates any contractual rights nor obligations on the parties.

   It is said that all agreements are not contract but on the other hand all contracts are agreement because every contract contains agreement as well as all essentials as required by the Indian contract Act. Agreement is the basis for every contract as Section 2(h) revels that "a contract is an agreement enforceable by law." therefore every contract is an agreement two but every agreement need not be contract necessarily. as there may be lack of any essential and due to absence of essential it remains an agreement.

   For example agreement between the family members, are remains agreement as there is no legal intention., similarly agreement by incompetent person cannot be converted into contract because the agreement by incompetent person are void under The Indian Contract Act.

## 1.7 Distinguish Between Agreement and Contract

An agreement differs from a contract in the following respects:

**Table – 1.3**

| Basis | Agreement | Contract |
|---|---|---|
| 1. Defination | Every promise and set of consideration for each other is an agreement. | An agreement enforceable by Law is a contract. |
| 2. Formation | Offer and its acceptance Constitute an agreement. | Agreement and its enforceability constitute a contract. |
| 3. Legal obligation | An agreement may of may not create a legal obligation. | A contract necessarily create a legal obligation. |
| 4. One in other | Every agreement need not necessarily be a contract. | All contracts are necessarily agreements. |
| 5. Scope | Scope of agreement is wider as it covers all types of agreement as wall as contract. | Scope of contract is narrow in comparison to agreement as it covers only those agreement which are enforceable. |

## 1.8 Essentials of Contract

According to **Section 10**, "All agreements are contracts if they are made by **free consent** of parties, **competent** to contract, for a **lawful consideration** and with a **lawful object** and are not hereby expressly declared to be void". The analysis of section 10 and section 2(b) reveals that an agreement must have certain essential elements to constitute contract. The essential elements of a valid contract are:

1. **Two Parties:** To constitute a contract there must be at least two parties. i.e. one party making an offer (offerer / proposar) and the other party accepting the offer (offeree / proposee). The terms of the offer must be definite.

2. **Agreement:** A contract is initially an agreement when person whom the offer has given signifies his acceptance on it there arises an agreement which is the foundation of a contract.

3. **Consent:** There must be consensus-ad-idem (meeting of minds) to constitute a valid contract unity of minds i.e. consensus-ad-idem means that the parties must agree to the same thing in the same sense and at the same time. An agreement without consent is void.

4. **Intention to Create Legal Relationship:** There must be an intention by both parties to create legal relationship and to legally bind themselves as a result of such agreement. Thus, agreements of social or household nature are not contracts, as the usual presumption is that the parties do not intend to create legal relationship unless otherwise agreed upon. However, in case of commercial transaction the usual presumption is that parties intend to create legal relationship.

5. **Contractual Capacity:** The parties to the agreement must be capable of entering into a valid contract. According to Section 11, every person is competent to contract if he or she,
   a. is of the age of majority;
   b. is of sound mind; and
   c. is not disqualified from contracting by any law to which he/she is subject.

6. **Consideration:** An agreement by incompetent person is void. A valid contract must be supported by consideration. Consideration means "something in return" (quid pro quo). It can be cash, kind, an act or abstinence. It can be past, present or future. However, consideration must be real and lawful. An agreement without consideration is void however, it need not to be adequate. if parties are agreed in it.

7. **Free consent:** The parties are said to be on consent when they are agreed upon the same thing in the same sense, in addition to it, to constitute a valid contract there must be free and genuine consent of the parties to the contract. consent is said to be free if it must not be obtained by misrepresentation, fraud, coercion, undue influence or mistake. It the consent is not free, the contract becomes voidable.

8. **Lawful Object and Consideration:** The object as well as consideration of the Contract must not be unlawful. According to Section 23, the consideration or object of an agreement is un lawful, if
   • It is forbidden by law; or
   • it Is of such nature that, if permitted it would defeat the provisions of any law or
   · It is fraudulent; or
   • it Involves or implies, injury to the person or property of another; or
   • The court regards it as immoral, or
   · it is opposed to public policy.

9. **Agreement Not Declared Void: U**nder the provisions of Indian Contract Act, 1872 certain agreement are expressly declared as void. Agreements which have been expressly declared void are not enforceable at law; hence does not constitute a valid contract. For example agreement of wager, agreement in restraint of trade and marriage.

10. **Certainty of Meaning:** The terms of agreement must be certain and not vague. It must be either certain or be certained at the time of execution. If it is not possible to ascertain the meaning of the agreement, it is not enforceable at law.

11. **Possibility to Perform:** The promises made under a valid contract must be executable. An agreement to do some impossible act is void from the beginning and never converted into contract.

12. **Legal Formalities:** Although Indian contract Act does not provide any formality to enter into contract therefore a contract may be express (oral or written) or even implied (by conduct). However, where the law requires for a particular contract, it must comply with all the legal formalities such as in writing, registration and attestation.

    a. For example under the provisions of Immovable Properties Act, a contract of immovable must be written, registered and duly stamped and unless not enforceable by law.


**Figure - 1.1**

## 1.9 Classification of Contract and Agreement

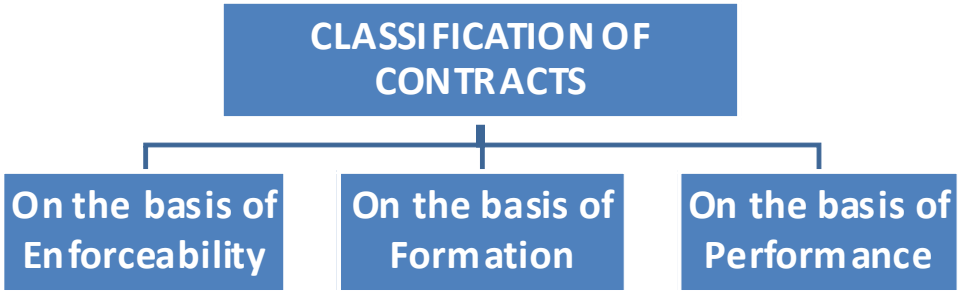


**Figure 1.2**

| | | |
|---|---|---|
| I. Contract | I. Express contract | I. Executed contract |
| II. Void agreement | II. Tacit contract | II. Executory contract |
| III. Contract | III. Implied/Quasi Contracts | |
| IV. Void contract | | a) Unilateral contract |
| V. Un enforceable Contract | | b) Bilateral contract |
| VI. Illegal Agreement | | |

I. **On The Basis of Enforceability: Contract: [Section 2 (b)]** "A contract is an agreement enforceable by law" an agreement becomes contract if it has all the essential elements of a contract. A valid contract can be enforced by law.

Example: X offers Y to supply 10 bags of rice for Rs. 50000/- Y agreed for it, it is a contract.

**Void Agreement:** Section 2 (g) "An agreement not enforceable by law is said to be void." Such agreement does not confer any right to any of the parties to it. An agreement becomes void due to absence of one or more essentials under section 10. The agreement, in such a case, is void-ab-initio (void from the very beginning) and can never converts contract. Such an agreement does not result in a contract at all.

Example X offers Y a minor to deliver 100 bags of rice. Y agrees but further not supplied the rice. Here X cannot sue Y as Y is minor.

**Voidable Contract [Section 2(i)]: "**An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of other or others, is a voidable contract". It is a contract where in, the law confers right on the aggrieved party either to reject the contract or to accept it. However, the contract continues to be valid and enforceable unless it is repudiated by the aggrieved party.

Example: A Threatens B to murder if he does not sell his land for Rs. 100000/- B agreed for it due to threat. It is a voidable contract which can be rejected by B.

**1. Void Contract [Section 2(j)]: "**A void contract is a contract which ceases to be enforceable by law". A contract which was valid at the time of formation and binding on the parties however, subsequently become void, due to impossibility to perform is said to be void contract.

Example X a famous singer agrees to sing an album for a musical company. Unfortunately suffered from throat cancer and not allowed to sing by doctor. Here the contract becomes void contract.

**2. Unenforceable Contract:** Where a contract is good in substance but becomes unenforceable due to some technical defect and cannot be enforced by law is called unenforceable contract. These contracts becomes enforceable when these technical defects (legal formalities) are completed.

Example A draw a promissory note without stamp it is not enforceable but further after one week a come to know about the mistake and stamped it become enforceable.

**3. Illegal Agreement:** When the object and consideration of an agreement is unlawful it is said to be illegal agreement, such an agreement is void. The object and consideration is said to be unlawful if (a) it is forbidden by law; or (b) is of such nature that, if permitted, would defeat the provisions of any law or (c) is fraudulent; or (d) involves or implies injury to a person or property of another, or (e) court regards it as immoral (f) opposed to public policy.

These agreements are punishable by law and are void-ab-initio.

Example X agrees to paid Rs. 100000/- to Y to murdered Z it is an illegal agreement as it is injurious to Z and forbidden under I.P.C.

"**All illegal agreements are void because an illegal agreement is not enforceable by law but all void agreements are not illegal," as it is not necessary that object and consideration of every agreement is unlawful.**

**II. On the Basis of Formation:**

**1. Express Contract:** Where the terms of the contract are expressly agreed upon in words (written or spoken) at the time of formation, the contract is said to be express contract.

**2. Implied Contract:** An implied contract is one which is inferred from the acts or conduct of the parties or from the circumstances of the cases. Where a proposal and acceptance is made otherwise than in words, it is said to be implied contract.

**3. Quasi Contracts:** A quasi contract is created by law on the basis of principal of equity. There, is no intention of parties to enter into a contract. It is legal obligation which is imposed on a party and is required to perform it. A quasi contract is based on the principle on equity which states that a person shall not be allowed to enrich himself at the cost of another. A quasi contract is a contract imposed by law.

**III. On the Basis of Execution: Executed contract:** when both of the parties to contract have preformed their contractual obligation and nothing remains to be performed it is said to be executory. It is a contract in which both the parties have performed their respective obligation.

**1. Executory Contract:** An executory contract is one where one or both the parties to the contract have to perform their obligations in future. Thus, a contract which is partially performed or wholly unperformed is termed as executory contract.

It is of two types:

**a) Unilateral Contract:** A unilateral contract is one in which only one party has to perform his obligation after formation of the contract and the other party have fulfilled his obligation at the time of the contract or before the contract comes into existence.

**b) Bilateral Contract:** A bilateral contract is one in which the obligation of both the parties to the contract is outstanding. In other words when both of parties have still to perform their obligation it is known as bi lateral contract. Bilateral contracts are also known as ***contracts with executory consideration***.

## 1.10 Distinguish Between Contract and Void Agreement

**Table – 1.4**

| Basis | Contract | Void Agreement |
|---|---|---|
| 1. Definition | An agreement enforceable by law is a contract. | An agreement not enforceable by law is void agreement. |
| 2. Legal Existence | It exist in the eyes of law. | It does not exist in the eyes of law. |
| 3. Essentials | It consists all essentials of valid contract. | It does not consists all essentials of valid contract. |
| 4. Enforceable | It is enforceable by law. | It is not enforceable by law. |
| 5. Damages | Damages can be claimed in case Of non performance. | No damages for non performance. |

## 1.11 Distinguish Between Void Agreement and Void Contract

**Table – 1.5**

| Basis | Void Agreement | Void Contract |
|---|---|---|
| 1. Definition | An agreement not enforceable By law is said to be void. [Sect. (g)] | A contract which ceases to be Enforceable by law becomes void When it ceases to be enforceable [Sec.2 (j)]. |
| 2. Void From beginning | It is void from very beginning. | It is valid in the beginning, it Becomes void subsequently due to or change in circumstances. |
| 3. Restitution | Generally no restitution is gran the by court may on Equitable grounds grant rest- itution in case of fraud or mis- Representation by minors. | Restitution may be granted When the contract is discover to Be void. |
| 4. Causes | An agreement becomes void Due to absence of one or more Essentials. | It becomes void due to impossibilit To perform. |

## 1.12 Distinguish Between Void Contract and Voidable Contract

**Table – 1.6**

| Basis of distinction | Void contract | Voidable contract |
|---|---|---|
| 1. Definition | A contract which ceases to be Enforceable by law become voi When it ceases to be enforceabl | A contract which is enforceable By law at the option of the aggrieved party is a voidable contract. |
| 2. Period of validity | It remains valid till it does not Cease to enforceable. | It remains valid till aggrieved party Avoid it. |
| 3. Option to the party | There is no option with the part To make it enforceable or not | Its validity depends upon the will o The aggrieved party. Aggrieved pa has to treat it either valid or void |
| 4. Causes | Contracts become void because Becomes impossible to perform Due to change in circumstances Or in the law of the land. | Contract is voidable when the Consent of the party is not free, Sometimes, it may be voidable under the provisions of the Secs. 39,53, and 55 |

## 1.13 Distinguish Between Void Agreement and Illegal Agreement

**Table – 1.7**

| Basis | Void Agreement | Illegal Agreement |
|---|---|---|
| 1. Definition | An agreement not enforceable by law is void | An agreement which is expressly or impliedly prohibited by law. is illegal. |
| 2. Effect on collateral agreement | An agreement collateral to the Void agreement is not Necessarily void. | An agreement which is collateral agreement is always void. |
| 3. Scope | The scope is wider than that of The illegal agreements. Becaus every illegal agreement is void also. | Every void agreement is not illegal thus, Its scope is narrow. |
| 4. Restitution | The court may grant restitution On the basis of equity | Restitution of money is not granted in Case of an illegal agreement. |
| 5. Punishment | There is no punishment for void Agreement. | The parties to an illegal agreement are Punishable as per the law of country |

## 1.14 Distinguish Between Executed and Executory Contract

**Table – 1.8**

| Basis | Executed contract | Executory contract |
|---|---|---|
| **1. Performance** | It such contract performance Of both parties are fulfilled. | It performance of both or At least one party remains. |
| **2. Obligations** | There remains no contractual Obligations as parties have Fulfilled their promises. | There remains legal obligations For the parties. |
| **3. Discharge** | The parties are discharge From contract. | The parties are not discharged and can be sued. |

## 1.15 Summary

"Law is the body of principles recognized and applied by the state in administration of justice." **Salmond**

"A Law is a rule of conduct imposed and enforced by sovereign." **Austin**

Mercantile law may be defined as a set of rules enforced to govern and regulate business. It is a branch of civil law which deals with the mercantile transactions. It includes law relating to contracts, sale of goods, companies, partnership, insurance, negotiable instruments, arbitration etc.

The major source of mercantile law in India is English Common Law, Indian Statute Law, judicial decisions ,customs and usage . The Indian Contract Act provides right in personam ,thus ,only parties to the contract can sue each other for enforcement of contract .

The law relating to contracts in India is contained in **Indian Contract Act, 1872**. It came into force from September, 1872. It is applicable to All the States of India except the State of Jammu & Kashmir.1 It determines the circumstances in which promise made by the parties to a contract shall be legally binding on them. **Section 2(h)** of the Act defines the term contract as "an agreement enforceable by law is a contract". The definition resolves that a contract is fundamentally an agreement that binds the parties legally, thus,

Contract = Agreement + Enforceability .The essential elements of a valid contract are: two parties ,agreement ,consent ,Intention to create legal relations ,contractual capacity ,lawful object and consideration ,free consent ,certainty of meaning ,possibility to perform andfulfillment of legal formalities .contract may be classified as

| | | |
|---|---|---|
| I. Contract | I. Express contract | I. Executed contract |
| II. Void agreement | II. Tacit contract | II. Executory contract |
| III. Contract | III. Implied/Quasi Contracts | |
| IV. Void contract | | a) Unilateral contract |
| V. Un enforceable Contract | | b) Bilateral contract |
| VI. Illegal Agreement | | |

## 1.16 Self Assessment Questions

**I-Very Short Type Question**:-

1. Define Agreement.
2. Define Contract.

3 what is enforceability of an agreement?

4 what is the usual presumption in social or domestic agreement ?

5 what is the usual presumption in commercial or business agreements?

6 what is an 'Express Contract'?

7 what is an 'Implied Contract'?

8 Define 'Executed Contract'.

9 Define 'Executory Contract'.

10 what is meant by 'Partly Executed and Partly Executory Contract?

11 what is meant by a Valid Contract?

12 Define 'Void Contract'.

13 Define Void Agreement'.

14 what is voidable Contract'.

15 What is illegal Agreement?

16 What is 'Unenforceable Contract'?

**II-Short Type Question**

1 Enumerate the essential of a valid contract.

2 Distinguish between the following:
- (a) Implied Contract and Express Contract
- (b) Executory Contract and Executed Contract
- (c) Void Contract and Voidable Contract
- (d) Void Contract and Void Agreement
- (e) Void Agreement and Illegal Agreement

3. Comment on the following statement:
- (a) All contract are agreements but all agreement are not contracts.
- (b) In commercial and business agreement the presumption is that the parties intend to create legal relations.

4 What do you mean by ' consensus ad idem' ?

5 what is meant by jus in rem and jus in personam.

6 A voidable contract is valid till the aggrieved party opts to avoid it. Explain.

7 All illegal agreements are void but all void are not illegal."Explain.

8 When does Indian Contract Act came into force ?

9 What is the extent of Indian Contract Act , 1872 ?

10 The provisions of Indian Contract Act does not applies on the contract made prior to first September 1872. Explain.

**III-Essay Type Question**

1 Define contract and describe essential elements of a valid contract.

2 "All contract are agreement but all agreement are not contract" Explain the statement and explain the essentials of valid contract .

3 "An agreement enforceable by law is a contract " Explain the statement and describe the essentials under section 10 of Indian Contract Act, 1872.

## 1.17 Reference Books

# Unit - 2 : (Proposal) Offer and Acceptance

**Structure of Unit:**



## 2.0 Objective

After studying this unit you would be able to understand:

- What is the valid Offer & Acceptance
- What are the prerequisites of a valid Offer & Acceptance
- Distinguish between Offer and Invitation to offer
- What are the various types of Offer
- What are the effects of valid Acceptance
- What are the rules regarding communication and revocation of Offer and Acceptance
- What are the various modes of revocation

## 2.1 Introduction

Offer is one of the essential elements of a contract it is the foundation of contract on which a contract formed.

Proposal is defined under **section 2(a) of the Indian contract Act, 1872** as "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtain the assent of that other to such act of abstinence, he is said to make a proposal/offer". Thus, for a valid offer, the party making it must express his willingness to do or not to do something. But mere expression of willingness does not constitute an offer. An offer should be made to obtain the assent of the other. The offer should be communicated to the offeree and is should not contain a term the non compliance of which would amount to acceptance.

According **Anson** "An offer is an intimation by word or conduct of a willingness to enter into a legally binding contract."

According to **Chetty** "proposal is the promise to do or not to do some act."

Example: "X" offers to sell his car to "y" for Rs.50,000/- it is an offer.

## 2.2 Related Terms

1. **Proposer (Offerer**): The person making the offer is called offerer.
2. **Promisor:** After acceptance of offer by offeree the person who has offered (offerer) becomes the promisor.
3. **Proposee (Offeree):** The person whom the offer is made is known as proposee (offeree)
4. **Promisee:** After acceptance of offer the person whom offer was made is known as promissee.

## 2.3 Essentials of a Valid Offer

1. **Two Parties:** There must be at least two parties to a valid offer. One is the proposer (offerer) and another is the proposee (offeree). A person cannot make a proposal to himself. In a case it was stated that "No man is his own right, be under an obligation to himself."
2. **It May Be To Do or to Not To Do Anything:** An offer is made with a view to obtaining the assent of the offeree to the proposed act or to some abstinence. Thus, there may be a "Positive" of "Negative" act which the offerer is willing to do.

   **Example:** (A)X offers to y to enter as a partner for ¼ share in his firm and to interest Rs. 100000 as capital it is a positive offer

   (B) "X" offers "Y" to not to due against him, if he agrees to pay the outstanding amount of Rs.50,000/- on him within seven days with an interest of 12% p.a. It is a negative offer where X is offering to be abstaine offer from filing a suit.
3. **The Object Must Be Made To Obtain Assent:** An offer is an expression of willingness thus, a casual enquiry or a mere aceptance of the other it recognize as valid offer in the law

**For Example**

(A) Do you intend to sell your car? is not an offer, similarity,

(B) I may sell my car if I can get Rs.50,000/- is also not an offer, as in both cases object is not to take assent, However

(C) I am willing to sell my car to you for Rs.40,000/- is an offer.

4. **Intention to Create Legal Relationship:** An offer must intend to create legal relations. An offer must be such that when accepted, it will create legal relationship among the parties. Thus, an invitation to join a friend on dinner is not a contract because it is a social offer without legal intention. The question whether or not the parties have intention to create legal relationship can be answered with reference to type and terms of agreement and the circumstances under which the agreement is made.
5. **The Offer & Terms of Offer Must Be Certain and Unambiguous:** The offer must be certain and definite not vague. If the terms of the offer are vague, no contract can be entered into because it is not clear as to what exactly the parties intended to do. However, where, the terms of the offer are capable of being made certain, the offer is not regarded as vague.

**Example:** X offers to sell to Y "a 100 tons of oil." if X is a dealer in coconut oil and mustard oil, his offer is not certain because it is not clear that he wants to sell coconut oil or mustard oil. But if X is a dealer in coconut oil only, it is clear that he wants to sell coconut oil. Hence, the offer is certain.

6. **It Must Not Be Mere Declaration of Intention:** The offer must be distinguished from a mere declaration of intention. Such statement or declaration merely indicates that an offer will be made or invited in future.

   **Example I :** A father wrote to his would be son-in-law that his daughter would have a share of what he left after the death of his wife. It was held that the letter was a mere statement of intention and not an offer. {Farine v. Fickar}

   **Example II:** X a broker of Mumbai wrote to Y a merchant of Ghaziabad stating the terms on which he is willing to do business. It was held that the letter was a mere statement of intention and not an offer. {Devidatt v. Shriram}

7. **Invitation to Offer Is Not an Offer:** An offer must be distinguished from an invitation to offer. In case of an invitation to offer, the person making an invitation invites others to make an offer to him and his object is to circulate information that he is willing to open for negotiation with him. Such invitation to offer are therefore not considered offer in the eyes of law and their acceptance does not amount to agreement.

   **Example I:** Goods were displayed in the shop for sale with price tags attached on each article and self service system was there. One customer selected the goods. It was held that the display of goods was only an intention to offer and the selection of the goods was an offer by the customer to buy and the contract was made when the cashier accepted the offer to bye and received the price. {Pharmaceutical Society of Great Britan v. Boots Cash Chemists Ltd.)

   **Example II:** A prospectus issued by a company for subscription of its shares and debentures is only an invitation to general public to make an offer to buy the shares/debentures which may or may not be accepted by the company.

   Similarly, an advertisement inviting quotations of lowest price in response to an enquiry amounts to invitation to offer but not an offer capable of acceptance e.g.( in Harvey v. facle (1893).)

8. **Communication of Offer:** An offer must be communicated to the person to whom it is made otherwise the offeree cannot accept it as he is not aware of the existence of the offer. An offer is complete only when it is communicated to the offeree. One can accept the offer only when he knows about it. Thus, an offer accepted without its knowledge does not confer any legal rights on the acceptor.

   **Example I:** G sent his servant L to trace his lost nephew. When the servant had left. G announced a reward of Rs.500/- to anyone who trace the missing boy. L found the boy and brought him home. When L came to know about reward, he filed a suit against G to recover the reward. It was held that L was not entitled the reward because he did not know about the reward when he found the missing boy. [Lalman Shukla v. Gauri Dutt.]

9. **It Must not Consists of Term The Non-Compliance of Which Amounts to Acceptance:** The offer must not contain a term the non-compliance of which would amount to acceptance. It means that while making the offer, the offerer cannot say that if offer is not accepted by a certain time. It will be presumed to have been accepted.

**Example:** X writes a letter to Y. I offer to sell my pen for Rs.10000. If I do not receive your reply by Friday next, I shall assume that you have accepted the offer. Here if Y does not reply. It does not mean that he has accepted the offer. Many times, there are certain special terms, which form part of the offer, but they not duly brought to the notice of the offeree, at the time the offer is made. If these special terms are not communicated to offeror at the time of offer is made, the offeree is not bound by the terms.


**Figure - 2.1**

## 2.4 Intention to Put an Offer Invitation to Put an Offer

Intention to put an offer is a willingness of a person to put offer in future, similarly Invitation to put an offer is to Invite people to put offers and to negotiate, these are not considered as offer. Here the object of the person is merely to circulate information that he is willing to deal with anybody who on such information or invitation , is willing and open to negotiate with him .Thus ,it does not constitute an offered do not become agreement by acceptance.

For example: Railway time table

Prospectus of a company
Menu-card
Price Tags
Auction sale

**Distinguish Between Invitation to Put An Offer and Offer**

| Basis | Invitation to offer | Offer |
|---|---|---|
| 1. Object | It's object is to invite people to make offer | The object of offer is to take acceptance |
| 2. Obligation | It does not gives rise to any legal obligation | There arises legal obligation as soon as offer gets acceptance |
| 3. Agreement | It's acceptance does not create agreement | Acceptance of offer result into formation of agreement |

## 2.5 Type of Offers

### I On the basis of formation

**1. Express Offer :** An express offer is one which is made by words either spoken or written.

**Example :X** says to y, "Will you purchase my car for Rs. 1,00,000?"

**Example :** X advertises in newspaper, "I will pay Rs. 1,000 to anyone who traces my missing nephew".

**2. Implied Offer :** An implied offer is one which is made otherwise than in words. It is inferred from the conduct of the person or the circumstances of the particular case.

**Example :** A bus runs on different routes to carry passengers. This is an implied offer to carry passengers for a certain fare.

### II On the basis of offeree

**1. Specific Offer :** A specific offer is one which is made to a definite person or particular group of persons. A specific offer can be accepted only by that definite person or that particular group of persons to whom it has been made.

**Example :**X offers to buy car from y for Rs 1.0 lakh. This offer is a specific offer which has been made to a definite person Y. No person other them Y can accept this offer. [**Boulton v. Jones**]

Similarly an offer made to a company is an offer to a group of persons and hence a specific offer.

**2. General Offer:** A General offer is one which made to the world at large or public in general. A general offer can be accepted by any person by fulfilling the terms of the offer. In case of general offer, the contract is made with person who having the knowledge of the offer comes forward and acts according to the conditions of the offer.

**Example :** X advertised in the newspaper that he would pay Rs. 5000 to anyone who traces his missing boy. Y who knew about the reward trace the boy and informed X. Therefore, Y is entitled for reward, as he accept it and fulfills the condition.

### III On the basis of Nature of offer

**1. Cross Offers:** Two offers which are similar in all respects made by two parties to each other at the same time and 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. Hence, no contract is entered into on cross offers.

**Example** X of Jaipur sends a letter by post to Y of Delhi offering to sell his car for Rs. 1 lakh. The letter is posted on 1st January and the same day. Y of Delhi sends a letter by post to X of Jaipur offering to buy X's car for Rs 1 lakh these two letters cross each other. Y's letter is merely an offer and not the acceptance of X's letter. Here, both the parties are making offer and has not accepted the offer. Therefore, there is no contract. If they want to enter into a contract, at least one of them must send his acceptance to the offer made by the other.

**2. Counter Offer :** An offer which is accepted with some conditions is treated as revoked, and such conditional and qualified acceptance is known as counter offer. A Counter offer is therefore a new offer by which original offer revoked.

**Example:** A offers B to sell his house for Rs. 10, 00,000. B agrees to purchase but he wants to pay the price in four installments it is a counter offer by B.

**3. Standing offer / Open offer / Continuing offer :** An offer which is open over a period of time for acceptance is standing offer.

A standing offer is in the nature of a tender. It is the same thing as an invitation to an offer.

**Example** X Ltd. requires a large quantity of certain goods during the 12 months period and gives an advertisement inviting tender in the leading newspaper. Z submitted the tender to supply those goods at a specific rate. Z's tender is accepted or approved. Now, Z's tender becomes a standing offer. Each order given by X Ltd. will be an offer and supply of each order is an acceptance of the offer.

**Types of Offer**

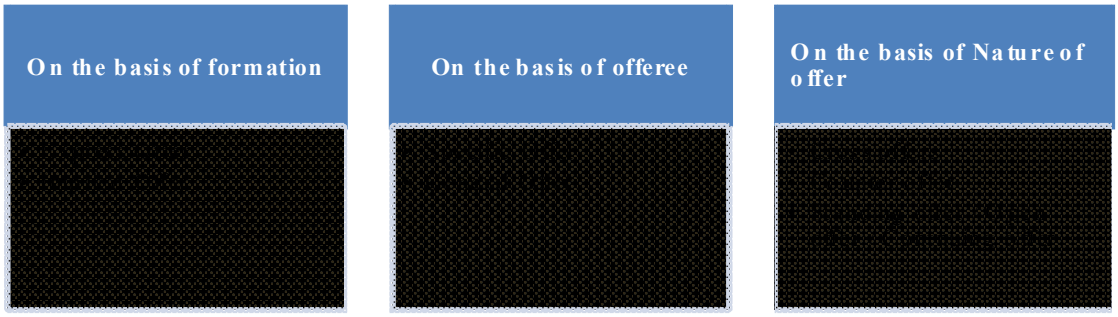


**Figure - 2.2**

## 2.6 Acceptance

Acceptance is the act of giving consent to a proposal. Section 2(b) defines "when the person to whom the offer is made signifies his assent there to, the offer is said to be accepted."

Thus 'acceptance' is the manifestation by the offeree of his assent to the terms of the offer.

## 2.7 Who Can Give Acceptance

Acceptance can be given by the following;

1. **In case of General offer** – It may be given by any person from among the public who has the knowledge of it, in such offer; acceptance is deemed to be given by fulfilling the terms of the offer.
2. **In case of Specific Offer**: Acceptance may be given only by that definite person whom the offer has been made.

## 2.8 Essential of Valid Acceptance

An acceptance to be valid must fulfill certain conditions which are as following:

1. **The Acceptance Must be Absolute and Unqualified: According to Section 7(1) of the Indian Contract Act, 1872**, "In order to convert a proposal into a promise, the acceptance must be absolute and unqualified." It means that an offer must be accepted as it is and without any change,

variation or condition. A qualified or conditional acceptance is not valid and amounts to marking of a counter offer which puts an end to the original offer and it cannot be revived by subsequent acceptance.

**Example :** X offered to sell his motor cycle for Rs. 10,000 to Y. B agreed to buy it for Rs 9,000. Y's act is a counter offer and not an acceptance of X's offer. Now if Y accepts the original offer to buy the car for Rs 10,000. X will not be bound to sell the house because Y's counter offer has put an end to the original offer. [ **Nihal Chand v Amar Nath** ]

**Example :** X offered to sell two plots of land to Y at a certain price. Y accepted the offer for one plot. It was held that the acceptance was not valid because it was not for the whole of the offer. **[ Bhawan v. Sadula** ]

2. **The Manner of Acceptance:** According to Section 7(2) of the Indian Contract Act, 1872, the acceptance of an offer must be given in the following manner.

| | |
|---|---|
| (a) If the proposal does not prescribe the manner in which it is to be accepted. | The offer must be accepted in any usual and reasonable manner. |
| (b) If the proposal prescribes the manner in which it is to be accepted. | The offer must be accepted in the prescribed manner. |

If the offer is not accepted in the prescribed manner, the offerer has an option to approve or reject such acceptance. However, If the offerer wants to reject it. He must inform the acceptor within a reasonable time that he is not bound by acceptance because it is not in the prescribed manner. If he fails to do so within a reasonable time the presumption will be the offer being accepted acceptance is valid.

**Example X** of Jaipur sends a letter by post to Y of Delhi offering to sell his car for Rs. 1,00,000 and also writes " send your acceptance by telegram," y sends his acceptance by an ordinary letter. X can reject such acceptance on the ground that it was not accepted in the prescribed manner. But if he does not inform y within the reasonable time, he shall be deemed to have accepted such acceptance and a valid contract will be formed between X and Y.

3. **Communication of Acceptance:** The acceptance must be signified to the offerer. In other words, the acceptance is complete only when it has been communicated to the offerer either expressly or impliedly. A mere mental determination to accept is no acceptance in the eyes of law. However, it may be communicated in any manner.

**Example** X offered to supply coal to a Railway Company. The manager of the company accepted the offer and put it in the drawer of his table and forgot all about it. It was held that no contract was made because acceptance was not communicated. (**Brogden v. Metropolitan Railway co. )**

**Note:** In case of acceptance made by post, the proposer becomes bound by the acceptance as soon as the properly addressed and stamped letter of acceptance is duly posted even if such letter of acceptance is lost or delayed in post.

In case of acceptance made by telephone acceptance is deemed to be communicated when it is properly listened by the offerer.

4. **Acceptance Must Be By Offeree Or His Authorized Person:** Acceptance must be communicated by the offeree himself or by a person who has the authority to accept it. In other

words, if acceptance is communicated by an unauthorized person, it will not give rise to legal relations as there is no contract arises between them.

**Example :**P applied for the post of a headmaster in school. The managing committee passed resolution approving P to the post but this decision was not communicated to P. But one member of the managing committee in his individual capacity and without any authority informed P about the decision. Subsequently, the managing committee cancelled its resolution and appointed someone else. P filed a suit for breach of contract. It was held that P's suit was not maintainable because there was no communication of acceptance as he was not informed about his appointment by some Authorized Person. [**Powell V Lee**]

5. **It Must Be Given To Offerer Or Authorized Person:** Acceptance must be communicated to the offerer himself or to his authorized agent. In other words, if acceptance is communicated to an unauthorized person, it will not give rise to legal relations.

**Example** F offered by a letter to buy his nephew's horse for $ 30 saying 'if hear no more about him. I shall consider the horse mine. "the nephew sent no reply at all but told B his auctioneer, not to sell that particular horse as he intended to sell that horse to F. B sold the horse by mistake. It was held that F will not succeed because his nephew had not communicated acceptance to him. [**Felthouse v. Bindley**]

6. **Acceptance Must Be Given Within Prescribed Time:** Acceptance is considered to be valid if it has given within the time prescribed (if any) or within a reasonable time (if no time prescribed).An acceptance after expiryof time is not valid because the offer has already lapsed. However, what is reasonable time depends upon the facts and circumstances of the case.

**Example:** An offer to buy shares of a company was made in June with the last date of acceptance 30th june but the acceptance was communicated in November, it was held that the offerer was not bound by the acceptance because the acceptance was not given within a reasonable time [**Ramsgafe Victoria Hotel co. v Montefiore]**

**Example:** X offered by a letter to sell his car for Rs. 1, 00,000. Subsequently, X withdrew his offer by a telegram which as duly received by Y. After the receipt of telegram, y sent his acceptance to X. In this case, the acceptance is invalid because it was made after the effective withdrawal of the offer

7. **Acceptance Of An Offer "Subject To A Contract" is Not Valid:** Acceptance or "Subject to a contract to be approved by solicitors" The significance of these words is that the parties do not intend to be bound and are not bound until a formal contract is prepared and signed by them. Thus, it is not a valid acceptance and does not constitute a contract here the acceptor may agree to all the terms of the offer and yet decline to be bound until formal agreement is drawn up.

8. **A Mere Mental Acceptance is No Acceptance:** To make a contract **acceptance** must be communicated to the offeror. However, the communication of acceptance may be either express or implied. But a mere mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and it does not deemed the communication of acceptance to the offeror.

**Example** A, a supplier, sent a draft agreement relating to the supply of coal and coke to the manager of a railway company for his acceptance. The manager wrote the word 'approved 'on the same and put the draft in the drawer of his table intending to send it to the company's solicitors for

a formal contract to be drawn up. By an oversight, the draft agreement remained in the drawer. Held, there was no contract as the manager had not communicated his acceptance to the offerer.

9. **Silence Does Not Considered as Acceptance:** The acceptance of an offer cannot be implied from the silence of the offeree or his failure to reply. In case, the offeree does not respond and keep silence it does not considered as acceptance.

**Example** A offered by a letter to buy his nephew's T.V set for Rs. 3000, Saying, " If I hear no more from you, I shall consider the T.V. Set is mine at Rs 300". The nephew did not reply at all, but he told an auctioneer who was selling his T.V. set, not to sell that particular T.V. set as he had sold it to his uncle. By mistake, the auctioneer sold the set. A sued the auctioneer for conversion. Held, A could not succeed as his nephew had not communicated acceptance and therefore no contract.

10. **Acceptance May Be Express Or Implied:** Acceptance May be given by words either spoken or written. It may also be given by conduct For example: performance of conditions, prescribed in offer or accepting consideration or paying consideration are the means of implied acceptance hence valid.

11. **Contracts Over Telephone Or Through, Telex Fax/ E-Mail.** One may enter into contracts either (i) when he is face to face with another person or (ii) over telephone or ( iii) through telex or ( iv) through post office. When one is face to face with another person, the contract comes into existence immediately after the negotiations are completed with the process of offer and acceptance. Contracts over telephone are just like contracts face to face. But the offeree must make it sure that his acceptance is received by the offeror otherwise there will be no contract, as communication of acceptance is not complete.

1.


**Figure 2.3**

## 2.9 Effects of Acceptance

After acceptance the proposal converts into the promise and there arises an agreement between the parties which create legal obligations for them, the effect and importance of acceptance have been expressed by **Sir William Anson,** according them," Acceptance is to offer what lighted match is to train of gunpowder." The effect of this observation is that what acceptance triggers cannot be recalled. However, there is a choice to the person to remove the train before the match is applied; it means that the offer can be withdrawn just before it is accepted.

## 2.10 Communication of Offer and Acceptance

The communication of offer and acceptance must complete to form contract and so as to bind the parties there arises obligations. As soon as the communication of offer and acceptance completes the parties loose the right of withdrawal or revocation and their arises contractual obligations under the contract. The legal provisions relating to the communication of offer and acceptance are as under:

**(a) Communication of Offer:** The Communication of offer is said to be complete when offer comes to the knowledge of the person to whom it is made. In case an offer is made by post, its communication will complete when the letter containing the offer reaches the offeree.

**Example** X of Jaipur sends a letter by post to Y of Delhi offering to sell his car for Rs. 1, 00,000. The letter is posted on 10th January and this letter reaches on 17th January. The communication of the offer is complete on 17th January.

**Note:** An offer accepted without its complete communication does not bind the offerer.

**Example** In case of **Lalman v. Gauri Dutt.** G sent his servant L to trace his lost nephew. When the servant had left, G announced a reward to anyone who traces the boy. L found the boy and brought him home. When L came to know of the reward, he claimed the reward. 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. (Based on Lalman Shukala vs. Gauri Dutt case)

**(b) Communication of Acceptance:** The communication of acceptance is complete of different times for the offerer and acceptor. The rules regarding the communication of acceptance are as under. As against the proposer and as aganist the acceptor. The communication of an 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 power of the acceptor, and (b) **as against the acceptor:** when it comes to the knowledge of the proposer i.e., when the letter of acceptance is received by the proposer.

**Example:** (i) A proposes, by letter, to sell a house to B for Rs. 80,000. the letter is posted, on 6th instant. The letter reaches B on 8th instant. The communication on the offer is complete when B, the offeree, receives the letter i.e., on 8th.

(ii) B accept A's proposal, in the above case, by a letter sent by post on 9th instant. The letter reaches A on 11th instant. The communication of the acceptance is complete. As against A when the letter is posted i.e., on 9th , and as against B, when the letter is received by A. i.e., on 11th.

**(C) Revocation of Acceptance:** When the contracting parties are face to face and negotiate in person, there is instantaneous communication of offer and acceptance, and a valid contract comes into existence the moment the offeree gives his absolute and unqualified acceptance to the proposal made by the offeror. The question of revocation of either offer or acceptance does not arise, for, in such cases a definite offer is made and accepted instantly at one and the same time.

But where services of the post office are utilized for communicating among themselves by the contracting parties because they are at a distance form one another, it is not always easy to ascertain the exact time at which an offer or /and an acceptance is made or revoked. In these cases the following rules, as laid down in section 4 and 5, will be applicable:-

**(i)Time of Revocation:**

**1. Revocation of Offer** "A proposal may be revoked at any time before the communica-tion of its acceptance is complete as against the proposer, but not afterwards.

**2. Revocation of Acceptance an** acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor but not afterwards.

Applying section 5 to example given above**.A** may revoke his offer at any time before or at the moment when **B** posts his letter of acceptance i.e., 9th, but not afterwards. **B** may revoke his acceptance at any time before or at the moment when the letter of acceptance reaches **A**. i.e., 11th, but not afterwards. While discussing the rule regarding communication of acceptance is complete as against A on the day of posting itself i.e., 9th, A's revocation of his offer, which is complete as against B on 10th is inoperative. B's acceptance is valid and there shall be a binding contract.

## 2.11 Lapse and Revocation of Offer

1. **By Expiry of Time:** An offer lapses after stipulated or reasonable time. It lapses if acceptance is not communicated within the time prescribed in the offer, where time has not prescribed, acceptance must be communicated within a reasonable time. [sec. 6 (2)]. What is a reasonable time is a question of fact depending upon the circumstances of each case. for example, an offer made by telegram suggests that a reply is required urgently and if the offeree delays the communication of his acceptance even by a day or two, the offer will be considered to have lapsed.

2. **By Non Acceptance in Prescribed Form:** An offer lapses by not being accepted in the mode prescribed, or where no mode is prescribed, in some usual and reasonable manner. But, according to section 7, however, if the offeree does not accept the offer according to the mode prescribed, the offer does not lapse automatically unless offerer reject the acceptance given in other manner and commnuincated it to the offeree at a reasonable time. It is for the offeror to insist that his proposal shall be accepted only in the prescribed offeror, and if he fails to do so he is deemed to have accepted the acceptance.

3. **By Rejection:** An offer lapses may be lapse by rejection. An offer lapses if it has been rejected by the offeree. The rejection may be express i.e., by words spoken or written, or implied. Implied rejection is one(a) where either the offeree makes a counter offer, or (b) where the offeree gives a conditional acceptance.

4. **By Death or Insanity:** If before acceptance of ofer there is death or insanity of the offeror or the offeree it results into lapse of offer. If the offeror dies or becomes insane before acceptance, the offer lapsed provided that the fact of his death or insanity comes to the knowledge of the acceptor before acceptance [sec. 6 (4)]. From the analysis of the section, it may be inferred that an acceptance in ignorance of the death or insanity of the offeror, is a valid acceptance, and gives rise to a contract. Thus the fact of death or insanity of the offeror would not put an end to the offer until it comes to the notice of the acceptor before acceptance. An offeree's death or insanity before accepting the offer puts an end to offer and his heirs cannot accept for him (Reynolds vs. Atherton).

5. **By Revocation:** An offer can be lapses by revocation. An offer is revoked when it is retracted back by the communication of notice of revocation by the offeror to the other party [sec. 6(1). For example, at an auction sale, A makes the highest bid. But he withdraws the bid before the fall of the hammer. There cannot be a concluded contract because the offer has been revoked before acceptance;

6. **By Non- Fulfillment of A Condition Precedent To Acceptance:** An offer stand revoked if the offeree fails to fulfill a condition precedent to acceptance [sec. 6 (3)]. Thus, where A, offers to sell his scooter to B for Rs. 4,000. If B gives entire amount within a week the offer stands revoked and cannot be accepted be B if B fails to pay within week.

7. **By Subsequent Illegality Or Destruction of Subject Matter:** If an offer becomes illegal after it is made, and before it is accepted it is considered as lapse automatically, Thus, where an offer is made to sell 10 bags of wheat for Rs. 2,000 and before it is accepted, a government law prohibiting the sale of wheat by private individuals is enacted, the offer comes to an end. In the same manner, an offer may lapse if the thing, which is the subject matter of the offer, is destroyed or substantially impaired before acceptance.

## 2.12 Summary

Offer is one of the essential element of a contract it is the foundation of contract on which a contract formed. According **Anson** "An offer is an intimation by word or conduct of a willingness to enter into a legally binding contract."

According to **Chetty** "proposal is the promise to do or not to do some act."

To make an offer valid there must be certain essentials as prescribed by law.and

to create a contract offer must be followed by a valid acceptance, An acceptance is said to be valid when it is unqualified and unconditional and it is essential to communicate the offer and acceptance.

However, it may be communicated in any manner, A valid acceptance to an offer creates contractual obligation on both of the parties, which cannot be withdrawn. Although an offer and acceptance may be revoked under certain circumstances.

## 2.13 Self Assessment Questions

**I Very Short Type Question**

1. What is an offer?
2. Who is called an offerer?
3. Who is called an offeree?
4. What is meant by an express offer?
5. What is meant by implied offer?
6. What is meant by specific offer?
7. What is meant by general offer?
8. What are cross offer?
9. What is 'Standing offer'?
10. What is acceptance?
11. What is an 'express acceptance'?
12. What is an 'implied acceptance'?

13. What happens if an offer is not accepted in the prescribed mode?

14. What is meant by revocation of an offer?

**II Short Type Question**

1. How can an offer be made ?

2. Who can accept an offer ?

3. How can an offer be accepted ?

4. " A mere mental acceptance is not valid " Explain.

5. When is communication of offer complete?

6. When is communication of acceptance complete as against the offerer?

7. When is communication of acceptance complete as against the acceptor?

8. When is communication of revocation complete?

9. Is there any limit of time after which an offer cannot be revoked?

10. Is there any limit of time after which an acceptance cannot be revoked?

11. When does an offer come to an end?

12. Can the following be regarded as offer ?
    (a) An advertisement to sell goods by auction.
    (b) An advertisement by a company for subscribing to its shares.
    (c) An advertisement offering reward to anyone who finds the lost dog of the advertiser.
    (d) Display of goods with price tags attached to them in the showcase
    (e) A catalogue of goods for sale

13 Comment on the following statements :
    (a) An invitation to offer is an offer
    (b) Acceptance must be something more than a mere mental assent.
    (c) There cannot be a contract to make a contract.
    (d) Acceptance is to offer what a lighted match is to train of gunpowder.
    (e) An acceptance to be effective must be communicated to the offerer.

14 Write Short notes on the following:
    (a) Counter offer
    (b) Cross offer
    (c) Standing offer
    (d) Lapse of offer
    (e) General offer
    (f) Implied offer
    (g) Implied acceptance
    (h) Invitation to offer
    (i) Contacts over telephone
    (j) Contracts by post

15 Distinguish between the following

(a) Offer and invitation to offer

(b) Offer and mere statement of intention

(c) Counter offer and cross offers

(d) Revocation of offer and lapse of offer

**III Essay Type Question**

1. What is an offer ? When does it complete?Discuss the legal rules of a valid offer.

2. What is an acceptance ? How can an offer be accepted? Discuss the legal rules of a valid acceptance.

3. Explain briefly the legal provisions relating to the communication of offer.

4. Explain briefly the legal provisions relating to the communication of acceptance.

5. How and on what ground does an offer stand revoked? Is there any limit of time which an offer cannot be revoked?

6. How can an acceptance be revoked? Is there any limit of time after which an acceptance cannot be revoked?

## 2.14 Reference Books


- Business Laws – Sharma, Gupta, Arya – Ajmera publication
- Business Laws - Tulsian – Tata Mcgraw hill educational publication
- Business Laws – Maheshwari & Maheshwari – Himalaya publishing house
- Business Laws – G.S. Gulshan – Excel publication

# Unit – 3 : Capacities of Parties

**Structure of Unit:**



## 3.0 Objectives

After completing this unit you would be able to :

- Understand the meaning of capacity of parties.
- Classification of persons who are not competent to make a contract.
- Point out the rules regarding agreement made by minor.
- Classification of persons who are of unsound mind
- Know about the effect of agreement made by unsound mind person.
- Classification of persons who are disqualified by law to make a Contract.

## 3.1 Introduction

It is a universal truth when we do or assign any work to anyone, that person should be capable enough to bear the responsibility up to the satisfaction similarly it has been clearly stipulated in sec. 10 of Indian contract act that parties to the contract must be capable enough to perform their rights and duties. When the parties are natured and competent enough then only in the eye of law the contract will be a legal one otherwise void.

## 3.2 Meaning of Capacity of Parties

Capacity to contract means legal capacity of parties where they can understand and perform their rights and duties as conferred in the agreement.Parties entering into contract must be capable. Capacity of parties emphasises that the parties entering into contract should be capable of understanding it and forming a rational judgment as to its effect upon their interests. It is possible only when the parties are mature enough to understand the effect of an agreement. For this purpose law insists that the parties should be major, i.e., they should have attained the age of eighteen years. Again, even if the parties are mature they should be in their senses, otherwise they will not understand properly the effect of contract entered by them. Therefore, law requires that the parties should have sound mind. Only a person with a sound mind can properly understand the implications of a contract. Thus law does not allow an agreement with an idiot or a drunken person because he will not be able to understand the consequences of the agreement entered into by him. Similarly, law does not allow certain persons to enter into an agreement in public interest, such persons are disqualified by law enter into contract.

## 3.3 Who is Competent to Contract

See 11 of the Indian Contract Act specifies that every person is competent to contract who is 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."

**Analysis :- Sec. 11** states that following persons have competent to contract.

(1) Major as per law
(2) Man of sound mind
(3) He is not disqualified by law to make a contract.

**Activity A:**

1. According to you who is competent to contract? and what are the essential ingredients of a valid contract?

## 3.4 Description of Persons Who are Incompetent to Contiract

(1) Minor
(2) Unsound mind person
(3) Disqualified by Law

Incompetent Persons to make a contract are showing in following chart.

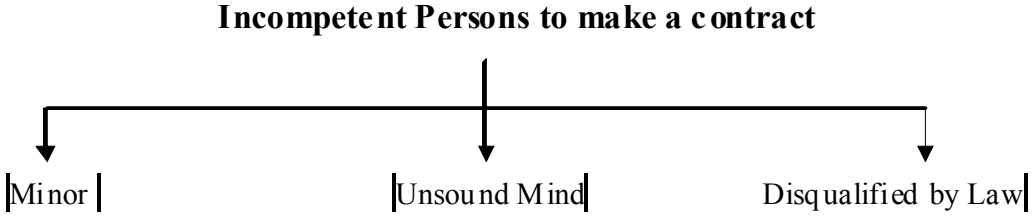


**Figure - 3.1**

### 3.4.1 Minor

Minor means, any person who has not completed the age of majority. According to Indian Majority Act, 1875.

"A minor is a person who has not completed 18 Year of his/her age."

In the following two cases minority continuous upto the age of 21 Yrs.

(1) Where the guardian has been appointed for the protection of property and body of a minor by the court or

(2) Where the property of minor is in the custody of courts of wards become major at completion of 21 Yrs.

### 3.4.2 Rules Regarding Agreements Made By Minor

**(1) An Agreement By A Minor Is Absolutely Void:** Law acts as the guardian of minors and protects their rights, because their mental faculties are not mature - they don't possess the capacity to judge what is good and what is bad for them. Accordingly, where a minor is charged with obligations and

the other contracting party seeks to enforce those obligations against minor, the agreement is deemed as void ab-initio.

**Illustration :-** In the case of Mohari Bibi V/s Dharmodas Ghosh a minor (Dharmodas) mortgaged his house for Rs. 20,000 and the money lander a sum of Rs.8000 to minor. Later on the minor filed a sued for setting as the mortgage on the ground of his minority. It was hold that according to sec. 11 a minor is incompetent to contract so the mortgage was void and it was cancelled. The money lander wanted refund of Rs. 8,000 paid by him to minor but the court held that the minor's agreement was void so, mortgagee has no right of restitution, under section 65.

**(2) A Minor Can Be A Promisory Or Beneficiary:** Any contract which is the interest of the minor and under which there is no obligation on his part is valid and enforced by law. Hence, the minor can be a beneficiary of any contract as the law also protect the interest of the minor under the contract.

**Illustration:-** Ram, a minor, sold goods on credit to shyam a major. He can recover the price from shyam as Ram is a beneficiary.

**(3) Minor as an Agent:** A minor can be appoint as an agent. Master is always responsible for the act done by minor. Minor is not responsible for any negligence and for the voluntary mistake committed by him, master cannot ask him to compensate for the same.

**(4) Minor as a Partner:** According to the provision of sec. 30 of Indian Partnership Act, "as a partnership is created by contract and a minor is unable to make a contract that's why he cannot be added as a partner to the contract. But he may join the partnership firm with the consent of all the partners for the share in the profits. On the other hand he cannot be liable for the losses sustained.

**(5) No Specific Performance:** As the contract made by minor is void in the eye of law. Hence, court cannot direct for specific performance. Specific performance means actual carrying out of the contract as agreed. A minor's agreement being void cannot be specifically enforced. Similarly, minor also cannot claim 'specific performance' from the other party. "Specific performance' is an equitable remedy.

**Illustration :-** A, a minor agrees to sells his house to B for Rs. 60,000 Later on A refuses to give the house. B cannot enforce specific performance by A. The agreement is void.

**(6) Minor and Insolvency:** From the beginning itself contract made by minor is void. so minor can't be adjudged insolved.

**(7) No Ratification:** Ratification means approving a past contract. When a minor becomes major, he cannot ratify any agreement entered into while he was a minor. "The consideration which passed under the earlier contract cannot to implied into the contract into which the minor enters on attaining majority". In Arumugam Chetti Vs. Duraisinga Tevar, it was held that there can be no ratification of a transaction which is void owing to the promisor possessing no contractual capacity at the time. Nor can avoid deed form a good consideration for a fresh contract made by the minor on attaining majority. Similarly, in Suraj Narain vs Sukhu Ahir, where a minor borrowed a sum of money by executing a promissory note, and after attaining majority executed a second bond in respect of the original loan, the court held that a suit upon the second bond was not maintainable as that bond was without consideration. Since ratification relates back to the date when the contract was originally made, it is necessary for a valid ratification that the person who purports to ratify must be competent to contract at the time of the contract. But if services are rendered or an advance is made to a minor

during his minority and the services are continued or a further advance is made after he attains majority, a promise to pay for such services or amount as a whole would be valid and enforceable.

**(8) Minor and Doctrine of Estoppel:** Doctrive of estoppel means, "When a person makes somebody believe by written or spoken or his conduct to believe on the existence of some fall things. He will not be allowed to deny the existence of that state of things, the doctrine of estoppel does not apply on minor. Even if a minor falsely represent himself as major and induced the other party to contract, by way of fraud, then to he cannot be liable but law does not allow him to commit fraud with others so, if the debt or anything is there with him, court may direct to return the same to the concern and if the same is already use by him and does not exist then the aggrieved party can't be compensated in any manner.

**Illustration :** A, a minor borrowed Rs. 5,000 from B by fraudulently representing himself to be a major. A refused to repay the money. B sued him for the money. A pleaded that he is a minor and the agreement between B and himself is void. Here B cannot recover his money

**(9) A Minor's Liability for Necessities of Life:** According to Sec. 68 of the Indian Contract Act, 1872 If a person is incapable of entering into a contract of any one whom he 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". The above provision is applicable to all persons who are not competent to contract, Talking in the context of minor. if a person supplies goods or services :

- To a minor or anyone whom he is legally bound to support.
- Which are necessaries suited to his condition of life,
- He is entitled to payment for the same out of minor's property.

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

**Illustration:** A supplied the ration goods to a minor; He can recover the price from the property of the minor.

**(10) Restitution:** Restitution means returning the benefit which a minor has received under a void agreement. When a minor received this property or money out of that contract then if the contract is declared void than the court may direct the minor to refund the money or give compensation.

**(11) Liable for Torts**: A minor is liable for his tort i.e. a civil wrong made by him but where a tort is a result of a contract, then a minor is not liable for fort because the contract made by minor is void.

**(12) Marriage Contract:** If a minor made a marriage contract during the period of minority, then this contract is void and cannot enforced by law.

**(13) Minor and His Parents:** The agreements made by minor is void , so the parents of minor are not liable for the agreement made by minor, However they can be liable when minor make agreement as an agent of parents.

**(14) Minor and Sales of Goods Act:** According to the provisions of sales of goods Act, if a minor made any agreement to sell or buy something then he cannot be liable.

**(15) Minor and Negotiable Instrument Act:** According to the provisions of negotiable instrument act a minor can draw, transfer or endorse negotiable instrument but when these instrument get dishonoured a minor is not liable. But other parties will be liable as per contract.

**(16) Minor as a Joint Promisor:** A minor can be a joint promisor with major but the major is liable to perform the contract. The minor is not liable. The contract cannot be enforced against the minor but the major cannot escape from his liability.

**(17) Surety for Minor:** A minor cannot stand as surety in a contract of guarantee. Because a minor can never be held personally liable.

**(18) Mortgage Contract:** A mortgage Contract made by minor is void.

**(19) Service Contract:** A contract of personal service by minor is void even if it is in the benefit of the minor. Morever, parents of minor cannot make any contract of service on behalf of minor the same shall be void.

**(20) Minor Shareholder:** A minor cannot enter into a contract so he cannot apply for allotment of shares in a company. But he can apply in case of transfer of fully paid up shares in a company. If a minor gets shares in a company by fraud or by misrepresenting his age, then after knowing the fraud the company can remove his name from the register of members.

**Activity B:**

1. Who is minor? Discuss the law regarding to minor's contract.

### 3.4.3 Unsound Mind Person

According to Sec. 12 of Indian Contract Act, "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 judgment as to its effect upon his interests".

**Analysis Sec. 12** specifies following essential characteristics of sound mind person:-

- Capacity to understand the purpose of making the contract.
- Capacity to make rational judgment as to its effect on a persons interest.

Classification of unsound mind person showing by following chart:-

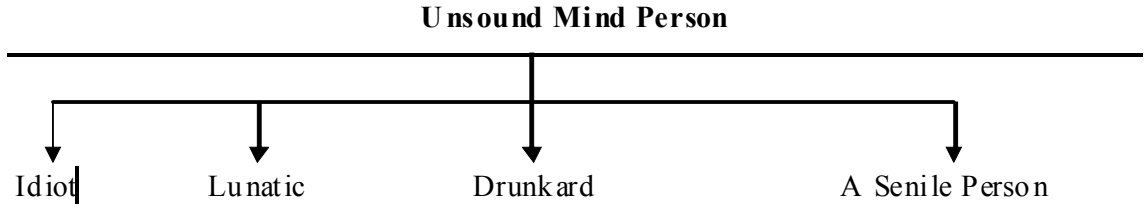


**Figure - 3.2**

**(1)** **Idiot:** An idiot is a person who is incapable of thinking or of forming rational judgment Idiocy is permanent. It is a congestal defect caused by lack of development of brain. Hence the agreement of an idiot is absolutely void ab initio.

**Illustration: -** Ram sold his car worth Rs. 1,20,000. His mother proved that he was a congenital idiot. He is unable to understand the transaction held. so, the sale was void

**(2)** **Lunatic:** Lunatic person is one, whose mental power are deranged due to some mental disease. It is a curable disease and not permanent. Lunatic person can make contract during their lucid intervals (when they are insense). The can make contract only when he is same. He is not liable for agreements made during the intervals of insanity. Any person who has been declared as Lunatic under Indian Lunacy Act, then he is cannot make contract even when he is mentally sound.

**(3)** **Drunkard:** A drunken or introicated person can not make a contract as long as he is under the effect of drink of intoricant this is competency to make a contract is temporarily.

**(4)** **A senile Person:** A senile person is unable to enter into contract because due to age or poor health he is unable to understand the contract and its effect upon his interest.

**Effects of the Agreement Entered Into By The Persons Of Unsound Mind.**

- The agreement made by person of unsound mind are absolutely void.
- When person of unsound mind make a contract for supply of necessaries of life it is valid as quasi contract under section 68, for such a contract he cannot be held personally liable but his estate is liable.
- **Burden of proof:** In the court of law burden of proving that a person was mentally incapable of contracting, lies on the party who seeks to cancel the contract in this ground. However, once it is established that a person is insane, the burden to prove that he was sane at the time of making contract is on the party who wants to establish that the contract is good.

### 3.4.4 Persons Disqualified by Law

Persons disqualified by law to make contract are showing in following chart :-

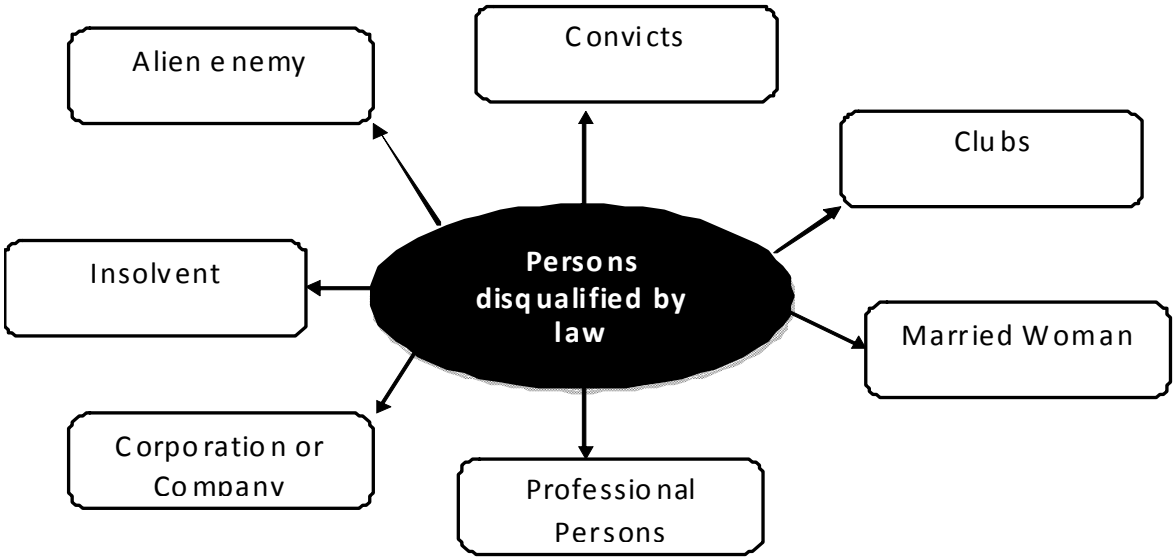


**Figure – 3.3**

(1) **Alien Enemy:** Alien means a foreign citizen living in India. An Alien may be friend or enemy. Alien may be a friend or enemy on declaration of war between his country and india an alien becomes an alien enemy. Contract with an alien friend is valid but with an alien enemy is void. An alien enemy cannot made contract with Indian national till such declaration remains in force.

(2) **Convicts:** According to law a convict cannot make valid contract during imprisonment. When the imprisonment is over, he become capable to make contract.

(3) **Insolvant:** According to the provisions of Indian insolvent act an insolvent cannot make a contract for sale of his property.

(4) **Corporations or Companies:** A corporation or company is an artificial person created by law. A company can make contract only through their agents according to the scope of mamorandum. A corporation or company cannot make a contract of personal nature.

(5) **Clubs:** Unregistered clubs or socities cannot enter into contract just because they have no legal unistence.

(6) **Married Woman:** Under Indian Law men and women have equal contractual capacity. Therefore a women married or unmarried can enter into a contract, if she is major, has sound mind and is not disqualified by any law. She can deal with her own property legally, her necessaries of life she can pledge the credit of her husband i.e. for necessaries of life punrchased by her even her husband can be held liable to make the payment. Under English Law, however, until 1883 property of married women passed to their husband on their marriage. But after 1883 Married Women Property Act has changed the position. Accordingly, now the law is the same as in India.

(7) **Professional Persons:** Our law does not disqualify a professional from claiming his fees from his client. Therefore, if a client fails to pay the fees of a lawyer who. is enrolled as an advocate of a high court, such an advocate can file a suit to recover his fees. But in England a barrister cannot sue his client for his fees. The prohibition is in relation to their fees only and not for any other claim.

**Activity C:**

1. According to you who are disqualified persons to be the contract?

## 3.5 Summary

A contract will be valid only when the parties to it are competent to contract.

Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject.

In summarized form it is easy to say that following three types of persons cannot make a valid contract :-

- Minor
- Unsound mind person
- Disqualified by law

The contract made by above are void from the begining itself in the eye of law. They may get benefit from the contract indirectly with the consent of other parties to the contract, But the losses sustained out of the contract they cannot be liable. They are also cannot be held liable in their personal capacity.

**Who is a Minor.** A minor is a person who has not attained the age of 18 years, and 21 years in case of guardian appointed under the Guardian and Wards Act or where a minor is under the Guardianship of the Court of Wards.

**Rules regarding agreements made by minor-**

(1) An agreement by a minor is absolutely void
(2) A minor can be a promissory or beneficiary
(3) Minor as an Agent
(4) Minor as a partner
(5) No specific performance
(6) Minor and insolvency
(7) No ratification
(8) Minor and doctrine of estoppel
(9) A Minor's liability for necessities of life
(10) Restitution
(11) Liable for Torts
(12) Marriage Contract
(13) Minor and his parents
(14) Minor and sales of goods Act
(15) Minor and Negotiable Instrument Act
(16) Minor as a joint promisor
(17) Surety for minor
(18) Mortgage Contract
(19) Service Contract
(20) Minor Shareholder

**Persons of Unsound Mind :** A person who is unable to understand and form a rational judgment as to the effect of a contract on his interest is a person of unsound mind.

**(i) Idiot -** a natural fool. He cannot enter into a contract at all.

**(ii) Lunatic -** whose mental power has deranged due to some mental strain. He can enter into a contract during lucid intervals, i.e. when he is sane.

**(iii) Drunkard or Intoxicated Person -** who is under the influence of liquor or drugs cannot enter into contract in such a condition.

**(iv) A senile Person -** A senile is person due to age or poor health, he is unable to understand the contract.

**Persons Disqualified by Law to enter into contract:**

**(i) Alien Enemy -** a person whose Government is at war with the Government of India is disqualified to enter into a contract. If there is an existing contract before the war was declared or broke out it would become void, or suspended if it can be postponed.

**(ii) Foreign Soverign -** representatives of foreign states have special status. They can file suit against an Indian but an Indian cannot sue them without the prior permission of the Central Government.

**(iii) Convicts -** a person undergoing imprisonment cannot enter into a contract until release.

**(iv) Insolvents -** an undischarged unsolvent is incapable of entering into contract. However, after his discharge he can enter into a contract.

**(v)** **Corporations or Companies -** A corporation or a company can enter into a binding contract, only if it is authorised by the Statute by which such corporation was created or by its memorandum of association.

**(vi)** **Married Women** - Under Indian Law a major married woman is free to enter into a contract is respect of her separate property. For necessaries of life she can pledge the credit of her husband.

## 3.6 Practical Problems

1 Ram a minor, obtain a loan of Rs. 40,000 from Kapil by falsely representing himself as major. Can ram be made liable to refund the money?

2 Sheela 15 years old drives a scooty corelessly and injured means. Is she liable for the accident i.e. fort?

3 A renewed a promissionery note which he wrote during his minory in favour of B can B enforce payment.

4 A is 17 Years old, obtaining a loan B.can A. asked to repay the Money.

5 A renders some service to B during his minority at the request of B.B, on attaining majority, into an agreement with A to compensate A for services rendered during B's minority. Is the agreement valid.

6 Ram renders services to Shyam during his minority at the request of Shyam. Shyam on attaining majority enters into an agreement with Ram to compensate Ram for services rendered during Shyam's minority. Is the agreement valid?

7 A, the wife of B pledges with C the furniture and the books in the library belonging to her husband for the price of (i) jewellery (ii) goods necessary for her maintenance, without B's knowledge and consent. What are the rights of C?

## 3.7 Self Assessment Questions

1 What do you understand by capacity to contract? Write all the essential ingredients of valid contract?

2 State briefly the position of a minor with regard to the contracts entered into by him.

3 Explain the following :-

(1) Mohri Bibi V/s. Dharmodas Ghosh
(2) Person of unsound mind.

4 Write the position of minor in the following situation.

(1) Minor and doctrive of estoppel
(2) Minor as a partner
(3) Minor and negotiable instrument act

5 Discuss all the rules regarding agreements made by minor?

6 Discuss the law relating to the following.

(1) Alien enemy

(2) Lunatic Person
(3) Drunkard
(4) Club

6 Who are disqualified persons to do the contract.

## 3.8 Reference Books


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- Dr. R.L. Nolakha; 'Business Law' (2012-13), R.B.D. Publications (2012-13), Jaipur
- Dr. S.M. Shukla, Dr. O.P. Gupta (1995); 'Mercantile Law', Sahitya Bhawan, Agra.

# Unit - 4 : Consideration

**Structure of Unit:**



## 4.0 Objectives

After studying this unit you would be able to understand:

- Consideration as an essential to make a contract
- What are the prerequisites and legal provisions of a valid consideration
- When can a contract be valid even without consideration
- What is meant by Privity of contract
- Who is Stranger to consideration
- When a stranger to contract can sue

## 4.1 Introduction

## 4.2 Meaning and Definition

Consideration is an essential element for formation of a contract. An agreement without consideration is said to be bare promise and is not binding on the parties (ex nudo pacto non aritio action).

Consideration is used as a term "quid pro quo" i.e. **something in return.** What is something has been defined by **Lush J**. in a leading English case **Currie v/s Misa** as under:

"A valuable consideration in the sense of the law, may consist either in some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility give, suffered or undertaken by the other."

It reveals that consideration needs not to be in the form of benefit to the promisor, if promisee has suffered from some loss or determint, it will also be a valid consideration in the eyes of law.

**Section 2(d) of Indian Contact Act, 1872** defines

"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 so or to abstain from doing something, such act or abstinence or promise is called consideration of the promise"

When the promisor promises to do or to abstain from doing something, the promisee must pay something in return which may be an act or abstinence or a promise to perform a future act or abstinence.

According to Blackstone: - "Consideration is the recompense given by the party contracting to the other."

Sir Fredric Pollack defines,:- " Consideration as an act of forbearance of the one party or the promise thereof is the price for which promise of the other is bought"

**Example:** A offers to pay Rs.5000/- to B in return of a laptop. Here Rs.5000/- is a consideration for B.

## 4.3 Legal Provisions of Consideration

1. **Consideration Must Move At The Desire Of The Promisor :** In order to constitute consideration the act or abstinence forming the consideration for the promise must be done at the desire or request of the promisor. Thus an act does or services rendered voluntarily, or at the desire of the third partly, will not amount of valid consideration so as to support a contract.

   **Example** A ordered the book seller to supply a book of company law, but he supplied a book of mercantile law, It is not a valid consideration as it is not at the desire of 'A'.

2. **Consideration May Move From Promise Or Any Other Person :** Consideration may move from the promisee or may proceed from any other person. Thus, as long as there is a consideration for a promise, it is immaterial who has furnished it. It may move from the promisee himself or from any other person. This means that even a stranger to the contract (one who is not a party in the contract) can provide consideration. If consideration is furnished by some other person then the promisee It is known as constructive consideration and constitute a valid consideration for the contract.

   **Example II** A, an old lady granted her estate to her daughter (the defendant) with a direction that the daughter should pay an annuity of Rs.653, to A's brothers (the plaintiffs). On the same day, the defendants made a promise with the plaintiffs that she would pay the annuity as directed by A. The defendant failed to pay the stipulated sum. In an action against her by the plaintiffs she contended that since the plaintiffs themselves had furnished no consideration, they had no right of action. The Madras High Court held that in this agreement the consideration had been furnished by the defendant's mother and that it was enough consideration to enforce the promise between the plaintiff and the defendant **(Chinnya vs.Ramaya)**.

3. **Consideration May Be Past, Present Or Future:** The words, has done or abstained from doing or does or has abstained from doing or promises to do or to abstained from doing or promises to do or to abstain from doing reveals that Consideration may consist of either something done or not done in the past or done or not done in the present, or promised to be done or not done in the future.

   In other words consideration may be past, present or future.

**(a) Past Consideration** - The consideration which has moved before formation of contract.(past services)

**(b) Present Consideration** – The consideration which is furnished simultaneously with promise at the time of formation of contract.(cash transactions)

**(c) Future Consideration** – The consideration which will be moved after formation of contract.(credit transactions)

However in English common law, past consideration is not valid.

4. **Consideration Need Not to Be Adequate** : It means that consideration must be something to which the law recognizes a value. Although the adequacy of consideration to the promise does not affect the validity of an agreement. The law only emphasis on the presence of consideration and not on the adequacy of it. It leaves the parties to the contract to make there own bargains. Thus an agreement without consideration is void but if there is consideration which is at the desire of the parties, it is immaterial that is adequate or not, hence,contract cannot be avoided on the ground of inadequacy of consideration . However it can be determined that whether consent was free or not.

**Example:** A agrees to lease his property to a hospital authority for 10 year in return of a consideration of Rs.1 every year. It is a valid contract and in future within a period of 10 year A cannot set aside the lease deed on the basis of inadequacy of consideration.

5. **It Need Not Benefit the Promisor Himself:** The consideration need not benefit the promisor himself. If consideration is for the benefit of some other person at the desire of the promisor it is a valid consideration

**Example:** A requests B to sell and deliver goods to C and gives guarantee for the payment of price within a month. Here, B is doing something at the desire of A but C is being benefited. This is a good consideration.

6. **It May Be Some Act Or Abstinence Or Promise** : Consideration may be (i) in the form of an act ;or (ii) abstinence; or (iii) a promise to do or to abstain from doing something . Therefore the consideration may be positive or negative.

**(a) It May Be an Act** – An act of a promisee at the desire of the promisor valid consideration for the promisor. It is a positive or affirmative consideration.

**Example**: A promises B to pay Rs. 1000 to paint his house .This is a positive consideration for A's promise.

**(b) It May Be an Abstinence**- Abstinence from doing something at the desire of the promisor may also be good consideration for the promisor .It is a negative form of consideration.

Following are examples of valid consideration in the form of abstinence

**Example**: A promises B not to file a FIR against him if he pays him Rs. 50000. Here, A is abstaining from doing something i.e. filing a suit against B for a consideration of Rs. 50000.

**(c) It May Be a Promise-** A promise to do or to abstain from doing something at the desire of the promisor is also a good consideration.

**Example:** (a) A agrees to manage the factory of B on monthly salary of Rs. 5000. It is a promise to do something and a valid consideration.

(a) Forbearance to sue (b) compromise in a pending suit (c) composition with creditors

7. **It Must Be Real Not Illusory:** Consideration must exist in the eye of law, It must not be illusory If a Consideration which does not have value in terms of money are not considered valid by law and Although it is not necessary that consideration must be in money is illusory consideration. A contract founded upon an illusory or deceptive consideration is not valid.

**Example:** X promises to put life into Y's dead brother and Y promise to pay Rs. 500000. This agreement is void as it as an illusory consideration.

8. **It Must Be Something More Than the Promisor's Existing Obligation :** The performance of an existing obligation is no consideration in the eye of law as person is already under a duty to do. It must be something which a promisor is not under an obligation to do either under a contract or by general law of land.

**Example:** X promise to pay to Y an advocate an additional sum of money if the suit was decided in his (X's) favour. Held there was no consideration for this promise and hence void .The Y an advocate after having accepted the case was under contractual duty to render the best of his services.

9 **It Must not be Unlawful:** A Valid consideration must not be unlawful consideration is said to be unlawful if it is (a) forbidden by law (b) defeats the provision of law (c)fraudulent(d)injurious to the person or property (e)oppesed to the public policy (f) immoral

10. **It Must Be Certain:** A promise which is vague o not definite does not constitute valid consideration . The law requires

## 4.4 No Consideration, No Contract

According to section 10 of Indian contract Act, 1872, Consideration being one of the essential elements of a valid contract the general rule is that "an agreement made without consideration is void and is known as 'nudum pactum' or a bare promise which cannot be enforced through law. However under section 25 of Act there are few exceptions to the rule, where an agreement without consideration will be perfectly valid and binding. These exceptions are as follows:

1. **Agreement Made On Account Of Natural Love And Affection [Sec. 25 (1)] :** An agreement made without consideration is **enforceable**. If it is
   (a) Expressed in writing,
   (b) Registered under the law for the time being in force for the registration of documents,
   (c) Is made on account of natural love and affection,
   (d) Is between parties standing in a close relation to each other.

   Thus there are four essential requirements which must be complied with to enforce an agreement made without consideration, as per Section 25 (1).

**Example:**

(a) A promises, to give Rs 1,000 to B without any consideration. Here in future if A refused to pay, B cannot take any legal action. Because this is a void agreement hich is not supported by consideration.

(b) A for natural love and affection, promises to give his son B, Rs 1,00000. A puts his promise to B into writing and registers it, this is a contract even without consideration.

(c) A registered agreement, whereby an elder brother, on account of natural love and affection, promised to pay the debts of his younger brother, was held to be valid and binding an the younger brother can cliam the elder brother if he is not carrying out the agreement (**Venkatasamy vs Rangasami**)

It should, however, be noted that mere existence of a close relation between the parties does not necessarily impart natural love and affection. Thus where a Hindu husband, after referring to quarrels and disagreement between him and his wife, executed a registered document in favour of his wife, agreeing to pay for separate residence and maintenance, it was held that the agreement was void for want of consideration because it was not merely out of natural love, and affection. (**Rajlakhi Devi vs Bhootnath**). Similarly, the law does not presume to be absence of consideration due to close relation, therefore, the contract must be written and registered to prove that parties are agree to execute the contract even without consideration.

2. **Agreement to Compensate for Past Voluntary service** (Sec.25 (2)] : A promise made without consideration is also valid, if it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor,' or done something which the promisor was legally compelled to do. In other words if something has done voluntarily for the pormisor and further such promisor, promise to do something he is bound to perform.

**Example**

(a) A finds B's purse and gives it to him. B promises to give A Rs 50. This is a contract.

(b) A supports B's infant. B promises to pay A's expenses in so doing. This is a contract.

(c) A rescued B from drowning in the river, and B, appreciating the service that had been rendered and promises to pay Rs 1,000 to A. There is a contract between A and B.

However, In order to attract this exception, the following points should be noted:

(a) The service should have been rendered voluntarily for the promisor. If it is not voluntary but rendered at the desire of the promisor, then it is covered under 'past consideration' [as per Sec. 2(d) and not under this exception].

(b) The promisor must be in existence at the time the service was, rendered. Thus where services were rendered by a promoter for a company not in corporate yet, a subsequent promise by the company to pay for them could not be brought within the exception. **(Ahmedabad Jubilee Spinning Co. vs Chhotalal).**

(c) The promise must be to compensate a person who has himself done something for the promisor and not to a person who has done nothing for the promisor. Thus, where B treated A during his illness but refused to accept payment from A; they being friends; and A in gratitude promises to pay Rs 1,000 to B's son D, the agreement between A and D is void for want of consideration as it is not covered under the exception.

(d) The intention of the promisor ought to be to compensate the promisee. A promise given for any motive other than the desire to compensate the promisee would not fall within the exception**. (Abdulla Khan vs Parshottam)**

(e) The promisor to whom the service has been rendered must be competent to contract at the time the service was rendered. Thus a promise- made after attaining majority to pay for goods supplied voluntarily to the promisor during his minority has been held valid and the promisee could enforce it ,**(Karam Chand vs Basant Kaur).**

(f) The service rendered must also be legal. Thus past cohabitation will not make a promise to pay for it enforceable under this exception **(Sabava vs Yamanappa).**

3. **Agreement to Pay a Time-Barred Debt :** According to the limitation Act,1963 in India, A debt which remains unpaid and unclaimed for a period of 3 years, after it is due for payment, becomes time barred and is not legally recoverable, However, (Sec. 25 (3)]. Where there is an agreement, made in writing and signed by the debtor or by his authorized agent, to pay wholly or in part such time barred debt by the law of limitation, the agreement is valid even though It is not supported by any consideration. Thus, A time barred debt cannot be recovered as parties are discharge from the contract by operation of law and therefore a promise to repay such a debt is without consideration and enforceable.

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

(a) The debt must be such of which the creditor might' have enforced payment but for the law for the limitation of suits.

(b) The promisor himself must be liable for the debt. So a promissory note executed by a widow in her personal capacity in payment of time-' barred debt of her husband cannot be brought within the exception **(Pestonji vs Maherbai28);**

(c) There must be an 'express promise to pay' a time barred debt as distinguished from a mere 'acknowledgement of a liability' in respect of a debt. Thus. a debtor's letter to his creditor, "I owe you Rs. 1,000 on account of my time-barred promissory note" is not a contract. There must be a distinct promise to pay; and

(d) The promise must be in writing and signed by the debtor or his agent. An oral. promise to pay a time-barred debt is unenforceable.

The logic behind this exception is that by lapse of time the debt is not destroyed but only the remedy is lost. The remedy is revived by a new promise under the exception.

**Example:** A owes B Rs 1,000, but the debt is barred by the Limitation Act. A signs a written promise to pay B Rs 500 on account of the debt. This is a valid contract (Appended to Sec. 25).

4. **Completed Gift :** A gift already given does not require consideration in order to be valid "As between the donor and the donee any of actually made will be valid and binding even though without consideration" [Explanation 1, to Section 25]. In order to attract this exception there need not be natural love and affection or nearness of relationship between the donor and done. The gift must, however, be complete. However a promise to gift is not enforceable by law

5. **Contract of Agency :** Section 185 of the Contract Act lays down that no consideration is necessary to create an agency. Therefore a contract of agency may be iratituos or non iratituos and is binding.

6. **Remission by the Promisee of Performance of the Promise (Sec. 63) :** For compromising a due debt, If a creditor agreeing to accept less than what is due, no consideration is necessary. In other words, a creditor can agree to give up a part of his claim and there need no consideration for such an agreement. Similarly, an agreement to extend time for performances of a contract need not be supported by consideration (Sec.63).

7. **Contribution to Charities :** Charity made is a valid contract even without consideration, but a promise to charity would be enforceable, if on the faith of the promised subscription, the promise

has undertakes a liability, hence, to the extent of liability incurred the promise to charity is enforceable but , not exceeding the promised amount of subscription.

**Example:** A had agreed to subscribe Rs 10,00,000 towards the construction of a Town Hall at Howrah. The plaintiff (secretary of the Town Hall) on the faith of the promise entrusted the work to a contractor and undertook liability to pay him Rs.6,00,000. The defendant was held liable for Rs.6, 00,000 **( Kedar Nath vs Ghorie Mohammad).** But where the promisee had done nothing on the faith on the promise, a promised subscription is not legally recoverable. Accordingly, in **Abdul Aziz vs Masum** Ali, the defendant promised to subscribe Rs 500 to a fund started for building of a Mosque but steps had been take to carry out the repairs. The defendant was held not liable and the suit was dismissed.


**Figure - 4.1**

## 4.5 Privity of Contract

The Doctrine of Privity of Contract in simple words means that only those persons who are parties to the contract can enforce the contract and a stranger to the contract cannot enforce it even though the contract may have been for his benefit Thus a stranger to consideration cas sue because he is a party in the contract although the consideration is furnished by some other person whether he is the promisee or not, but a stranger to contract cannot sue as he is not a party in the contract. Any contract may be enforce by its parties if it is supported by consideration and it is immaterial whether it was furnished by the promisee or any other person even by a stranger.

**Example I:** A enters in a contract with B, but A himself has not given any consideration to B, but the consideration has been provided by third party i.e. C to B. Although A is a stranger to consideration, he can still enforce the contract against B because he is a party to the contract. One has to remember that this is only true under Indian Law and the situation is different under English Law where the consideration can only move from the promisee and a stranger to the consideration in no condition can maintain any action.

Now it can be conclude that:

1. Stranger to the contract cannot sue even though he has given consideration.

2. A stranger to consideration can sue on a contract provided he is a party to it.

**Example :** The doctrine of privity of contract can be best illustrated by and English case **Dunlop Pneumatic Tyre Co. Ltd., V Selfridge & Co., Ltd.** As per the facts of the case, Dunlop & co. sold some tyres to one Dew & Co., with an agreement that these tyres will not be sold below the listed price. Dew & co., in turn, sold some of the tyres to selfridge & Co., (S) with an agreement that they (S) will observe condition as to price and they (S) also promised that they would pay to the Dunlop & Co., a sum of Pounds 5 every tyre sold below the list price. S sold some tyres below the list price and Dunlop & Co., brought an action against to recover damages for the same. House of Lords held, Dunlop & Co., cannot bring an action against because; there was no contract between the two.

**Exceptions :**

In the following cases, a stranger to contract can sue and enforce the contract:

1. **A Trust or Charges** : In an agreement which is creating a trust or charge for a beneficiary it can be enforced by the beneficiary under it even through he is not a party to the agreement. However, the beneficiary must be clearly mentioned in the agreement and the trust or charge must be created on a specific property in his favour.

   X transferred certain properties to Y for the benefit of Z can enforce it even through he is not a party to the agreement.

2. **Marriage Contract** : Where the parents or guardians enter into a contract for marriage of their wards, the contract may be enforced by the wards even though they are not parties to contract.

3. **Family Agreement for Marriage Expenses, Maintenance of Members etc**. : Where a provision is made for the marriage or maintenance expenses of the female family members under a family agreement, such beneficiaries may sue to enforce it even though they are not parties to the agreement.

   **Example:** (a) A daughter entered into a family arrangement with his father. Accordingly, the father's house was to be conveyed to his daughter and the daughter undertook to maintain her mother. Held, the mother was entitled to sue for specific performance as she was beneficiary under the arrangement.[ Veeramma v. Appayya,]

   (b) A partition deed between the male member of a family made a provision for the expenses of marriage of a female member had also agreed. Accordingly, the expenses of the marriage were to contributed by her brothers but they refused. Held, she was entitled to the amount even though she was not a party to the contract. **[ Sundararaja Aiyanger v. Lakshminmmal]**

4. **Acknowledgement:** Where a person by his words or conduct acknowledges or admits himself as an agent of a third party, he is liable to the third party.

**Example :** A sold his house to B and the sale price was left in hand of the buyer, B for payment to his creditor, C. B made a part payment to C promising to pay the balance soon to C. Held, C was entitled to recover the balance. **[ Deveraja Urs. V Ram Krishniah.]**

5. **Assignment of a Contract** : Where the rights under a contract are assigned, i.e. transferred to a third party voluntarily or by operation of law the assignee can enforce the benefits under it even though he is not a party to the contract.

6. **Conditions Running With the Land** : Where the buyer of a land has a notice that the owner of the land is bound by certain duties created by an agreement or covenants affecting ti, such buyer shall be bound by them although he was not a party to the original agreement. [ Tulk v. Moxhay ] But nowadays courts regard that purchaser of the immovable property is not bound by the duties alone but also has a right to benefits under the agreement.

**Example:** Certain land- owners adjoining a stream agreed with "Catchment Board" to improve the banks of the stream and to maintain them in good condition. The land owners on their part paid the proportionate cost to the Board. Subsequently, one of the land-owners sold his land to A and who, in turn, sold to B. Due to negligence on the part of the Board, banks of the stream burst and the land was flooded. Both A and B filed suit against the Board. The Court of appeal allowed them to sue even though they were strangers to the agreement.[ Smith and Snipes Hall Farms Ltd.v River Douglas Catchment Board]

**Example I** A enters in a contract with B, but A himself has not given any consideration to B, but the consideration has been provided by third party i.e. C to B. Although A is a stranger to consideration, he can still enforce the contract against B because he is a party to the contract. One has to remember that this is only true under Indian Law and the situation is different under English Law where the consideration can only move from the promisee and a stranger to the consideration in no condition can maintain any action.


**Figure – 4.2**

## 4.6 Summary

Consideration is an essential element for formation of a contract. An agreement without consideration is said to be bare promise and is not binding on the parties (ex nudo pacto non aritio action).

A valid consideration must move at the desire of the promisor, It may move from promise or any other person .and may be past, present or future the law does not requires consideration to be adequate and to benefit the promisor himself .if it is at the willing of the promisor It may be some act or abstinence or promise but must be real not illusory and must be something more than the promisor's existing obligation

A Contract without consideration is void subject to certain exceptions. According to the provisions of Indian Contract Act only parties to the contract can sue it is known as privity of Contarct.However in certain exceptional cases stranger can also sue.

## 4.7 Self Assessment Questions

**I Very Short Type Question**

1 Define Consideration.

2 What is meant by 'stranger to consideration'?

3 What is meant by 'stranger to contract'?

4 What is meant by ' privity of Contract'?

5 What is meant by 'constructive consideration'?

6 What are time barred debts.?

7 "Consideration must be real not illusory" Explain?

8 "An agreement without consideration is void" Explain?

**II Short Type Questions**

1 Comment on the following statement:
   (a) No consideration, No contract.
   (b) Insufficiency of consideration is immaterial but an agreement without consideration is void.
   (c) A stranger to consideration can sue.
   (d) A stranger to a contract cannot sue.

2 Is it compulsory that consideration must move from the promise himself?

3 "Consideration may be past, present or future" Explain?

4 State any four essentials of valid consideration.

5 "Completed gift need no consideration" Discuss?

6 Enumerate any four circumstances when a contract may be valid even without consideration.

7 "Adequacy of consideration does not effect the validity of contract."Discuss.

8 "Past consideration is not valid consideration" Explain?

**Essay type Questions**

1 Define Consideration. What are the essentials element of a valid consideration?

2 Explain the rule that a stranger to a contract cannot sue with the help of an illustration. Isthere any exception to this rule?

3 Explain the rule 'No consideration, No contract .Are there any exception to this rule?

4 "A Stranger to contract cannot sue and stranger to consideration can sue". Explain with exception.

5 "An agreement without consideration is void "Explain with exception.

6 Define consideration. Discuss the legal provisions of a valid consideration.

## 4.8 Reference Books


- Business Laws – Sharma, Gupta, Arya – Ajmera publication
- Business Laws - Tulsian – Tata Mcgraw hill educational publication
- Business Laws – Maheshwari & Maheshwari – Himalaya publishing house
- Business Laws – G.S. Gulshan – Excel publication

# Unit - 5 : Free Consent

**Structure of Unit:**



## 5.0 Objectives

After completing this unit, you would be able to:

- Understand the meaning of consent
- Point out the obstacles in free consent
- Know the difference between coercion and undue influence
- Know the difference between fraud and misrepresentation
- Learn the consequences and outcomes of coercion, undue influence, fraud, misrepresentation, and mistake.
- Understand Exceptions to various Laws related to free consent

## 5.1 Introduction: Consent

Section 13 defines 'two or more persons are said to consent when they agree upon the same thing in the same sense.' It means that there should be consensus ad idem i.e.; identical thinking about the subject matter of the contract. If same thing is understood in different sense by the parties than no contract would exist between them at all. There would be absence of consent. Salmond describes it as **'Error in Consensus'.**

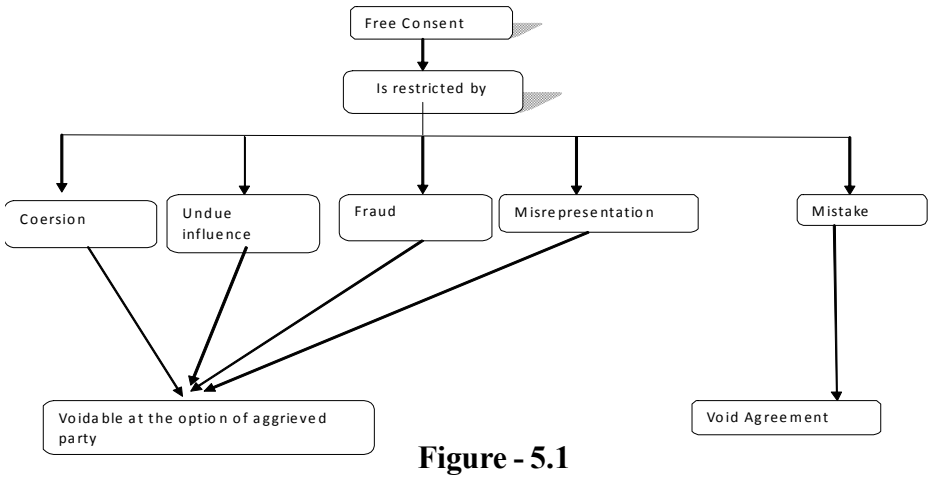


**Figure - 5.1**

## 5.2 Free Consent

Free consent is one of the important characteristics of a valid contract in which both the party's consent should be free while entering into a contract. According to Section 14 consent is not said to be free when it is caused by any of the following:

1. Coercion
2. Undue Influence
3. Fraud
4. Misrepresentation
5. Mistake.

Before discussing about the concept of free consent, it is important to differentiate between 'no consent' and 'no free consent'. In coercion, undue influence, fraud and misrepresentation there is existence of consent but there is no free consent. Salmond calls it **'error in causa'.** In case of mistake, similar thinking of the parties is not present; so there is no consent at all. A person cannot acquire the title without the consent of real owner neither he can transfer title of anything which he does not possess.

When the consent of the person is obtained by coersion, undue influence, misrepresentation and fraud, the aggrieved party can make the contract voidable at his option as his consent was not free. Section 2(i) of the Contract Act defines voidable contract as; "An agreement which is enforceable by law at the option of one or more the parties thereto, but, not at the option of the other or other's"

**Example:** X acquired a scooter from Y by coercion. X sells it to Z. Now, this is a voidable contract at the option of Y and it is enforceable by Law but only unless Z gets the title from X.

While in mistake, there is absence of **consensus ad idem** (no consent at all) and thus, it is **void ab initio** i.e**.,** void from the beginning.

Generally, it is very difficult to draw a line between error in consensus and error in causa because the mistake can be the outcome of a fraud by either of the parties. In other words, both the errors can coexist together and such contract will be void, and not voidable.

**Activity A:**

1. Explain 'Consent as an element of a contract'. When can be saying that consent is not free?

## 5.3 Coersion

According to Section 15, 'Coersion is the committing or threating to commit any act forbidden by Indian Penal Code, or the unlawful detaining or threatening to detain, any property, to the prejudice of any person, what so ever, with the intension of causing any person to enter into an agreement.' It reveals that one party induces a person to enter into a contract by the use of force or threat.

On the basis of above definition of coersion following characterises can be studied:

1. Committing or threatening to commit any act forbidden by Indian Penal Code amounts to coercion.

   **Example:** A gave severe assault to B and caused him to sign a gift deed in his favour. The assault amounts to coercion.

   **Threatening to Commit**: Under the Indian Penal code an attempt to commit suicide is an offence, but a threat to commit suicide is no offence, therefore, a consent obtained by threatening to commit

suicide does not amount to coercion. It means that if a person threatens to commit an act forbidden by Indian Panel Code the agreement is voidable at the option of the other party.

**Example:** If A induces B to sign a contract at gun point or threaten to kill him. A have used coercion.

However, Madras High Court has held a judgement that even a threat to commit suicide is coercion even though it is not punishable under the Indian Penal Code. The following observation made by the court is worth noting.

The term 'any act forbidden by the Indian Penal Code' is broader than the term 'punishable' by the Indian Penal Code, simply because a man escapes punishment, it does not follow that the act is not forbidden by the Indian Penal Code.

**Example,** if a lunatic or a minor commits a criminal act he may not be punished but this means that their acts are not forbidden by the Indian Penal Code.

**Example:** A person by giving a threat to commit suicide induces his wife and son to execute a release deed in favour of his brother in respect of certain property. It was held that the deed was obtained by coercion [Chikham Amiraju v. Chikham Seshamma (1912) 16 IC 344].

**Threat to File a Suit:** A threat to file a civil or criminal suit does not amount to coercion since the act is not forbidden by the Indian Penal Code. However, a threat to file a suit on a false charge amount to coercion since such an act is forbidden by Indian Penal Code.

2. Detaining or threatening to detain unlawfully property of another person also amounts to coercion.

   **Example**: A principal refused to pay commission to agent unless the agent hide his fraud from the books of account. Held, this hiding of fraud amounts to coercion and therefore is not binding.

3. The purpose or aim of coercion should be to induce or force other person to enter into a contract if there is no intention of causing other person to enter into a contract, it will not amount to coersion.

   **Example:** A takes the possession by B's house by threatening him. This is not coercion as A has no intention to induce B to enter into a contract. This is mere a threat with no element of coercion.

4. When a party or person exercises coercion than it is not necessary that he is a party to the contract. He can even be a stranger to the contract. Also, the coercion can be directed to a person, who is not a party to the contract i.e., he is a stranger to the contract. In other words, both the person initiating threat amounting to coercion and the person to whom coercion is directed can be a third party who has nothing to do with the contract.

   **Example:** If A is threatened by Q to enter into a contract of selling an agriculture land with B and A agrees to sell it. Q's threat will amount to coercion even though Q is a not a party to the contract between A and B.

   **Example:** A is threatened to hurt B's son P if B does not enter into a contract of sale of farm house with A. B agrees. But, it is not binding on him because his consent is acquired by coersion.

5. It is not compulsory that the Indian penal code is applicable at the place where coersion has been exercised.

   **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 under the law of England and although section 506/566 of Indian Penal Code was not in force at the time or place where the act was done.

### 5.3.1 Remedies to Coercion

According to Section 19 of Indian Contract Act "When consent to an agreement is obtained by coersion, the contract becomes voidable at the option of the party whose consent is so obtained."

According to Section 72 of the Act, "A person to whom money has been paid or anything delivered under coersion must repay or return it."It means that the if party exercising coercion has received anything from the aggrieved party he must return it at a time of rescinding the contract.

According to Section 19 when the agreement is voidable at the option of aggrieved party then the party can either avoid or set aside the contract or it can abide by the contract and bind the other party for the performance of the contract.

However, the party who wants to avoid the contract shall bear the burden of proving that his consent was obtained by coercion. It means that he has to prove that if coercion would not have been exercised, he would not have entered into the contract.

**Example:** A agrees to sell his car to B under fear of assault. It is a contract voidable at the option of A.

Section 64 states that if the aggrieved party has received some benefit from the party who exercised coercion, than the former must return the same to the letter at a time of rescinding the contract.

**Example:** X at whose option a contract is voidable has received Rs 100 from Y. X rescinds the contract. X must refund the same to Y.

**Activity B:**

1. A at a pistol point asked B to sell his car for Rs 10000 only. B sold his car. Can B sell his car? Can B avoid the contract? Give full reasons for your answer.

## 5.4 Undue Influence

The improper use of any power and authority possessed over the mind of contracting party is known as Undue influence. If the consent is acquired by undue influence then it is not said to be a free consent and such contract is voidable at the option of the party whose consent is so acquired.

According to Section 16 a contract is said to be affected by undue influence when:

(a) The relation existing between the parties are such that one of the parties is in a position to influence the will of the other, and

(b) Uses that position to obtain an undue advantage over the other.

**A Person Deemed to be in a Position to Dominate the Will of Another:**

In following three situations law assumes to be in a position to influence the will of the other:

(i) Where he holds a real or obvious authority over the other (master or servant, parent and child). Real or obvious authority may rise due to inequality of the parties.

(ii) Where he stand in a fiduciary relationship (religions guru and disciple, trustee and beneficiary, doctor and patient, lawyer and client).

(iii) Where he makes a contract with a person whose mental ability is temporarily or permanently challenged by the reason of age, illness or mental or bodily suffering.

When a influential party enters in a contract with the weaker party, and the transaction appears on the face of it or on the proof given to be immoral, then the influential party must bear the burden of proving that the contract is not a result of undue influence as he is in the position to control the will of the weaker party.

The above assumption can be rebutted if it is proved that

(a) All material facts were revealed to the party who is complaining for the use of undue influence.

(b) The consideration was adequate.

(c) The party complaining use of undue influence had an independent advice and was free to exercise it.

**Example**: B contracts with A his debtor, for a fresh loan on terms which appear to be immoral. The burden to prove that the contract was not induced by undue influence lies on B.

**Example:** A person suffering from cancer was confined to hospital. He transferred all his property to his elder son only. Supreme Court held that this might be a case of use of undue influence.

**Burden of Proof**

To prove that the contract was induced by undue influence, it has to be exhibiting that:

(i) There was an unequal relationship.

(ii) One person was in a position to influence the will of the other; and

(iii) He has used that position to obtain undue advantage.

**Contracts With 'Pardanashin Woman:** There is no statutory or judicial definition of the term 'paradanashin woman'. The term probably means a woman who is totally isolated or secluded from the ordinary social inter-course. It is more likely that such ladies are exposed to undue influence and they require protection from the court. Once it is shown that the contract was with a paradanashin woman the burden shifts on to the other party to show that no undue influence was used; the contract was fully explained to her and her consent was free. A contract with a pardanashin woman is presumed to have been induced by undue influence.

The burden, therefore, lies on the other party to show that:

(a) The terms of the contract are fair and equitable.

(b) The transaction is real and bona fide.

(c) The lady had an independent advice in the matter.

(d) She acted at an arm's length from the other party to the contract.

(e) The deed was explained to her, and

(f) She understood it and its effects on her interests in full.

Further, the protection given to a pardanashin woman is also applicable to illiterate and ignorant woman who are equally exposed to the danger and risk of an unfair deal.

### 5.4.1 Remedies of Undue Influence

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 it has received any benefit thereunder – upon such terms and conditions as to the court may seem just." (Section 19A) Further, the court has given powers under section 19 A to allow or not to allow the refund of benefits taken.

**Example:** A moneylender, advanced Rs. 1000 to B, a farmer and, by undue influence, induces B to execute a bond of Rs. 2000 with interest @ 9% per month. The court may set the bond aside ordering B to repay Rs. 1000 with such interest as may seem fit.

### 5.4.2 Difference Between Coersion and Undue Influence

In Coersion and undue influence both, the consent of one of the party is not free and his freedom of will is affected. As a result, the agreement is voidable at the option of such party under both. However, there are some points on which they can be differentiated. They are:

**(1) Mode of Obtaining Consent**: In coercion the consent of the aggrieved party is taken by committing or threatening to commit an act forbidden by Indian Penal Code or detaining or threatening to detain some property unlawfully. While in undue influence consent is acquired by influencing the will of weaker party by the stronger party and thereby taking advantage of one's superior position.

**(2) Type of Force**: In case of coercion physical force is exercised while in undue influence moral or mental pressure is used.

**(3) Existence of Relationship**: In coercion, relationship between the parties entering into a contract need not be there. But in case of undue influence some kind of relationship between the parties must exist where one party influences the will of the other party.

**(4) Third Parties**: Coercion need not be directed to a party to the contract; it can be directed against third party also. But undue influences must be exercised upon to the party to the contract.

**(5) Burden of Proof**: In coercion, party rescinding the contract has to prove the act of coercion and in no case is coercion assumed by law. But in special cases, undue influence may be assumed by law.

**Activity C:**

1. A, a man and enfeebled by disease and old age induced by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional services. Discuss.

## 5.5 Misrepresentation

Misrepresentation is a wrong representation where the person making a false statement believes it to be true and does not intend to mislead the other party to the contract. It may include two things.

a) Wrong statement of a material fact not known to be false or

b) Non-disclosure of facts where there is legal duty to disclose without any intention to deceive

Thus, the consent obtained by misrepresentation is not a free consent and the contract is voidable at the option of party whose consent is obtained. Misrepresentation includes the other party to act upon the mis-statement and enter into the contract. But the mis-statement must relate to the material facts of the contract otherwise it is not termed as misrepresentation. A general statement or comment whether right or wrong is not misrepresentation.

**Example:** A who is about to sell his bike to B says my bike is in good condition without knowing the fact that his son has damaged the bike yesterday. B buys the bike. There is misrepresentation on the part of A.

As per Section 18, misrepresentation can be committed in any of the following ways:

**(i)** **By Positive Statement :** If a person without any logical basis makes complete and clear statement of fact, which is not true though he believes it to be true, it will be said that he is guilty of misrepresentation.

**(ii)** **By Breach of Duty :** When a person gains something on account of breach of duty and the other person loses and if it is done unintentionally then it is misrepresentation. The person committing any breach of duty, without an intension to deceive, gains an advantage to him, it will be termed as misrepresentation.

**(iii)** **Causing Mistake By Innocent Misrepresentation:** In misrepresentation, though unknowingly, a party makes a mistake as to the substance of the subject-matter of the contract which is material to the contract.

### 5.5.1 Essentials of Misrepresentation

**(1)** **False Representation**: Misrepresentation is a false statement made without intent to mislead the other party. But the person making the statement should genuinely believe it to be true and he should be unaware of its falsehood.

**(2)** **Misrepresentation Must be of Material Facts**: Praising expressions made by the businessman about their goods does not amount to misrepresentation. Misrepresentation is always related to the facts which are important to the contract. Misrepresentation of facts not related to contract are insignificant and does not affect the contract.

**(3)** **Misrepresentation Should be Made Before or at the Time of Entering a Contract:** A subsequent statement made after entering into the contract is unimportant.

(4) If Misrepresentation is made by a stranger it does not affect the contract, as he is neither a party nor agent to the contract.

(5) If there had been no misrepresentation the party would not have entered the contact. Thus, misrepresentation must lead to the consent of the other party. If misrepresentation has not resulted in the consent of the party, it is unimportant.

### 5.5.2 Outcome of Misrepresentation

Misrepresentation makes the contract voidable at the option of the party whose consent was obtained by misrepresentation.

"A party whose consent was caused by misrepresentation may if thinks fit, insist he shall be in the position in which he would have been if the representation made had been true."

**Example:** A informs B that his estate is free from encumbrances. B there upon buys the estate. The estate is subject to mortgage, though unknown to A also. B may either avoid the contract or insist on its being carried out and mortgage debt redeemed.

So, in view of above, following are the remedies available to the aggrieved party whose consent was obtained by misrepresentation:

**(a) Right to Rescission** : The aggrieved party who is misled by innocent misrepresentation may sue for rescission of the contract and anything he has transferred to the other party shall be restituted to him but the right of denial will be lost in the following cases :

(1) Where the party misled by Misrepresentation had the ways to find out the truth by ordinary diligence (Exception to Sec. 19). But if the truth cannot be exposed with ordinary diligence then the contract is voidable.

**Example:** A, by a Misrepresentation leads B to believe that 500 engine are manufactured annually in A's factory. B examines his accounts and finds that only 400 engines are manufactured. After this B buys the factory, the contract is not voidable on account of A's misrepresentation.

(2) Where the representation has not been material in causing the other party to enter into a contract. The party enters into the contract in ignorance of misrepresentation.

(3) Where the party after becoming aware of misrepresentation expressly affirms the contract or acts in such a manner as to be taken to have impliedly accepted it. In case of implied affirmation the party does some act which is inconsistent with his right to affirm.

**Example:** A, by misrepresentation, leads B to believe wrongly that 2000 lt. of oil is made every day in his factory. B examines the accounts of the factory which show that only 1000 lt. oil has been made daily in the past. B purchases the factory. B cannot avoid the contract for there is no misrepresentation. B shall be deemed not to have relied upon the information given to him by A but upon his own knowledge. He had verified the true state of affairs and he had full opportunity to disbelieve the statement of A.

(4) Where the interest of third party has intervened before the exercise of the right of rescission of the contract by the party entitled to do so. The third party should acquire the rights in good faith and with consideration.

(5) Where the parties cannot be brought back to their original position, the contract cannot be rescinded.

**(b) Right to Insist Upon Performance** : Section 19 provides in this regard that "A party whose consent was caused by Misrepresentation may if he thinks fit, insist that the contract should be performed and that he shall be put in the position in which he would have been if the Misrepresentation made had been true." This means that the aggrieved party can compel the other party to put him in a position if there would have been no Misrepresentation & then he can accept the contract.

**(c) Right to Claim Damages** :Usually, innocent misrepresentation does not entitle the aggrieved party to claim damages. He can insist on restitution. But in the following cases he can get damages.

(1) Where misrepresentation has been made by the promoters or directors of the company in the prospectus relying on which the public applies for shares. Such public is liable for damages.

(2) Damages can be claimed for breach of the condition of warranty where innocent Misrepresentation was embodied in the contract as a condition or a warranty,

(3) An agent who is guilty of breach of warranty of authority is liable to pay damages. Sometimes an agent may mislead another person to enter into a contract with him by making a misrepresentation as to his powers. In such cases, even though he is only guilty of innocent Misrepresentation, he is liable for damages to such person who enters into a contract with him.

**Activity D:**

1. "Mere silence as to facts likely the willingness of a person to enter into contract is not fraud, unless the circumstances of the case are such that regards being had to them, it is the duty of the person keeping silence to speak or his silence is equivalent to speech." Explain.

## 5.6 Fraud

The term 'fraud' includes all intentional or wilful misrepresentation of facts, which are material for the formation of a contract. Misrepresentation made with the purpose of cheating or deceiving others is fraud.

Misrepresentation of facts may be both intentional and innocent. Intentional misrepresentation has been termed as 'fraud' and innocent misrepresentation has been termed simply as Misrepresentation in the Contract Act.

Definition: Section 17 of the Indian Contract Act defines fraud as follows:

"Fraud means and includes any of the following acts committed by a party to a contract, or by anyone 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 a fact, of that which is not true, by one who does not believe it to be true.

(ii) An active concealment of a fact by one having knowledge or belief of the fact.

(iii) A promise made without the intention of performing it.

(iv) Any other act fitted to deceive.

(v) Any such act or omission as the law specially declared fraudulent."

### 5.6.1 Essential Elements of Fraud

**(1) False Representation of Facts**: The most important element of fraud is that there must be a false statement or representation of facts with the intension of deceiving others. If the statement made is not false then the person making the statement is not guilty of fraud. There can be no fraud if there is no false mis-statement except:

(i) where silence may itself amount to fraud, and

(ii) where there is an active concealment of facts.

But when he knows that it is false, or when he makes careless statement without considering for its truth, he is guilty of fraud.

**Example:** A says to B that her saree is made of pure silk, though she knows that is untrue. B purchases the saree believing A's statement to be true. It is a fraud by A, and therefore, contract is voidable at B's option.

It is important to remind here that fraudulent representation must always speak about a matter of fact and not of an opinion. Commendatory expressions cannot be considered fraudulent as every seller has a right to appreciate his goods.

(2) The act must have been committed by a party to the contract with his connivance or by agent. It should not have been committed by a stranger.

**Example:** A person was forced to buy shares in a company on the basis of a false statement made by a stranger. It was held that he could not get out the deal because the false statement was not held by the company or its agent.

**(3) Acts Committed Must be of Following Nature** :

**a. Active Concealment of a Fact:** When a person takes positive steps to hide important facts relating to the contract, the revelation of which would be harmful to his interest will amount to fraud. But mere concealment of facts to sell the goods is not fraud as a seller never disclose faults in the goods he is going to sell. It is the obligation of buyer to assure for the quality and price of goods.

**Example** : A contracts to sell to B a piece of wool, B thinks that is the English wool, A knows that B thinks so, but knows it is Japanese wool. A does not correct B's impression. Subsequently B discovers the fact. Can B repudiate the contract?

B cannot reject the contract as there is no fraud on the part of A because has no duty to disclose the fact that piece of wool is a Japanese one. A's silence cannot be taken as a fraud.

**b. Suggestion of an Untrue Fact:** If a person states a fact which is untrue or which he himself does not believe to be true, then it will be treated as a fraud on his part.

**Example**: A, who is about to sell a dog to B says 'the dog is a beauty and worth Rs. 800. B buys the dog for Rs. 600. Afterwards B learns that A had bought it for Rs. 400 and B cannot get more than Rs. 200 for it. What is B's remedy?

B does not have any remedy against A, as the statement made by A is a mere expression of an opinion and cannot be taken as a fraud. It is necessary that false statement must always relate to a fact and not opinion. Mere expression of a view will not amount to fraud.

**c. A Promise Made Without Intention of Performing it:** If a person enters into a contract and has no intention of performing it, such a promise is considered fraud.

**Example**: A purchases grains from B. He has no intention of paying for them. The contract is said to be induced by fraud.

**d. Any Other Act Fitted to Deceive:** Under this clause are covered all such cases which cannot aptly be covered under any other clause. Human mind is very productive, can think of many ways to cheat others. Thus, this sub-section covers all tricks dissembling other unfair means which are used by cunning people to cheat others.

**e. Any Such Act or Omission Which the Law Specially Declares to be Fraudulent:**
**Example**: Under the Transfer of Property Act, Companies Act certain kinds of transfers are declared to be of fraudulent preference.

f. **The Representation Must Have Induced the Other Party to Act Upon it :** 'An attempt to deceive which does not deceive is no fraud.' The fraud must have influenced the willingness of the other party to act upon the contract.

**Example**: H sold certain birds to W which were to his knowledge suffering from bird flu. The birds were sold with all faults and H did not disclose the flu to W. It was held that there was no fraud.

g. **The Act Must Have in Fact Deceived the Other Party:** If a party is not deceived by the fraudulent acts committed which were intended to deceive them then it will not amount to fraud and the person shall not be held guilty of fraud. It has been observed, "a deceit which does not deceive is no fraud."

**Example**: A says to B that his camel is in a healthy condition although he knows that it is not true. Relying on A's statement B purchases the camel. The contract is voidable at the option of B.

h. **The party Misled Must Have Suffered:** "There is no fraud without damages" and therefore, to comprise fraud it is necessary that the misled party must have suffered some loss of money or money's worth or some other tangible loss capable of assessment. Without damage fraud does not give rise to any action for deceit.

**Example**: T bought a cannon from H. The cannon had a defect and H inserted a metal plug into the weak spot of the gun. T accepted it without inspection. When he used it, the gun burst. He refused to pay for it on the ground of fraud. But it was held that he could not do so because he would have bought the gun even if the plug would not have been there. (Hersfall v. Thomas 1952)

### 5.6.2 Silence as Fraud

Explanation to Section 17 explains that mere silence without any legal duty to speak will not amount to fraud except where:

a. The circumstances of the case are such, that regard being had to them, it is the duty of the person keeping silence to speak, or

b. Silence, in itself, will be equivalent to speech.

A party to the contract has no obligation to reveal all the information or facts to the other party which may affect the subject matter of the contract. However, he may abstain from active misstatement of facts. Mere non disclosure does not render a contract voidable.

**Duty to Speak:** In following types of contracts the law requires that person knowing material facts must speak out the facts, otherwise it will be treated as a fraud on his part. In such contracts one party has a unusual means of knowledge which are not accessible to the other. Such contracts are known as contracts of utmost good faith and in such cases the burden to speak or disclose the truth rests upon only one party as imposed by the law. Such types of contracts are:

**(1) Contracts of Uberrimae Fidei** : In case of contracts of uberrimae fidei (absolute good faith) law imposes upon parties the duty of making a true and full disclosure of material facts. Following contracts come in this class :

(i) **Contracts of Insurance:** In such contracts both parties must truly reveal facts but the burden is more on the insured since he possess more information about the subject matter which are likely to affect the risk. If he fails to do so insurer can avoid the policy.

(ii) **Contracts for the Sale of Immovable Properties:** Under Section 55 (1) of the Transfer of Property Act, the seller is bound to 'disclose all defects in his property or in seller's title thereto, of which the seller is, and the buyer is not aware and which the buyer could not with ordinary care discover.' In case buyer knows a material fact of which the seller is unaware, he must disclose it to the seller.

**Example:** B, having discovered a mine of silver on the estate of A, adopts means to obscure, and does obscure, the existence of silver from A. Through A's ignorance B is entitled to buy the estate at an under value. The contract is voidable at the option of A.

(iii) **Allotment of Shares in Companies:** A company offering subscription of its shares to the public must disclose all information regarding all important matters in the prospectus with strict accuracy. Any non-disclosure will amount to fraud. This rule is known as the Rule of Golden Legacy.

(iv) **Family Settlement:** Full disclosure of all material facts is necessary when family disputes are settled by mutual agreement.

**Example**: A knows that there is a treasure in the portion of the house in which he is living. Before partition he did not disclose this fact to other brothers. Brothers can claim share in the treasure.

(v) **Contracts of Marriage:** Strictly speaking contracts of marriage are not contracts of good faith, but even then both the parties to marriage must disclose all material facts which all likely to affect the other party's decision to marry.

**(2) Contracts of Partnership**: Mutual trust and confidence is the basis of partnership. It requires utmost good faith among the partners before and after the formation of partnership agreement. They are also required to render true accounts and full information of all things affecting the firm, to every partner or his legal representative.

**(3) Contracts of Guarantee**: Section 143 of the contract act lays down that any guarantee which the creditor has obtained by means of keeping silence as to material facts is invalid.

**(4) Fiduciary relationship**: Parties sharing a fiduciary relation with each other are duty bound to disclose all material facts which are likely to affect the willingness of the other party to enter into a contract, e.g. Solicitor and client, doctor and patient etc.

**Example**: A sells by auction to B, a pet dog which A knows is unhealthy. A says nothing to B about the dog's illness. There is no fraud on the part of A.

### 5.6.4 Remedies to Fraud

The party whose consent to the contract was obtained by fraud can exercise any of the following rights:

(A) He may avoid the contract and may (i) ask for the damages suffered because of the non-fulfilment of the contract of (ii) ask for restitution.

(B) He may insist for the performance of the contract and may ask the other party to put him in the position in which he could have been if the representation made has been true. It can bring an action for damages for the fraudulent representation.

### 5.6.5 Difference between Fraud and Misrepresentation

**(1) Intention:** In both fraud and misrepresentation, there is a false statement. But in fraud wrong statement is made knowingly with an intention to deceive the other party and in case of misrepresentation there is no intention to deceive the other party, the person making it honestly believes it to be true or does not know that it is false.

**(2) Rights:** The remedy of rescission is available under both. The aggrieved party can claim damages suffered by him as fraud is a civil wrong. But as misrepresentation makes the contract voidable at the option of aggrieved party but it cannot claim damages.

**(3) Defence:** A person complaining misrepresentation can be met with a defence that he had the means of discovering truth by ordinary diligence. In case of fraud (except fraud by silence), the person who has played it, cannot set up the defence that the injured party had the means of discovering the truth by ordinary diligence.

**(4) Criminal Act:** In certain cases fraud can be a criminal act and punishable under Indian Penal Code. But misrepresentation does not show any criminal intent on the part of the person making the statement and it is not a criminal act and hence not punishable under act.

**(5) Silence:** In some cases, silence, may amount to fraud e.g. in case of contracts of utmost good faith. But silence cannot amount to an act of misrepresentation,

**Activity E:**

1. A, the owner of a ship, by fraudulently representing her to be seaworthy induces B, an underwriter to insure the ship. Can B obtain cancellation of the policy?

## 5.7 Mistake

Mistake means wrong belief concerning something. Free consent is needed for the validity of a contract, but when the consent of the party is caused by mistake, the consent is not said to be free. Either or both the parties are under a misapprehension of some fact relating to the agreement. If there would not have been such misunderstanding, probably they would not have entered into the agreement. Such contracts are said to have been caused by mistake.

Mistake may be of various types as shown by the chart below:

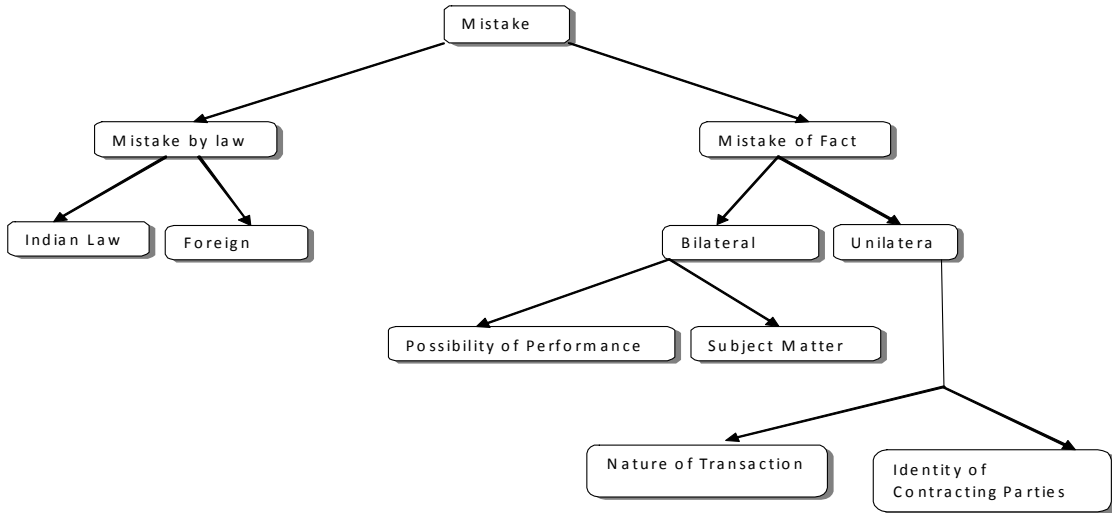


**Figure - 5.2**

### 5.7.1 Mistake of Law

i) **Mistake as to Indian Law**: When the mistake is made as to the Indian Law, the contract will not be voidable because every citizen or resident of a country is expected and should know the law of the land where he lives. Ignorance of law is no excuse (ignorantia juris nemi nem excusat). Ignorance of law cannot be the basis of relief to any person.

**Example** : If A and B entered into a contract on a erroneous belief that a particular debt was barred by Indian Law of Limitation, the contract cannot be set aside on the basis of mistake by law.

ii) **Mistake as to Foreign Law**: Mistake as to a foreign law has some effect as a mistake of fact, and, therefore, the contract can be avoided.

**Example**: A and B purchase and sell a plot of land of 200 sq. m. in Dubai believing that a house on be constructed over it. Actually it turns out that in Dubai no house can be constructed on a plot of less than 300 sq. m. The contract can be avoided.

### 5.7.2 Mistake of Fact (Section 20 and 22)

**(A) Bilateral Mistake:** According to Section 20 "where both the parties to a contract are at a mistake about the facts which are essential to the agreement, the agreement shall be void."

In order to avoid a contract on the grounds of mistake of fact, it is necessary to show:-

(i) that the mistake was bilateral, and

(ii) the mistake was as to a fact essential to the agreement.

**Example**: X having cars, blue and red, offers to sell blue car to Y and Y not knowing that X has two cars thinks of red car and agrees to buy it. Here, there is no real consent and therefore, the contract is void on the ground of bilateral mistake of fact.

A bilateral also known as identical bilateral mistake may be either a common mistake or mutual mistake. Where both the parties have made the same mistake it is termed as common mistake. When both the parties make different mistakes it is mutual mistake and may also be called non-identical bilateral mistake. In case of common mistake the contract is void. In case of non identical mistake the contract does not comes into existence at all because there is no consensus ad idem. The parties are never in agreement.

Again, bilateral mistake of fact may be

(1) **Mistake as to Subject Matter:** Where both the parties are working under a mistake regarding the subject matter, the agreement is void. It may be of following types :

**(i) Regarding Existence of Subject Matter**: It may happen that both the parties are not aware of the fact that at the time of the contract the subject-matter may ceased to exist or it may never have been in existence. It is a common bilateral mistake.

**Example:** A agrees to purchase a specific article from B. Unknown to both the article has already lost. The contract is void.

**(ii) Regarding Identity of the Subject Matter**: **Example**: Satyam transport sales a cargo to W which arriving from Jaipur. There were two companies of the similar name carrying cargo on the same date. Both the parties have different company in mind. The contract was held to be void for mutual bilateral mistake.

**(iii) Regarding Title to the Subject Matter**: Both the parties are unaware of the fact that the buyer is already the owner of that which the seller claims to sell him. Such agreement of sale is void.

**Example:** A nephew of B, purchases a house from B. But both are unknown that A's grandfather has already given this house to A in his will. Held, the agreement is void.

**(iv) Regarding Quality of the Subject Matter**: **Example:** A agrees to buy from B a number of sacks which both A and B believes to contain jute. But in fact, the sacks contain cotton. The agreement is void.

**(v) Regarding Quantity of the Subject Matter**: **Example:** 'P' wrote to 'H' inquiring about the price of guns and suggested that he might buy as many as 70 guns. On receipt of reply, he sent a telegram 'Send three guns'. Due to mistake of telegraph officer the message was sent 'Send the guns'. 'H' dispatched 70 rifles. Held there was no contract between the parties on a ground of consensus ad idem and mistake of third party. P was not held liable for damages but was required to pay the price of the three guns.

(vi) **Regarding Price of the Subject Matter**: There may sometimes be a genuine mistake as to the price of an article for sale.

**Example:** A contract of lease of house was agreed at a rent of Rs. 4500 pm but in the written contract the figure was put as Rs 1500 by mistake. Held, that the contract was enforceable.

**(2) Mistake as to the Possibility of Performance:** If the presence of certain set of circumstance is necessary for the performance of the contract and both the parties are unaware about the existence of such circumstance of at the time of the contract. Then the contract will be void on the grounds of mistake.

**Example:** A hires a Television from B for watching the cricket match between India and Pakistan. Unknown to both the parties the match had already been cancelled due to rain. The contract is void.

**(B) Unilateral Mistake**: It is the mistake on the part of one of the parties only as to a matter of fact. Generally, a unilateral mistake does not affect the validity of the contract. Section 22 of the Indian contract Act states in this regard that "a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to matter of fact."

In the words of **Anson**, "We are not concerned with cases in which a man finds the obligations of a contract more onerous than he intended or is disappointed in the performance which he receives from the other party." Thus is not mistake, but error of judgement.

**Example:** A intends to sell his cell phone. B intending to offer Rs. 3000 for it, by mistake offers Rs. 5000. A accepts the offer. The contract cannot be avoided by B on the ground of mistake.

However, a contract can be repudiated in case of unilateral mistake if it is proved that the mistake was a result of fraud or misrepresentation on the part of other party. A unilateral mistake will make an agreement void if (i) it is about a fact which is material to the agreement, and (ii) secondly, the mistake restricts or hinders the consent of the parties.

Contract shall also be void where the offeror makes a material mistake in expressing his intention and the other party knows or is deemed to know the error. But if there is a mistake on the part of one party alone and the other does not, or cannot be deemed to know of the mistake the contract is binding. Mistake caused due to carelessness of the party will not grant any right to such party to avoid the contract. Unilateral mistake may be of two types:-

**(a) Mistake About Identity of Parties**: Mistake as to identity occurs when one of the parties represents himself to be someone who he is not then, it is the mistake of identity of parties. In the words of **Sir Anson, "**if a man accepts an offer which is plainly meant for another or if he becomes party to a contract by falsely representing himself to be another contract in either case is void, or to put in more accurately no contract comes into existence. In the first case one party takes the advantage of the mistake, in the other he creates it". When the personality of the party contracted with is important in a contract then no one has the power to step in and declare that he is the party contracted with. There is a mistake of identity only when the complaining party wants to deal with a person having a particular identity. If the name is fictitious, there will be no mistake of identity.

**Example:** [King's Norton metal Co. V. Edridge, Merrett & co.(1897) 14 LTR 98] A man named W adopted a name of H and company, a firm not in existence, and by letters placed an order for some goods with K N & Co., who complied with the order. It further sold these goods to E M & Co. who acted in good faith. K N & Co. sued E M & Co. for the value of goods. The contract was held voidable for fraud but not void for mistake as K N & Co. did not make a mistake regarding identity.

**Example:** X falsely representing herself as the wife of a well-known millionaire takes a ring from the jewellers' shop for the approval of her husband. She pledges it with a pawnbroker who in good faith and without notice of the first transaction pays her Rs. 10,000. Can the jeweller recover the ring from pawnbroker?

In this case there was no contract between the jeweller and the woman and the pawnbroker does not take good title and must return the ring to the jeweller. Though the woman got possession physically, there was no mental assent as the jewellers intended to deal not with her but quite a different person viz. the wife of the millionaire [Lake v Simmens (1927) ac 487]

**(b) Mistake as to the Nature of the Transaction**: When a party with the fault of his own, make a mistake as to the very nature of the contract, than the contract is void. The mistake can be due to blindness, illness, illiteracy or other inabilities of the person signing the contract. It may also be due to tricks or fraud of the other person as to the nature of the contract so that the plaintiff signs the contract. A contract shall be void if a party to the contract without any fault of his own makes a mistake about the very nature of the contract.

**Example:** (Raja Singh v. Chaichoo Singh [AIR1940 part 201])- A appointed the B to look after his cultivation and his affairs as he had become to old to manage them. B asked him to grant a lease of his land. A agreed to it and placed his thumb impression upon a deed which was in fact a gift of the land.

The court held the deed to be **void ab initio**.

Usually, such mistakes are result of fraud by one of the parties to the contract who has the obligation to reveal true nature of the document or contract to the other person who is signing it. If it fails to do so intentionally and thus, induces other party to sign the document of different nature. In such a case the agreement is negated by mistake.

### 5.7.3 Remedies of Mistake

When contract is caused by mistake and is void, the following are the consequences :

(1) Under Section-65, any person who has received any advantage under such contract is bound to restore it or make compensation for it to the person from whom he received it.

(2) A person to whom money has been paid, or anything delivered by mistake, must re-pay or return it (Section-72).

**Activity F:**

1. "The law relating to mistake is a comedy of errors." Comment.

## 5.8 Summary

The consent means when two parties enter into a contract with reasonable consideration and they mutually approve the contract by fulfilling all elements of valid contract. They agree on terms, conditions, situations, circumstance, with another person. It means that a party mutually agree upon above mentioned terms without any threat, pressure, force, inducement. As per sections 15, 16, 17, 18, 19, 20, 21&22 of Indian Contract Act the consent is free when two parties enter into a contract in the absence of coercion, undue influence, fraud, misrepresentation, and mistake. To make a valid contract, 'consent' of all the parties is important and that too it has to be free.

## 5.9 Self Assessment Questions

1. 'An agreement requires a meeting of the minds'. Comment
2. What is 'undue influence'? How does it differ from 'coercion'?
3. "An attempt to deceive which does not deceive is no fraud". Comment
4. What is the importance of distinction between Bilateral Mistake and Unilateral Mistake?

## 5.10 Reference Books


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# Unit - 6 : Legality of object and Consideration and Agreements Opposed to Public Policy

**Structure of Unit:**



## 6.0 Objectives

After reading this chapter you should be able to

- Understand the importance of Legality of Object and Consideration of a contract
- Learn what objects and considerations are unlawful
- Understand the meaning of Public Policy and agreements against Public Policy
- Know partial lawful object and consideration
- Remedies available in such cases

## 6.1 Introduction

**Legality of Object and Consideration**: For a contract to be valid, one essential element is that the consideration and object of the contract should be lawful. 'Consideration' for a contract is different from its object. 'Consideration' means acting, abstinence or promising something at the desire of the promisor whereas 'object' is the purpose for which the agreement is entered into. Consideration is given to fulfill the object of the contract. For example an agreement made for the purchase of arms and ammunitions for continuing a war against the nation. Here, the object is to continue war and consideration is the promise to provide arms and ammunitions and pay for the same. Therefore, for a valid contract both object and consideration should be lawful otherwise it cannot be enforced by Law.

Section 23 mentions the circumstances when the consideration or object of an agreement is not lawful:

**What Consideration and Objects are Lawful, and What Not**? The consideration or object of an agreement is lawful, unless-

it is forbidden by law; or

is of such a nature that, if permitted, it would defeat the provisions of law; or

is fraudulent; or

involves or implies injury to the person or property of another; or

the Court regards it as immoral, or opposed to public policy.

In each of the above cases, the consideration or object of an agreement is unlawful and void.

Section 10 lays down that all agreements are contracts if made for lawful consideration and with a lawful object. If any one of the reasons mentioned in section 23 exists in the object or consideration of the contract, the agreement is 'illegal' and therefore void.

The use of word 'illegal' is not apt here as it refers to an offence deserving punishment. But the parties involved in a so-called illegal agreement are not liable for punishment unless it is expressly a criminal or a civic wrong declared by law. The parties have only accomplished a transaction that is shunned by law.

According to Section 23 the words 'object' and 'consideration' are not synonymous. The object here, means 'rationale or aim'. In Jaffer Maher Ali v. Budge Budge Jute Mills Co. (1906) 33 Cal. 702, an insolvent person with the object of defrauding his other creditors, transferred his property to one of his creditors, the court thus held the agreement void and the transfer inoperative. In this case the court was of the opinion that though the consideration of the contract was lawful, the object was to defeat the provisions of Insolvency Law which is unlawful.

## 6.2 Unlawful Consideration and Object

Section 23 declares the agreement whose either object or consideration is unlawful and void. What kinds of considerations and objects are unlawful shown as under?

1. **If it is Forbidden By Law**, i.e. it has specifically been declared to be unlawful by any of the country for the time being in force. An act or an undertaking is forbidden by law:

   **(a)** when it is liable to be punished by the criminal law of the country, or

   **(b)** when it forbidden by the special legislation or regulations made by a expert authority under the powers resulting from the legislature.

   **Case**: An agreement to pay consideration to a tenant to induce him to vacate premises governed by the Rent Restriction Act is illegal and can be enforced because such an act is forbidden by the said act [Mohanchana v. Manindra AIR (1955) Cal.442.]

   **Example:** A agrees to sell certain gems to B which B will smuggle out of the country. The contract is unlawful.

2. **If it is of Such a Nature That, if Permitted, Would Defeat the Provisions of Law–** This clause includes cases where the object or consideration of an agreement is of such a nature that, though not directly prohibited by law, it would indirectly lead to a breach of law, whether enacted or otherwise (e.g. Hindu and Mohammedan Laws). Such an agreement is also void.

   **Example**: A gives a loan of Rs. 10,000 to B. B agrees not to raise the plea of limitation in case a sue has to be filed against him for recovery of loan even if it becomes time barred. The agreement is void as it defeats the provisions of the Indian Limitation Act.

   **Case:** An agreement between husband and wife to live separately is invalid as being opposed to Hindu Law [A.E. Thimmal Naidu v. Rajammal (1968), AIR Mad. 201]

3. **If it is Fraudulent**, i.e. the object of the contract is to cheat the other party by concealment of any material fact or otherwise.

**Example**: (i) A promises to pay Rs. 20,000 to B, if B would commit fraud on C. B agrees. B's agreeing to trick is unlawful consideration for A's promise to pay. Hence, the agreement is illegal and void.

**Example**: (ii) A, B and C enter into an agreement of partnership for the division profits earned by them from business as well as by illegal activities. The agreement is void, as its object is unlawful.

4. **If it Involves or Implies Injury to the Person or Property of Another**:

**Case**: An agreement which compels a debtor to do manual labor for the creditor as long as the debt is not paid in full is void [Ram Sarup vs Bansi Mandar (1915) 42 Cal. 742.]

**Example**: An agreement to put certain property to fire is illegitimate and void under this clause.

5. **If the court regards it as Immoral** — 'Immorality' depends upon the principles of morality existing at a particular time and as approved by courts. Such agreements whose object and consideration are immoral, is illegal and therefore, void. The scope of word 'immoral' here extends to the following:

**(i) Sexual Immorality e.g. Illicit Cohabitation or Concubinage or Prostitution**

**Example**: A agrees to let her daughter to B for concubinage. The agreement is void because it is immoral, though the letting may not be punishable under the Indian Penal Code. ( Illustration (k) to Section 23).

It is important to note that consideration paid for past cohabitation and promise to pay for future cohabitation both are immoral and thus, illegal and void. Past immoral consideration does not become right with the passage of time, it remains unlawful.

**(ii) Furtherance of Sexual Immorality**

**Case**: A prostitute was sued for the hire money of a carriage in which she used to go every evening in order to make a display of her beauty and thus to attract customers. The suit was dismissed on the ground that the plaintiff contributed towards the performance of an immoral and illegal act and hence he was liable to suffer. [Pearce v. Brooks (1866), L.R. 1 Ex. 213].

**Case**: A man who intentionally lets out his house for prostitution cannot recover the rent, it being an act for furtherance of sexual immorality [Choga Lal v. Piyasi (1909), All. 58]. The landlord may, however, recover if he did not know the purpose.

**(iii) Interference With the Marital Status**

**Case**: Money advanced to a married woman to enable her to procure divorce and to marry the plaintiff could not be recovered back as the object of the agreement was held immoral. [Bai Vijli v. Nansa Nagar (1885) 10 Bom. 152].

**Example**: An agreement for future separation between a husband and a wife is void ab initio, it being immoral in the eye of Law.

(iv) Such acts which are against Good Public Morals

**Case:** An agreement for future marriage, after the death of first wife is against good morals and hence would be void. [Wilson v. Cornley (1908), 1 KB. 729].

**Activity A:**

1. A, being already married to B, agrees with C, during B's lifetime that he will marry C in case B dies. Can C ask for the performance of the promise in the event of B's death?

## 6.3 Public Policy

Public Policy means any Principle of Law which no person can lawfully do that which can be harmful for public law or it can harm public. Anything which is beyond the good of public or against the public interest can be termed as 'opposed to Public Policy' and any agreement which is opposed to public policy is unlawful. Public Policy can be different at different places and its implication varies with the social structure of the country. Any agreement which promotes corruption, injustice, immorality is said to be 'opposed to public policy'. It is remarkable to know that the term 'immoral' and 'opposed to public policy' can be used interchangeably, as they both have somewhat related character. What is immoral is opposed to public policy and vice versa is also true.

Public policy is a vague concept. It has been described as an 'untrustworthy guide', 'unruly horse', etc., and therefore, the set of guidelines of public policy is generally governed by traditions. In Gherulal v. Mahadeodas [(1959), A.I.R. S.C.781] the Supreme Court observed, "…though the heads(of public policy) are not closed and though theoretically it may be permissible to evolve a new head under exceptional circumstances of a changing world, it is advisable in the interest of stability of society not to make any attempt to discover new heads in these days." The courts, thus, are generally disinclined to invent new heads of public policy.

### 6.4.1 Meaning of Public Interest

'Public Interest' implies common good or general social welfare. Public interest is to be differentiated from private interest. According to dictionary of sociology, a thing may be said to be in the public interest where it is or can be made to appear to be contributive to the general welfare rather than to special opportunity of a class, group or individual. Anything which is not injurious to public good shall be in public interest.

### 6.4.2 Agreement against Public Policy

Following are some cases, in which the courts have hold the agreements to be against public policy:

1. **Trading With the Enemy:** It is clear that trading with an alien enemy (i.e. a citizen of other country at war with the nation) is against public policy in so far as it tends to aid the economy of the enemy country. Such agreements are illegal, unless made with the special permission of Court.

2. **Agreements for Stifling Prosecution:** It is well known law if anyone commits a crime, he should be punished. Therefore, any agreement which restricts the prosecution of a criminal or a guilty, such agreement is opposed to public policy and is void for "no one can be allowed to make a trade of a felony." No court can give effect to an agreement which takes the administration of law from the hands of Judges and put it in the hands of general public."

   **Example**: A promises B to drop a prosecution which he has instituted against B for robbery and B promises to restore the value of the goods taken. The agreement is void, as its object is to stifle prosecution.

3. **Agreement of Maintenance and Champerty:** 'Maintenance' means an agreement in which a person promises to help another by money or otherwise to continue legal action in which he is not himself interested.

**'Champerty'** is an agreement whereby a person agrees to serve another in recovering property in consideration of the latter giving the former a share in the property so recovered.

In both the cases, financial and professional help is provided by the third party who is stranger to the contract but in case of champerty the party supporting demands a share or gain from the litigation in addition to his fees.

**Case**: An agreement by a client to pay his lawyer according to the result of the case was held opposed to public policy and void, it being against professional code of conduct. [Kothi Jairam v. Vishwanath A.I.R. (1925) Bom. 470].

**Case**: An agreement to pay 75 paisa in a rupee as a share of the financer from the property recovered, it was held that the agreement was irrational and void. However, the plaintiff was eligible for the expenses actually incurred by him with interest. [Nuthaki Venkataswami v. Katta Nagi Reddy A.I.R. (1962) A.P. 457].

In, England, all Maintenance and Champerty agreements are illegal and unenforceable. The Indian Law however, does not make them absolutely void because of the peculiar position of Indian litigants many of whom are too poor to afford expensive litigation.

4. **Marriage Brokerage Contracts:** In these agreements the consideration paid is for marriage. However, it does not affect the validity of marriage but the reward paid for consideration of marriage cannot be recovered and if not paid, a suit for recovery of the promised reward cannot be maintained because such agreement is illegal. But the money can be recovered when the marriage is not performed [Dharnidhar v. Kanji Sahay A.I.R. (1949) Pat. 250]. Similarly, the value of clothes or ornaments can also be recovered if marriage does not take place [Girdhari Singh v. Neeladhar Singh (1912) 16 I.C. 1004]. Further, an agreement of dowry is also illegal and cannot be enforced. But such an agreement is illegal in respect of payment only; the validity of marriage is not affected.

   Example : A promises to pay a sum of Rs. 1,100 to B, the father of the bridegroom, and actually pays Rs. 400. The marriage falls through, Rs. 400 can be recovered by A. (In case certain presents are given, they can be recovered).

5. **Traffic in Public Offices:** The agreements for sale or transfer of public offices and recommendations for appointment in public offices by taking bribes or money considerations are illegal as being opposed to public policy. Such agreements corrupt public services and the dignity attached to them. If enforced, then such agreements would lead to inefficiency and corruption in public life.

   **Example**: A promise by a person to obtain an employment for the other in any of the government services for some consideration (bribery) shall be void for the reason that traffic in public offices is forbidden by law and consideration as an offence.

   **Case:** A promise to pay money to a public servant to induce him to retire to pave the way for the appointment of the promisor is void [Saminatha v. Muthusami (1907), 30 Mad, 530].

6. **Agreements Creating Interest Opposed to Duty:** When a person enters into an agreement as a result of which he will have to pursue a cause which is against his public or professional duty, the agreement is void because it creates a conflict between his interest and responsibility as a professional and it is opposed to public policy.

**Example**: A agrees to pay B the Major in the army, Rs. 20,000 if he will give him the secrets of the army then, the object of the agreement is opposed to public policy and hence it is illegal and void.

**Example:** An agreement made by a solicitor with the third party that he will not produce the evidence favoring his client in the court is illegal, and opposed to public policy as well as the professional code of conduct of a solicitor. This agreement conflicts between the interest and duty of solicitor.

7. **Agreements Unduly Restraining Personal Liberty:** All agreements which unjustifiably hamper the personal freedom of an individual are held to be void and illegal as they are opposed to public policy.

   **Example:** A borrowed money from B, a money lender, and agreed that he would not, leave his job, borrow money, dispose of his property or change his residence without the written consent of A. It was held that the agreement was unduly restricting the personal independence of A.

8. **Agreements in Restraint of Parental Rights:** A father and in his absence the mother, is the legal guardian of his/her minor child. This right cannot be bartered away by any agreement. Therefore, an agreement, in which a father agreed to transfer custody or guardianship of his two minor children in favour of the lady, was held to be void, though the father agreed not to rescind the authority of the lady. [Giddu Narayanish vs Mrs. Annie Besant (1907), 38 Mad. 807]

**Activity B:**

1. In a suit by A against B for the recovery of Rs. 5000, A is in need of money. C agrees to provide funds to A in consideration of sharing one-forth of the money recovered from B. Decide the validity of the agreement between C and A.

**Activity C:**

1. X promises a sum of Rs. 500 to Y, who is an intended witness in a suit against X, in consideration of Y's absenting himself from the court on one pretext or the other. Y absents himself and demands payment from X who refuses to pay. Can Y recover Rs. 500 from X.

## 6.4 Agreements, The Consideration or Object of Which is Unlawful in Part

In section 23, we have studied that when object and consideration is lawful, the agreement is void. Section 24 describes the cases where only a part of consideration and object is unlawful as under :-

(i) if there are several objects but a single consideration, the agreement is void if any of the objects is unlawful. (Section 24)

(ii) If there is a single object but several consideration, the agreement is void if any of the consideration is unlawful. (Section 24)

There are some agreements which comprise of both legal and illegal aspect. Section 24, 57 and 58 of the Contract Act deals with such cases where object and consideration are partially unlawful. In such cases following rules are applicable:

1. When an agreement contains various promises to do legal as well as illegal things, and the legal part cannot be distinguished from the illegal part, the whole agreement is illegal and void.

**Example** : A promises the Incharge, on behalf of B, a legal manufacturer of dyes, and an smuggler of gold. B promises to pay him a salary of Rs. 20,000 a year. The agreement is void and unlawful

because a part of the object is legal and a part is illegal which are not separable i.e., the object of A and consideration of B are unlawful in part. (Section 24)

**2.** Where there is a mutual promise to do things legal and also other things illegal, and the legal part can be separated from the illegal part, i.e., there is a separate consideration for different promises, the legal part is a contract and the illegal part is a void agreement. (Section 57)

**Example:** A agrees to sell a house to B for Rs. 20,000 but if B uses it as a godown for smuggled articles, he shall pay Rs. 80,000 for it. The first set of reciprocal promises, namely, to sell the house and pay Rs. 20,000 for it, is a contract. But the second set has an unlawful object i.e., to use the house for smuggling is void and illegal.

It must be noted here that there are two distinct promises and separate consideration for each promise. The promises are two but they form a part of single contract.

**3.** In case of an alternative promise one branch of which is legal and the other illegal, the legal branch alone can be enforced (Section 58).

**Example:** A and B agree that A shall pay B Rs. 10,000 for which B shall afterwards deliver to A either wheat or smuggled opium. There is a valid contract to deliver wheat and a void contract as to opium.

**Activity D:**

1. A promises to B to pay Rs.5000 for arranging a housemaid to look after his kids. A arranges for the same. But unknown to A, B is involved in human trafficking. Can A recover the amount from B?

## 6.5 Effect of Illegal Agreements on Collateral Transactions

It has been discussed earlier that 'illegal agreements' and 'void agreements' are unenforceable. But an illegal agreement also affects the other transactions which are collateral to it and such transactions are also ruined by illegality. But if the parties of the collateral transaction have the knowledge of the illegal aspect of the principal agreement then the void agreement does not makes the collateral transaction illegal.

**Example**: A enters into an agreement of smuggling goods with B for which he borrows Rs. 3000 from C to pay it to B. If C knew the purpose for which A has borrowed money from him, he cannot recover the money lent because his loan was a collateral transaction to an illegal agreement. But if C did not know the purpose of money lent by him, he can recover it from A even though A had used the money for an illegal object.

## 6.6 Recovery of Benefits Given Under Illegal Agreements

Money paid or property transferred under an illegal agreement is written off except in following cases:

(i) Where the transferor is not equally blameworthy with the other party i.e., transferee.

(ii) Where the transferor remorse of making the agreement before any part of the illegal purpose is carried out.

(iii) Where the transferee was under a fiduciary duty to protect the plaintiff's interests and has harmed his duty by making the illegal agreement.

## 6.7 Provision of Restitution

Parties to an illegal agreement cannot get any assistance from a court of law, for, "no polluted hands shall touch the pure foundation of justice." Nothing can be recovered under an illegal agreement and if something

has been paid it cannot be recovered back, whether the illegal object has been carried out or has not been carried out, is irrelevant. The rule of law is that "no action is allowed on an illegal agreement" and "in case of equal guilt, the position of a defendant is better than that of the plaintiff."

**Example :** X promises Y to pay Rs. 10,000 if he murders Z. If Y commits the murder, he cannot recover the amount from X. If X has already paid the amount and Y fails in murdering Z, X cannot recover the amount back.

**Activity E:**

1. A pays Rs. 10,000 to B in consideration of his assaulting C. B did not performed his promise. Can A recover his money?

## 6.8 Summary

This chapter describes that an agreement is a contract if its object and consideration are lawful (Section 10). It also deals with those transactions which are void ab initio due to unlawful object and consideration.

Section 23 of the Act explains the circumstances in which both object and consideration are unlawful as: (a) it is forbidden by law, (b) it is of such a nature that, if permitted, it would defeat the provisions of law, (c) it is fraudulent, (d) it involves or implies injury to any person or property of another, (e) the court regards it as immoral or (f) opposed to public policy.

The chapter deals with the transactions which are against the public policy and which defeats the public interest. Such agreements are void and illegal as they are injurious to the welfare of the society.

There are also certain agreements a part of which is legal and the other part is illegal. Such agreements are also dealt with in this chapter. In such cases, either the object or the consideration is illegal. However, the validity of the contract in these cases depends on the set of promises that are legal or illegal.

At last the chapter describes the remedies available in case of unlawful object and consideration. The assistance they can get from the court and the recovery benefits, if any, available to the party are also constituted in this part of the chapter.

## 6.9 Self Assessment Questions

1. "An agreement is illegal and shall not be enforced if the court regards it as immoral." Comment.
2. What do you understand by an illegal agreement? What is the effect of illegal agreements on collateral transactions?
3. Examine the validity of agreements with consideration and object unlawful in part.
4. When is consideration illegal?
5. What are the contracts of uberrimae fidei? Give any four examples.
6. What do you understand by the 'Doctrine of Public Policy'?
7. Differentiate between champerty and maintenance.
8. Under which circumstances are object and consideration unlawful? Explain in brief.

## 6.10 Reference Books


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# Unit - 7 : Void Agreement and Contingent Contract

**Structure of Unit:**



## 7.0 Objectives

After studying this unit, you would be able to:

- Meaning and Definition of Void Agreement and Contingent Contract.
- Features of void agreement and provision of Indian Contract Act.
- Essential elements of valid contingent contracts.
- Rules as to enforce of contingent contracts

## 7.1 Introduction

Business Laws are essentially required, in present day modern business environment, when several business activities have turned to be of global nature elevating from the local level, these business and commercial activities are being operated, only through appropriate contracts and agreements. In general sense, the laws, by-laws. Legal provisions, legal procedures, legal systems, etc. framed by the government of any country, state and local body to systematize and regulate the human behaviour in social, economic and political fields, are called, law. An agreement is in simple term "every promise and every set of promises, forming the consideration for each other".

## 7.2 Meaning and Definition of Agreement

An agreement is a very wide term. "**All contracts are agreements but all agreements are not contracts"**

**AGREEMENT [SECTION 2(e)]:** An agreement means, "Every promise or every set of promises, forming consideration for each other".

**AGREEMENT = PROMISE(S) BY ONE PARTY (+) PROMISE(S) BY THE OTHER PARTY**

When we are going to classify the contract, on the basis of validity under that come Void agreement. All agreements which have been declared to be void by the law of the land are not contracts. They are born as agreements and die without fruits. Agreements without consideration or for unlawful object or consideration,

agreement in restraint of marriage, trade, legal proceedings, wagering agreements etc. are some of the agreements which have been expressly declared to be void under the Act. They can never be enforced.

**Illustration:** Mutual consent between Jai and Vijay for sale and purchase of Maruti car in Rs. 80,000 is called, agreement.

**Illustration:** Ram agrees to take dinner with Shyam on his Birthday. This is social agreement between Ram and Shyam.

**Activity A:**

1. Very contract is an agreement but every agreement is not a contract. This statement is -

   (a) Wrong (b) Correct (c) Correct subject to certain exceptions (d) Partially correct.

   **An Agreement is -**

   (a) Offer (b) Offer + Acceptance (c) Offer + Enforceability (d) Contract.

## 7.3 Meaning and Definition of Void Agreement

**"Void Agreement [Section 2(g)]:** An agreement not enforceable by law is said to be void". Hence, void agreement continues to be void, from the beginning to the end. Such agreement does not confer any right to any of the parties to it. The agreement, in such a case, is void-ab-initio (from the very beginning). Such an agreement does not result in a contract at all.

In other words, it does not create any obligation of the parties. All agreements with incompetent person and agreements which have been expressly declared to be void under this Act.

**Illustration:** A promises to superintend, on behalf of B, a legal manufacture of indigo, and an illegal traffic in other articles. B promises to pay to A a salary of 10,000 rupees a year. The agreement is void, the object of A's promise, and the consideration for B's promise, being in part unlawful.

As per Section 2(g) of The Indian Contract Act , 1872 "An agreement not enforceable by law is said to be void", and as per Section 2(j) of The Act "A Contract which ceases to be enforceable by law becomes void when it ceases to be enforceable".

Thus void contracts can be of the following two types:-

(i) Void ab initio:- Void-ab-initio i.e. unenforceable from the very beginning

(ii) Void due to the impossibility of its performance: - A contract can also be void due to the impossibility of its performance. E g: If a contract is formed between two parties A & B but during the performance of the contract the object of the contract becomes impossible to achieve (due to action by someone or something other than the contracting parties), then the contract cannot be enforced in the court of law and is thus void.

**Illustration:** Sudha says to Ram that if he promises not to marry, during his entire life period, she will give him Rs 20 lakh. Ram, who has attained majority, receives Rs. 20 lakhs, by promising not to marry. But, thereafter, he gets married with Sarika. However, Sudha can not impose any legal restriction on his marriage, because this is a void agreement.

**Effects:**

- **Void From Beginning:** The agreement is void from beginning. It does not give rise to legal obligation of either party.
- **No Restitution:** no restitution can be granted. Any consideration passed on by parties to each other, cannot be generally restored. However, the law courts may on equitable ground, grant restitution where one of the parties is minor and he/she has misrepresented or defrauded the other.

**Activity B:**

1. A void agreement is one which is:

   (a)Enforceable at the option of one party.

   (b) Enforceable at the option of both the parties.

   (c) Valid but not enforceable.

   (d) Not enforceable in a court of law.

## 7.4 Features of Void Agreement

- An agreement made by incompetent parties (Minor/Incapacitated Person) is void.
- Any agreement with a bilateral mistake is void.
- Agreements which have unlawful consideration is void.
- Agreement with a unlawful object is void.
- Agreements made without consideration is void.
- Agreement in restraint of marriage of any major person is void (absolute restriction).
- Agreement in restraint of trade is void.(reasonable reason)
- Agreement in restraint of legal proceedings is void.
- An agreement the terms of which are uncertain is void.
- An agreement by way of wager (betting/gambling) is void.
- An agreement contingent upon the happening of an impossible event is void.
- Agreement to do impossible acts is void.

## 7.5 Void Agreements as Per the Provisions of Indian Contract Act, 1872

1. **An Agreement Made by Incompetent Parties (Minor/Incapacitated Person) is Void:** According to Section 11 of Indian Contract Act, agreement by incompetent persons e.g. minors, persons of unsound mind and persons disqualified by law of the land is absolutely void from very beginning. A minor can enforce an agreement is which he is a beneficiary or promise. This right is subject to the condition that he must have performed his promise under this agreement. A minor cannot ratify his agreement even after attaining the age of majority because void agreement cannot be ratified. He can always plead minority even if he has falsely represented to be a major. It is so because rule of estoppels is not applicable to a minor. Incompetent parties are not personally liable for the payment of price of necessaries of life supplied to him or his legal dependents. However, a person who furnishes such supplies is entitled to be reimbursed from the property of the minor.

**Activity C:**

1. An agreement with a minor is:

   (a) Void (b) Void ab initio (c) Voidable (d) Valid

2. **Agreement Made Under Bilateral Mistake as to Material Fact is Void. (Section 20)**: Where both the parties to an agreement are under a mistake as to matter of fact essential to agreement, the agreement is void, for ex. 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. But 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. (Section 22)

3. **Agreements Which Have Unlawful Consideration and Objects are Void. (Section 23)**: The consideration or object of an agreement is unlawful if it is forbidden by law or of such a nature that if permitted, it would defeat the provisions of any law or is fraudulent or involves injury to the person or property of another or court regards it as immoral or opposed to public policy .

If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void. But where the legal part of an agreement is severable from the illegal, the former would be enforced.

**Illustration:** Promises to superintend, on behalf of B, a legal manufacture of indigo, and an illegal traffic in other articles. B promises to pay to A a salary of 10,000 rupees a year. The agreement is void, the object of A's promise, and the consideration for B's promise, being in part unlawful.

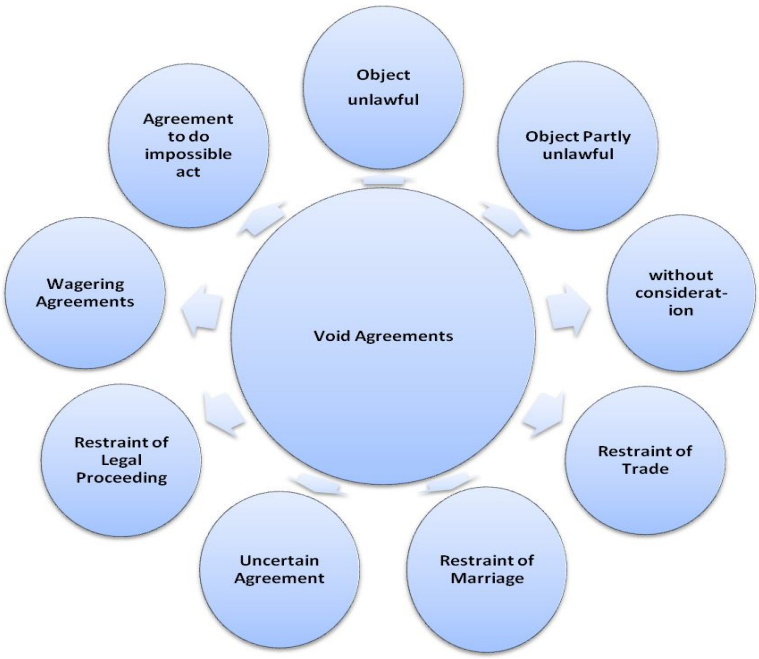


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**Figure 7.1**

4. **Agreements With Unlawful Consideration and Objectives, in Past (Section 24):** According to Section 24 of Indian Contract Act, if consideration and object of any agreement is unlawful, in past such agreement is absolutely, void. But if the lawful and unlawful consideration of the agreement may be separated, the past of the contract with lawful consideration and object, will be valid agreement and the past with unlawful consideration and object will be regarded, invalid and void.

   **Illustration:** Clark appointed, Allis, a married woman to perform domestic work and for adultery with Clark to satisfy his sexual needs, jobs at his place on Rs.50 per month.

The first objective of the agreement is lawful.

The second object of the agreement is unlawful.

5. **Agreements Made Without Consideration is Void.(Section 25) :-** Section 25 if Indian contract Act, some such agreements have been mentioned, which are lawful, even without consideration i.e. such agreements may be made enforceable by law. Hence, barring certain exceptions the agreements without consideration are absolutely void. An agreement without the consideration is void unless :-

(i) It is made on account of natural love and affection and it is expressed in writing and registered under the law for the time being in force.

(ii) It is a promise to compensate, a person who has already voluntarily done something for the promisor.

(iii) It is a promise to pay a time barred debt.

(iv) Agreements to agency.

(v) Agreements for donations and gifts.

(vi) Agreements to bailment, without charges.

6. **Agreement in Restraint of Marriage of Any Major Person is Void (Section 26):** Every agreement in restraint of the marriage of any person, other than a minor is void. It is the policy of the law to discourage agreements which restrains freedom of marriage. The restraint may be general or partial , that is to say , the party may be restrained from marrying at all , or from marrying for a fixed time or from marrying a particular person or class of persons , the agreement is void.

**Illustration:** Raj tells to Jai that if he does not marry with Kajal, he will pay 21,000 to Jai. This agreement made between Raj and Jai is void.

7. **An Agreement the Terms of Which are Uncertain is Void. (Section 29):** Agreements, the meaning of which is not certain, or capable of being made certain, are void. It is a necessary requirement that an agreement in order to be binding must be sufficiently definite to enable the court to give it a practical meaning. An agreement to agree in the future is void, for there is no certainty whether the parties will b able to agree.

Where only a part or a clause of the contract is uncertain , but the rest is capable of bearing a reasonably certain meaning , the contract will be regarded as binding. Similarly , if the agreement is totally silent as to price , it will be valid , for , in that case , Section 9 of the Sale of Goods Act,1930 will apply and reasonable price shall be payable.

**Illustration:** Surya & Company made agreement to sell 500 tons of oil to Chand & Company. It is not clear in this agreement what type of oil or of which brand of oil is to be sold. Hence, the agreement is void, due to uncertainty.

8. **An Agreement By Way of Wager (Betting/Gambling) is Void. (Section 30):** Agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made. The section does not define "Wager". But wager can be said as a promise to give money or money's worth upon the determination or ascertainment of an uncertain event.

Meaning: In general terms, wagering agreements are such agreements, according to which one party agrees to p[ay certain amount of money or any commodity, on the happening or non-happening of any uncertain event. Hence, in these agreements, one party is a winner and another is the looser.

This rule has two **exceptions** to it, which is as follows:

1. **Horse Race**: This section does not render void a subscription or contribution, or an agreement to subscribe or contribute, towards any plate, prize or sum of money of the value or amount of 500 Rs. Or upwards to the winner or winners of any horse races .

2. **Crossword Competitions & Lottery**: If skill plays a substantial part in the result and prizes are awarded according to the merits of the solution, the competition is not a lottery. Otherwise it is. Thus, literary competitions which involve the application of skill and in which an effort is made to select the best and most skilful competitor, are not wagers.

9. **Agreement in Restraint of Trade is Void. (Section 27):** Every agreement by which anyone is restrained from exercising a lawful profession, or trade or business of any kind, is to that extent void.

The words, to that extent is void, in section 27, means that if the agreement can be divided in two part, will be void, which restrains the trade. In such situation, the entire agreement will not be void. But, if the lawful and unlawful parts of the agreement can not be separated the entire agreement will be void.

There are two kinds of **exception** to the rule, those created by Statutes: -

**Sale of Goodwill:** The only exception mentioned in the proviso to section 27 is that relating to sale of goodwill. It states that "One who sells the goodwill of the business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer , or any person deriving the title to the goodwill from him , carries on a like business therein : Provided that such limits appear to the court reasonable , regard being had to the nature of the business.

**Partnership Act:** There are four provisions in the Partnership Act which validate agreements in restraint of trade. Section 11 enables partners during the continuance of the firm to restrict their mutual liberty by agreeing that none of them shall carry on any business other than that of the firm. Section 36 enables them to restrain an outgoing partner from carrying on a similar business within a specified period or within specific local limits. A similar agreement may be made by partners upon or I anticipation of dissolution...

**Exception to the Rule as Per Judicial Interpretation:**

**1.Exclusive Dealing Agreements :-** Business practice in vogue is that a producer or manufacturer likes to market his goods through a sole agent or distributor and the latter agrees in turn not to deal with the goods of any other manufacturer. In the case of Percept D. Mark (India) Pvt. Ltd. v Zaheer Khan [1], it was observed by the Court that Negative Covenant in a contract that the covenantee would not sell a similar product of a competitor does not necessarily in restraint of trade , it could also be in furtherance of the trade.

**2. Restraints Upon Employee: -** An agreement of service often contain negative covenants preventing the employee from working elsewhere during the period covered by the agreement. Trade Secrets, name of customers etc. are also the property of master and servant is not supposed to disclose it to anyone else. An agreement of this class does not falls within Section 27.

10. **An Agreement Contingent Upon the Happening of an Impossible Event is Void. (Section 36):** 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. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

**Illustration:** Anil and Sarita makes agreement that if Anil joins two parallel lines, Sarita will give Rs 5,100 to Anil. Since, this agreement is based on future impossible event, such agreements are void.

11. **Agreement to Do Impossible Acts is Void. (Section 56):** An agreement to do an act impossible in itself is void. A contract to do an act which, after the contract is made, becomes impossible, or , by reason of some event which the promisor could not prevent , unlawful , becomes void when the act becomes impossible or unlawful .

**Illustration:** Ram and Shyam make agreement between themselves that Ram will give Rs 50,000 to Shyam, if he makes his dead wife, alive. Such agreement is void, because it is impossible to make any dead person, alive. Hence, the agreement is , void.

12. **Agreement in Restraint of Legal Proceedings is Void. (Section 28):** Every agreements by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract or which extinguishes the rights of any party thereto, or discharges any party thereto from any liability, under or in respect of any contract, on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to that extent. Section 28 of the Act renders void two kinds of agreement, namely:

1. 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.

2. An agreement which limits the time within which the contract rights may be enforced.

Agreement in restraint of legal proceedings is void, this is also not an absolute rule and it has two exceptions to it which is as follows:

1. This section shall not render illegal a contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration, and that only the amount awarded in such arbitration shall be recoverable in respect of the dispute so referred.

2. Nor shall this section render illegal any contract in writing, by which two or more persons agree to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration.

But right to Appeal does not come within the purview of this section. A party to a suit may agree not to appeal against the decision.

**Activity C:**

1. X gave consent to sell his shop to Y, at such price, which Y can give. Such agreement will be:

(a) Void (b) Valid (c) Voidable (d) Contingent

## 7.6 Differences Between Void, Illegal and Voidable Agreement

**Void and Illegal Agreement: -** The Contract Act draws distinction between an agreement which is only void and the one which is unlawful or illegal. An illegal agreement is one which is forbidden by law; but a void agreement may not be forbidden, the law may merely say that if it is made, the courts will not enforce it. Thus every illegal contract is void but a void contract is not necessarily illegal.

The main difference between a void and illegal contract is that, a void contract is not punishable and its collateral transactions are not affected but on the contrary illegal contract is punishable and its collateral transactions are also void.

**Activity D:**

1. Agreement for insurance is:

   (a) Valid (b) Void (c) Invalid (d) Voidable

**Void and Voidable Agreement: -** A void contract is considered to be a legal contract that is invalid, even from the start of signing the contract. On the other hand, a voidable contract is also a legal contract which is declared invalid by one of the two parties, for certain legal reasons.

While a void contract becomes invalid at the time of its creation, a voidable contract only becomes invalid if it is cancelled by one of the two parties who are engaged in the contract.

In the case of a void contract, no performance is possible, whereas it is possible in a voidable contract. While a void contract is not valid at face value, a voidable contract is valid, but can be declared invalid at any time.

While a void contract is nonexistent and cannot be upheld by any law, a voidable contract is an existing contract, and is binding to at least one party involved in the contract.

## 7.7 Meaning and Definition of Contingent Contracts

Contracts, which absolutely depend upon happening of any event or chance, are contingent. These also have their significance, because in the sphere of contract business, several such occasions arise, when contingent agreements are required to be made to effectively operate the business activities, due to happening or non- happening of certain events.

**Meaning of contingent contract** in general such contract, which depends upon happening or not happening of any future event and such events collateral to such contract?

**Contingent Contract" Defined. According to Section 31-A** "Contingent Contract is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen".

Such types of contracts may be called, conditional contracts, also, because these are related to fulfillment or non-fulfillment of any condition.

From the analysis of above definition, it becomes clear that:

- On happening of any future event: Such contracts may be for doing or not doing something.
- On non-happening of any future event: Such contract may be for doing or not doing something.

**Illustration:** A contract to pay B Rs. 10,000 if B's house is burnt. This is a contingent contract.

So, in simple words, it may be defined as a conditional contract**.**

**Illustration:** United Insurance Company undertakes fire insurance of Rs. 20 lakhs of Kamal and Company. In case, Kamal and Company gets fire causing loss to it, the United Insurance Company will compensate the loss caused by fire to Kamal and Company. Lighting or non-lighting of fire depends upon contingency. Hence, such type of contract is called, contingent contracts.

**Activity F:**

1. XYZ makes promise to give Rs 3, 00,000 to ABC, if ABC plucks and brings ten stars from the sky. This is a contingent contact, as also, is.

## 7.8 Essential Elements of Valid Contingent Contracts

- There must be a valid contract.
- The performance of the contract must be conditional.
- The event must be collateral to the contract. For example incidental to the contact.
- There should be existence of a contingency; happening or non-happening of some event in future.
- Contingency must be uncertain.

**Activity F:**

1. Sonia promises to pay to Anil, certain amount of money, if a particular ship returns back within three months. However, this ship gets burnt, within three months. Give advice to Anil.

## 7.9 Rules as to Enforce of Contingent Contracts

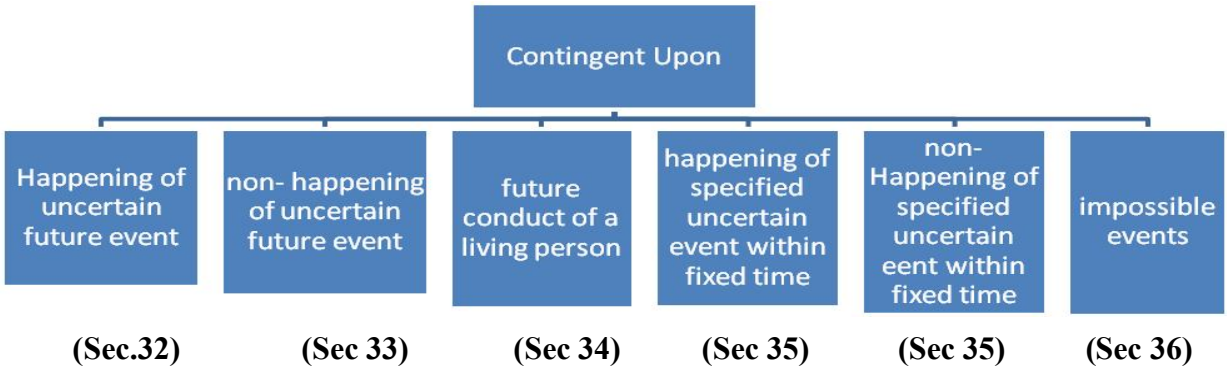


**Figure 7.2**

- **On Happening of the Event (Sec. 32):** According to Section 32 of Indian Contract Act, Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.

**Illustrations**

(a) 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 lifetime.

(b) A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse has been offered, refuses to buy him. The contract cannot be enforced by law unless and until C refuses to buy the horse.

(a) A contract to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.

- **Enforcement of Contracts Contingent on an Event Not Happening (Section 33):** Contingent contracts to do or not to do anything if an uncertain future event does not happen can be enforced when the happening of that event becomes impossible, and not before.

**Illustration:** 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.

- **When Event on Which Contract is Contingent to Be Deemed Impossible, if it is the Future Conduct of a Living Person (Section 34) :** When event on which contract is contingent to be deemed impossible, if it is the future conduct of a living person. If the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.

**Illustration:** A agrees to pay B a sum of money if B marries C. C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and that C may afterwards marry B

**Happening of an Uncertain Event Within Fixed Time (Section 35):** When contracts become void which are contingent on happening of specified event within fixed time. Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time become void if, at the expiration of the time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible. When contracts may be enforced which are contingent on specified event not happening within fixed time.-Contingent contracts to do or

not to do anything if a specified uncertain event does not happen within a fixed time may be enforced by law when the time fixed has expired and such event has not happened or, before the time fixed has expired, if it becomes certain that such event will not happen.

**Illustrations**

(a) 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.

(b) 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.

**Agreement Contingent on Impossible Events Void. (Section 36):** Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

**Illustrations:**

(a) A agrees to pay B 1,000 rupees if two straight lines should enclose a space. The agreement is void.

(b) A agrees to pay B 1,000 rupees if B will marry A's daughter C. C was dead at the time of the agreement. The agreement is void.

**Activity G**:

1. Salman makes contract to give Rs. 50,000 to Yash, on his marrying with Rekha. However, Rekha dies, without being married to Yash. Is the contract Valid and enforceable?

**Hints for Solution:** The contract is not valid, rather it is void. Hence, it cannot be enforced by law.

## 7.10 Summary

To secure the performance and enforceability of a contract, the contract should be a valid contract. As the void contracts can't be enforced.

A void contract, also known as a void agreement, is not actually a contract. Void Contract means that a contract does not exist at all. The law cannot enforce any legal obligation to either party especially the disappointed party because they are not entitled to any protective laws as far as contracts are concerned. An agreement to carry out an illegal act is an example of a void contract or void agreement. For example, a contract between drug dealers and buyers is a void contract simply because the terms of the contract are illegal. In such a case, neither party can go to court to enforce the contract.

A void contract cannot be enforced by law. Void contracts are different from voidable contracts, which are contracts that may be (but not necessarily will be) nullified.

An agreement to carry out an illegal act is an example of a void contract or void agreement. For example, a contract between drug dealers and buyers is a void contract simply because the terms of the contract are illegal. In such a case, neither party can go to court to enforce the contract. A void contract is void ab initio, i e from the beginning while a voidable contract can be voidable by one or all of the parties.

A contract can also be void due to the impossibility of its performance. **E g: If a contract is formed between two parties A & B but during the performance of the contract the object of the contract becomes impossible to achieve (due to action by someone or something other than the contracting parties), then the contract cannot be enforced in the court of law and is thus void**. A void contract can be one in which any of the prerequisites of a valid contract is/are absent for example if there is no contractual capacity, the contract can be deemed as void. In fact, void means that a contract does not exist at all. The law cannot enforce any legal obligation to either party especially the disappointed party because they are not entitled to any protective laws as far as contracts are concerned.

A void contract is a contract which ceases to be enforceable by law. A contract when originally entered into may be valid and binding on the parties. It may subsequently become void.

A contract may be unconditional or absolute on the one hand and conditional or contingent on the other. The absolute or unconditional contract is one without any reservations or conditions and is to be performed under any event. On the other hand, conditional or contingent contract is one in which a promise is conditional and the contract shall be performed only on the happening or not happening of some future uncertain event. The event must be collateral to the contract. The condition may be precedent or subsequent.

A collateral event is defined as one which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise. The event, therefore independent of the contract and does not form part of consideration to it.

The performance of such a contract depends on contingency and such contingency is uncertain. The test of determining whether the contract is contingent or not, is uncertainty. If contingency is certain it is not a contingent contract.

## 7.11 Key Terms

- **Agreement:** "Every promise and every set of promises forming the consideration for each other, is an agreement".

- **Contract:** "An agreement enforceable by law is a contract".
- **Void Agreement:** "An agreement not enforceable by law is said to be void".
- **Voidable Contract:** "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract".
- **Void Contract:** "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable".
- **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".
- **Illegal Agreement:** "An illegal agreement is one which is forbidden by law; but a void agreement may not be forbidden, the law may merely say that if it is made, the courts will not enforce it. Thus every illegal contract is void but a void contract is not necessarily illegal"

## 7.12 Self Assessment Questions

**Very Short Answer Type Questions:**

1. Agreement of Mistake is void. Why?
2. What is meant by Wagering Agreement?
3. What is Uncertain Agreement?
4. What is meant by Agreement of doing Impossible Acts?
5. Explain the characteristics of Void Agreement.
6. Define Contingent Contract.
7. Explain any four characteristics of contingent contract.
8. "A contract of guarantee is not a contingent Contract". Discuss.

**Short Answer Type Question:**

1. Explain the agreements in Restraint of Marriage.
2. Explain the difference between Insurance and a Wagering Agreement.
3. Contingent contract depends upon Contingency. Explain.
4. Explain difference between Contingent Contract and Wagering Agreement.

**Essay Type Questions:**

1. What is a Void Agreement? Briefly, state the various agreements that are expressly to be void by the Indian Contract Act.
2. "Section 24 to 30 deal with agreements expressly declared as void". State them and give suitable examples of each.
3. Explain with the help of suitable examples, the rules that apply in the case of Contingent Contracts.
4. Write a note on Contingent Contract.

5. Define Contingent Contract and explain its chief elements.

## 7.13 Reference Books


- Elements of Mercantile Law N.D.Kapoor
- Business Law Dr. R.L.Nolakha
- Business Law Dr. Ashok Sharma, Dr. Rashmi Arya & Dr. Anju Gupta

# Unit - 8 : Performance of a Contract

**Structure of Unit:**



## 8.0 Objectives

After studying this unit, you would be able to:

- Understand how obligations under a contract must be carried out by the parties.
- Be familiar with the various modes of performance.
- Be clear about the consequence of refusal of performance or refusal to accept performance, by either of the parties.
- Understand rights of joint promises, liabilities of joint promisors, and rules regarding appropriation of payments.

## 8.1 Introduction

The law relating to contracts in India is contained in Indian Contract Act, 1872. The Act was passed by British India and is based on the principles of English Common Law. It is applicable to the All the States of India except the State of Jammu & Kashmir. It determines the circumstances in which promise made by the parties to a contract shall be legally binding on them. All of us enter into a number of contracts everyday knowingly or unknowingly. Each contract creates some right and duties upon the contracting parties. Indian contract deals with the enforcement of these rights and duties upon the parties in India.

A Contract being an agreement enforceable by law, creates a legal obligation, which subsits until discharged. Performance of the promise or promises remaining to be performed is the principal and most usual mode of discharge.

Basic tenet of performance: In a contract where there are two parties, each one has to perform his part and demands the other to perform. This obligation is the primary tenet. The parties would be treated as having been absolved only under the provisions of any law or by the conduct of the other party.

## 8.2 Meaning of Performance

**Sec 37:-** That the parties to a contract **must either perform or offer to perform**, their respective promises unless such performance is **dispensed with or excused** under the provisions of **contract Act, or of any other law.**

**Performance: - Two types**

**1. Actual performance** – actually performed – liability of such a party comes to an end.

**2. Attempted performance or tender of performance refusal to accept offer of performance by promise [38]**

Promisor is not responsible for non performance and they can sue the promisee for breach of **contract** – nor he (promisor) thereby lose his rights under the contract.


**Figure 8.1**

## 8.3 Performance of Contract

Performance of contract means performing all the promises and fulfilling all the obligations required by the contract.

Illustration: Mohan makes promise to sell his Honda bike to Ram for Rs 40,000 and Ram makes promise to purchase it, in Rs 40,000. So, it is essential that both the parties fulfill their respective promise. Mohan should fulfill his promise, by giving the bike and Ram should fulfill her promise by taking the delivery of the bike and paying 40,000.

Thus, when both the parties fulfill their promise, it is said that they have fulfilled their promise and that the contract has been performed.

**For detailed study, we may divide performance of contract into following parts:**

i. Obligation of the parties regarding performance of the contract ( Sec 37-39)

ii. By whom contract should be performed. (Sec 40-45)

iii. Time and Place of performance. (Sec 46-50)

iv. Performance of reciprocal Promises (Sec 51-58)

**Activity A:**

1. A, B and C are under joint promise to pay Rs. 50,000 to Hari. C is unable to pay anything and B is compelled to pay the entire amount. What amount can B successfully recover from A?

## 8.4 Types of Performance

According to section 37, for performance of contract, the obligation of the parties is that they must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of Indian Contract Act, or of any other law.

Section 37 also makes it clear that a contract may be performed in either of the two ways:

- By performing promises, i.e actual performance.
- By offer to perform promise, i.e. by tender of performance.

**Actual Performance:** It takes place when both the parties to a contract perform their respective promises and nothing remains to be performed in future by them. In other words the contract may be actually performed,. When for performance of contract, the parties to the contract fulfill their respective obligations, within specified time and procedures, it is called actual performance.

**Illustration:** Anta buys a car from Soma for Rs one laks. Anta pays the price and Soma delivers the car. This is actual performance of the contract because nothing is executor in the contract.

**Tender of Performance (Sec 38):** Attempted performance is also a way of performance of contract. When a party makes offer before another party for fulfillment of his obligation, it is called tender of performance. This offer is in the form of request. Hence, it is also called offer of performance. Therefore, if the promise doesnot accept or fails to accept the tender, the promisor is not responsible for the non-performance of the promise and promisor stands discharged from his liabilities. Thus, when a valid tender of performance is not accepted by the promise, it is called an attempted performance of the contract.

**Illustration:** Jai makes contract to give his bike to Kajal, for Rs. 30,000. Jai makes the bike to deliver his bike to Kajal. This is called, attempted performance.

**Type of Tender:**

- **Tender of Goods and Services:** When a promisor offers to delivery of goods or service to the promise, it is said to be tender of goods or services, if promisee does not accept a valid tender,

  It has the following effects:

  (i) The promisor is not responsible for non – performance of the contract.

  (ii) The promisor is discharged from his obligation under the contract. Therefore, he need not offer again.

  (iii) He does not lose his right under the contract. Therefore, he can sue the promise.

- **Tender of Money:** Tender of money is an offer to make payment. In case a valid tender of money is not accepted, it will have the following effects:

  (i) The offeror is not discharged from his obligation to pay the amount.

  (ii) The offeror is discharged from his liability for payment of interest from the date of the tender of money.

## 8.5 Essentials of a Valid Tender

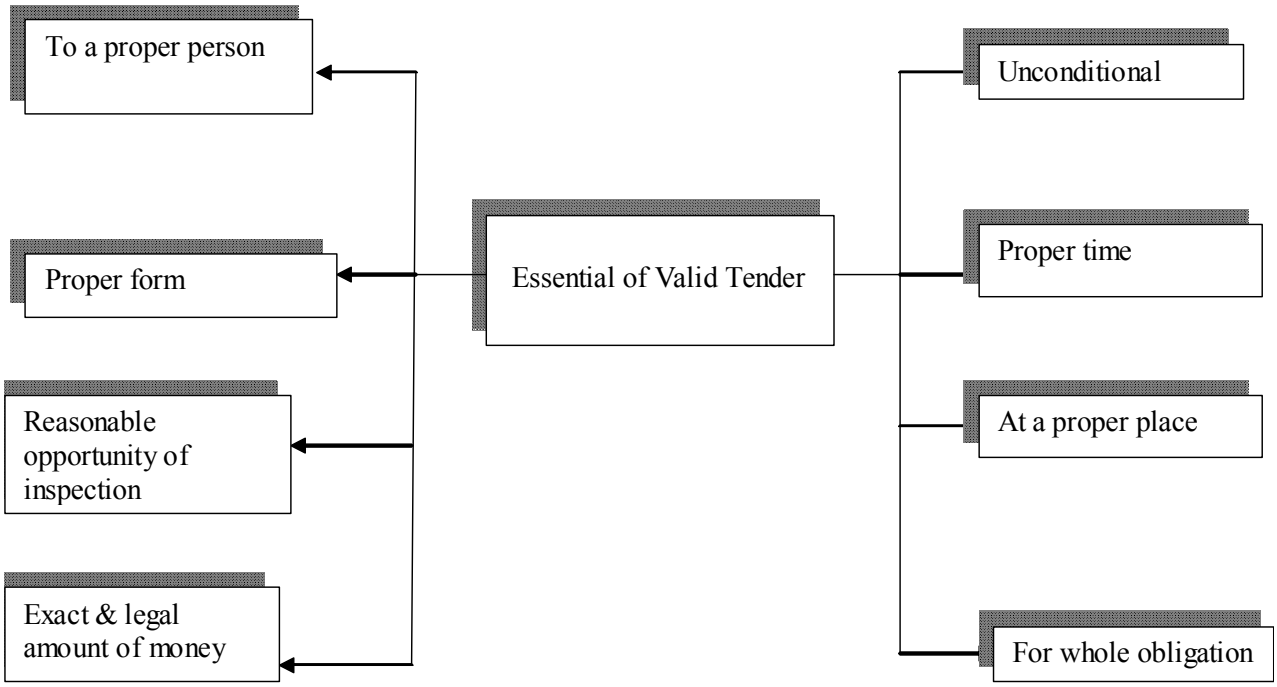


**Figure 8.2**

**Activity B:**

1. Who among the following can perform the contract?

(A) Promisor (B) Agent of the promisor

(C) Legal representative of the promisor (D) All these

Tender or offer of performance to be valid must satisfy the following conditions:-

**(i)** It must be unconditional

**Ex: -** 'X' offers to 'Y' the principal amount of the loan. This is not a valid tender since the whole amount of principal and interest is not offered.

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

**Ex: -** If the promisor wants to deliver the goods at 1 am. This is not a valid tender unless it was so agreed;

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

**Ex: -** Delivery of something to the promise by the promisor promise must have reasonable opportunity of inspection.

**(iv)** It must be for the whole obligation: - goods and amount.

**Ex: -** 'X' a debtor, offer's to pay 'Y' the debt due in installments and tenders the first installment. This is not a valid tender minor deviation – not invalid [Behari lal v ram gulam]

**(v)** It must be made to the promise or his duty authorized agent or proper person.

**Ex: -** It must be person who is willing to person his part of performance.

**(vi)** In case of payment of money, tender must be of the exact amount due and it must be in the legal tender.

(vii) In case of proper form tender must be made in the proper form. The form may be decided by the parties while making the contract.

**Ex: -** Parties may decide the goods must be in the packs of 100 grams. If the parties do not decide, the tender must be in the form usually adopted by the trade.

## 8.6 Rules Regarding Performance of Contract

- **Effect of Refusal of Party to Perform Promise Wholly (Sec 39).**

Where a party to a contract has refused to perform the promise he has made or had disabled himself from performing his promise in its entirely, the promise may put an end to the contract, unless his acquiescence in the continuance of the contract has been conveyed either by words or by deeds ( Sec 39). Thus from the above it could be seen that the following two rights accrue to the aggrieved party- (i) to terminate the contract and (ii) to indicate by words or conduct that he is interested in its continuance.

Promisor – Refuse – Promise – wholly
Promisee can put – can end of the contract or – he can continue the contract if he has given his consent either by words or – by conducts in its continuance.
**Result –** claim damages. [compensation]

**Ex:-** A, a singer enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B engages to pay her 100 rupees for each night's performance. On the sixth night A willfully absents herself from the theatre. B is at liberty to put an end to the contract.

If A, after his absence on sixth night, comes on the seventh night and starts singing with B's acquiescence, i.e. tacit assent. B cannot now put an end to it, but B is entitled to compensation for the damange sustained by him through A's failure to sing on the sixth night.

**Who Can Demand Performance?**

1. **Promisee –** stranger can't demand performance of the contract.

2. **Legal Representative** – legal representative can demand Exception performance.
   - contrary intention appears from the contract
   - Contract is of a personal nature.

3. **Third Party – Exception to "Stranger to a Contract"**

   - **Person by whom promise is to be performed Sec 40.**

Any of the following parties may be liable for the performance of the contract:

1. **Promisor:** If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor( Sec 40). This means contracts which involve the exercise of personal skill and diligence or which are founded on personal confidence between the parties must be performed by the promisor himself.

**Illustration:** Hari is a reputed goldsmith. He makes contract to make a golden necklace for Soha , in return of Rs 1,20,000. Here, the intention of the parties is that the promisor himself should fulfill the promise.

2. **Legal Representative- [does not involve personal skill and taste]**

3. **Third Party [Sec 41]:-** Acceptance of promise from the third party:-

   If the promisor accepts performance of a contract by a third party, he can't after wards enforce the performance against the promisor although the promisor had neither authorized not ratified the act of the third party.

   [In other meaning once the promise accepts the performe from a third person, he cannot compel the promisor the perform the contract again]

4. **Agent –** In case of those contracts, which do not require personal confidence and skill, the promisor or his representative may employ a competent person to perform the contract.

5. **Performance in Case of Joint Promisors**: When two or more persons have made a joint promise, then unless a contrary intention appears from the contract, all such persons must jointly with surviving promisors, fulfill the promise.

- **Performed by All the Joint Promisor [42]**
  - All the joint promisor – liable
  - Thus in India the liability of joint promisors is joint as well as several.
  - In England, however the liability of the joint promisors is only joint and not several and accordingly all the joint promisors must be sued jointly.
- **Liability of Joint Promisor [43]**
  - **Liability –** joint as well as several [unless express A + B + C 900 D. D may compel either A, B or C or any of two of them or all of them.
  - Where a joint promisor has been compelled to perform the whole promise, be may compel every other joint promisor to contribute equally with himself to the performance of the promise (unless a contrary intention appears from the contract).

    C – 9000 – D  A + B – C

    3000  3000

**3.** If any one of the joint promisors make default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares

A + B + C – 9000  (A) – Insolvent

B + C = 4500 + 4500 = 9000

- **Sec 43 Lays Down Three Rules as Regards Performance of Joint Promises:**

1. When two or more persons make a joint promise and there is no express agreement to the contrary, the promise may compel any one or more of the joint promisors to perform the whole of the promise. This means the liability of joint promisors is joint and several.

Eg: A, B, C jointly promises to pay D Rs 3000. D may compel either A or B or C to pay him Rs 3000.

2. When a joint promisor has been compelled to perform the whole of the promise, he may compel the other joint promisors to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract. (Sec 43).

   Eg: A,B and C are under a joint promise to pay D Rs 600, A is compelled to pay the whole amount D. He may recover Rs 200 each from B and C.

3. If any one of the joint promisors makes default in the contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. The same principle applies to the case of recovery of a loan by a creditor from the heirs who by operation of law become joint promisors after the death of the single promisor.

   Eg: Ram, Shyam and Sohan are under a joint promise to pay Sita Rs 30,000. Sohan is unable to pay anything and Ram is compelled to pay the whole. Ram is entitled to receive Rs 15000 from Shyam

- **Release of One Joint Promisor (Sec 44*)***: A release by the promise of any one of the joint promisors doesn not discharge the other joint promisors from liability. The released joint promisor also continues to be liable to the other joint promisors. In other words, where one of the joint promisors is released other joint promisors shall continue to be liable.

  [In English law if one joint promisor – discharge then all the joint promisors discharge]

- **Rights to Claim Performance of Joint [Devolution of Joint Rights] Sec 45:** When a person has made a promise to several persons, then unless a contrary intention appears from the contract, the right to claim performance rests, with all of them. When one of the promise dies, it rests with his legal representatives jointly with the surviving promises. When all the promises die, it rests with their legal representatives jointly.

  **1.** During their joint lives – all the joint promisors .

  **2.** After the death of any of them – The representative of such deceased promise jointly with the surging promise .With the representatives of all jointly.

  **Ex:-** 'A' in consideration of Rs 50,000 lent to him by 'B' and ' C' promises 'B' and 'C' jointly to replace them that sum with interest on a day specifies.

  'B' dies. The right to claim performance rests with 'B' representatives jointly with 'c' during 'C' life.

  And after 'C's death with the representatives of 'B' and 'C' jointly.

- **Time Place and Manner of Performance [46–50]**

  The parties are free to decide the time, place and manner of performance of a promise made under a contract. Usually, the contract is performed, within the usual business hours and proper place. In general, the place and date of the performance will be the same, as has been specified in the contract. However, rules governing the decision as to time, place and manner of performance of promise are given in Section 46-50 of this Act.

They are as under:

1. **No Time is Specified for Performance [Sec 46]**: Where, by the contract, a promisor is to perform his promise without application by the promise, and no time for performance is specified, the engagement , must be perfomed within a reasonable time.

   Time of performance is not specified + promisor agreed to perform without, a demand from the promise the performance must be made within a reasonable time. Reasonable time – in each particulars case – a **question of fact.**

2. **Time Specified But Hour Not Mentioned [47]:** Time of performance specified + promisor agreed to perform without application by the promisee

   Performance must perform on the day fixed during the usual business hours and at the place at which the promise ought to be performed.

**Illustration:** Anta promises to deliver goods at Banta's warehouse on the first January. On that day Anta brings the goods to Banta's warehouse but after the usual hour for closing it and they are not received. Anta has not performed his promise.

3. **Where Time is Fixed and Application to Be Made [48]**

   Proper place and within the usual hour of business

   Promisee to apply for performance

   **Illustration:** A makes promise to supply 500 tons of groundnut oil to B, on 10 December usual hours of business are 10 A.M to 8 P.M. Demand by B to make the delivery of the oil tins at 12 in the night is not proper. Hence, A can refuse for supply of oil tins.

4. **Performance of Promise Where no place is Specified and No Application is to be Made by the Promise [49]:** When a promise is to be performed without application by the promise, and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promise to appoint a reasonable place for the performance of the promise, and to perform it at such place.

   **Illustration:** A undertakes to deliver 1,000 quintals of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. **Performance in Manner or at Time Prescribed or Sanctioned by Promise [50]:** The performance of any promise may be made in any manner, or at any time which the promise prescribes or sanctions

   **Ex:** 'A' desires 'B' who owes him Rs 10,000 to send him a promissory note for Rs 10,000 by Post. The debt is discharged as soon as 'B' puts into the post a letter containing the promissory note duly addressed to 'A'.

- **Performance of reciprocal promises (Section 51-58):**

  **Reciprocal Promise: "**Promises which form the consideration or part of consideration for each other as called reciprocal promises" (Sec 2(f)). They are also known as mutual promises in which promises are exchanged for promises by the parties.

  Contract may be unilateral or bilateral. In unilateral contract, when a party fulfills its promise, only another party is required to fulfill its promises. However, in bilateral contracts, both the parties are left with the responsibility to fulfill their respective promises. This is called, reciprocal promises.

**Illustration:** Ram promises Mohan to pay a monthly salary of Rs. 5000 in return for his promise to work as a salesman in his shop. Here, Ram and Mohan are making reciprocal promises, Mohan is promising to work as salesman in consideration of a promise to pay a salary of Rs 5,000.

**Lord Mansfield in Jones V Barkley**, [(1781) Dough 659] classified reciprocal promises into three categories:

1. **Mutual and Independent:-** Such promises all to be performed by each party independently without waiting for the other party to perform his promise can't excuse himself on the ground of non-performance by the default party.


Y – Price – non Payment

X – Goods delivered

**Figure 8.3**

2. **Mutual and Dependent: -** Sue damage. The performance of promise by one party depended on the prior performance of the promise by other party.

[The party at fault becomes liable to pay compensation to the other party may sustain by the non performance of the contract – **[54]**

**Illustration:** X agrees with Y to sell certain goods for cash. Here, both X and Y are required to perform their promises simultaneously.

3. **Mutual and concurrent: -** when reciprocal promises are to be performed simultaneously a promisor need not perform his part unless the promise is ready and willing to perform **[51]**

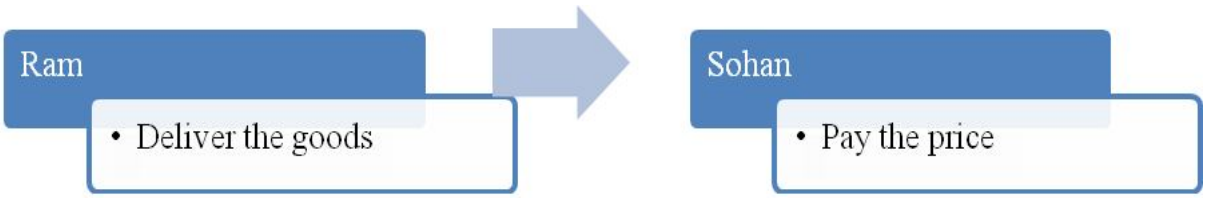


**Figure 8.4**

**Activity C:**

1. X promises Y that he will sell his car to Z for Rs.20, 000. However, due to certain unavoidable reasons, X is not in a position to perform the contract can Z bring a suit, against X.

**Rules as to Performance of Reciprocal Promises:** These are contained in Sections 51 to 54 and 57&58.

1. **Simultaneous Performance of Reciprocal Promises (Sec 51):** When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promise is ready and willing to perform his reciprocal promise.

**Illustration:** X and Y contract that X shall deliver car to Y at a price to be paid by installments, the first installment to be paid on delivery. X need not deliver, unless Y is ready and willing to pay the first installment on delivery and similarly. Y need not pay the first installment, unless X is ready and willing to deliver the goods on payment of the first installment.

2. **Order of Performance of Reciprocal Promises (Sec 52):** Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they must be performed in that order; and where the order is not expressly fixed by the contract, they must be performed in that order which the nature of the transaction requires.

   **Illustration:** A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

3. **Effect of One Party Preventing Another From Performing Promise (Sec 53):** When a contract contains reciprocal promises, it may happen that one party to the contract prevents the other from performing his promise. In such a case, the contract become voidable at the option of the party so prevented, and he is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract.

   **Illustration:** Nishi makes contract to paint a picture for Radha, for Rs.2, 000. Afterwards, Radha refuses to take the picture, even before its completion. In this situation, Nishi can claim compensation for the loss sustained, due to non-performance of the contract.

4. **Effect of Default as to Promise to Be Performed First (Sec 54):** Where the nature of reciprocal promises is such that one of them cannot be performed till the other party has performed his promise then if the latter fails to perform it, he cannot claim the performance of the promise from the other. In such a case, he must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

   **Illustration:** X promises Y to sell him one hundred bales of merchandise, to be delivered next day, and Y promises X to pay for them within a month. X does not deliver according to his promise. Y's promise to pay need not to performed, and X must make compensation.

5. **Reciprocal Promise to Do Things Legal and Also Other Thing Illegal (Sec 57):** Where persons reciprocally promise, firstly, to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal, the first set of promises is a contract, but the second is a void agreement.

   **Illustration:** A contract was made to appoint Satish as Manager in Gunn & Company, on monthly payment of Rs. 20,000. However, it was also stated in the contract that if Satish manages tax evasion and smuggling activities also, he will get monthly salary of Rs 22,000. In it, the first part is, the contract and second part is, void agreement.

6. **Alternative Promise, One Branch Being Illegal ( Section 58) :** In the case of an alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced by law and not the other one.

   **Illustration:** Nazir makes agreement to pay Rs. 2 lacs to Sonal and in return of it, Sonal will supply him either wheat or the smuggled opium. Here, the contract for supply of wheat is valid, but agreement for supply of smuggled opium is, void. Only the agreement for supplying the wheat is enforceable by law.

7. **Contract in Which Reciprocal Promises are Independent:** In various contracts, every party has the right to perform its respective promise, without waiting for performance by another party. However, any party claim to compensate loss sustained, due to non-performance of the contract, by another party.

   **Illustration:** X pays the price of rice to Y on 12 November, whereas Y will deliver the goods on 20 November. Both these are independent reciprocal promises and each party can claim, from each other the compensation of loss due to non- performance of the promise.

## 8.7 Appropriation of Payments

When a debtor, owing several distinct debt to any one person makes payment of these debts to the creditor, how the payment so received may be appropriated against which particular debt, is called appropriation of payments. In other words **Appropriation means application of payments;** the question of appropriation of payments arises when a debtor owes several debts to the same creditor and makes a payment that is not sufficient to discharge the whole in debtless.

**Illustration:** Gunn & Company owes to Shyam Ji & Sons, three debts of Rs. 10,000, Rs. 15,000 & Rs. 25,000. Determination, as to against which debt payment of Rs. 35,000 by Gunn & Company may be appropriated, whether, Rs. 10,000 for first loan, Rs. 15,000 for second loan and remaining Rs. 10,000 for the third debt or the entire amount for the third debtor, is called appropriation of payments.

The general rule regarding appropriation of payments is that when a debtor makes payments to the creditor, its appropriation may be made, only according to the wishes of the debtor, and not of the creditor. Sections 59 to 61 of the Act lay down following rules as to appropriation of payments which provide an answer to this question:

**Activity D:**

**1.** Appropriation of payments means:

(A) In which order payments against debts be made, when a debtor owes several debts to the same creditor.

(B) How payment of one single debt be made.

(C) How payment be made of debt

(D) None of these

**1. Appropriation as Per Express Instructions (Sec 59):** Every debtor who owes several debts to a creditor has a right to instruct his creditor to which particular debt, the payment is to be appropriated or adjusted. Therefore, where the debtor expressly states that the payment is to be applied to the discharge of a particular debt, the payment must be applied accordingly.

**Example:** A owes B three distinct debts of Rs.2, 000, 3,000 and 5,000. A sends Rs.5,000 and instructs B that the payment should be appropriated against the third debt. He is bound to appropriate the payment against the third debt only.

**Application of Payment Where Debt to Be Discharge is Not Indicated (Sec 59):** If section 60 is attracted, the creditor shall have the discretion to apply such payment for any lawful debt which is due to him from the person making the payment.

**Example:** A owes to B, among other debts; the sum of Rs.520. B writes to A and demands payment of this sum. A sends to B Rs.520. This payment is to be applied to the discharge of the debt of which B had demanded payment.

**2. Appropriation at the Discretion of the Creditor (Sec 60):** Sometimes, neither the debtor sends express instructions nor the circumstances imply as to which debt the payment is to be applied. In such a case, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor. It makes no difference whether the recovery of the debt is or is not barred by the law of limitations. The creditor cannot, however, apply the payment to a disputed or unlawful debt, but he may apply it to a debt which is barred by the law of limitation.

**Illustration:** In this regard, the case, Syndicate Bank V/s M/s West Bengal Cement Ltd, 1989 is worth mention.

In this case, the plaintiff bank had granted overdraft facility of Rs. Ten Lakhs to the respondent, for which the respondent had submitted a promissory note. Every third month, interest was booked on the amount of overdraft and it was added to the principal amount. The respondent paid several installments to the bank for paying this amount. But, did not intimate to the bank, for which debt, this payment was being made. The court, in its judgment held that the respondent cannot compel the bank to appropriate these installments, against the principal amount of the loan.

**3. Application of Payment Where Neither Party Appropriates (Sec 61):** The payment shall be applied in discharge of the debts in order of time whether they are or are not based by the limitation Act 1963, if the debt are of equal standing (i.e. payable on the same date) the payment shall be applied in discharge of each of these debt proportionately.

- First interest then principle
- Director of payer not receiver.
- Right primary of the debtor

**Whatever is paid, paid according to the intention of paying it**

**Example:** A owes B, the following debts:

| **Amount of the debt** | **Positions of the debt** |
|---|---|
| Rs.2, 000 | Time barred |
| Rs.1, 000 | Time barred |
| Rs.2, 000 | due on 10th June |
| Rs.3, 000 | due on 20th September |

A sends Rs. 1,500 in the month of June. He neither expressly intimates nor circumstance of the case imply as to which debt the amount is to be applied. Moreover, B also does not appropriate the payment at his own discretion. Therefore, the payment will be appropriated in order of time. However, here in this case two debts are of equal standing. The payment will, therefore, be appropriated in order of time but to all equal standing debts. In this case, Rs.1,500 will be appropriated towards the first two debts of equal standing proportionately, i.e. in the ratio of 2:1.

**4. In Case Interest is Also Due:** If interest is also due to be paid, along with debt, the amount paid will be appropriated first for payment of interest and the remaining amount, if any, will be appropriated against the principal amount.

**5. In Case of Current Account:** In case of current account, payment will be appropriated, in the order of time, according to the provision of Section 61 of Indian Contract Act. In other words, in current account, first debit entry is offset against first credit entry.

**6. In Case of Payment Received in Demand for Various Debts:** Sometimes, creditor's makes a demand for payment of various debts due from the debtor and the debtor pays a part of the amount due. In such a case, the payment will be appropriated to the each debt due proportionately.

**7. In case of Appropriation of Trust Fund:** Sometimes, a man keeps one bank account and makes a series of deposits and withdrawals in it of his own money as well as the money of which he is a trustee. Firstly the withdrawals are of his money and withdrawals thereafter are of the trust. Similarly, when money will be deposited in the account, it will be presumed that firstly, the deposit is of the trust and only thereafter the deposit is of the individual, irrespective of any order of depositing or withdrawing the money. This system is based on the principle of public interest, Justice and the security of the assets of the public institutions.

**Activity F:**

1. How payments are appropriated, in case of current account:

   (A) Appropriation of payments will be in order of time.

   (B) Last debt will be paid first.

   (C) Payment will not be made.

   (D) None of these

## 8.8 Summary

The parties to a contract must either perform or offer to perform their respective promises. Performance of a contract within the time and in the manner prescribed.

Attempted performance or tender is an offer of performance by the promisor in accordance with the terms of the contract. If the promises do not accept performance, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract. Thus a tender is equivalent to actual performance. The tender, in order to have this effect must be unconditional of the whole quantity contracted for at the proper time, place and in the manner specified; and, where these are not specified, it must be made in a reasonable manner. Tender may be of goods and money.

Reciprocal Promises are promises which form the consideration or part of the consideration for each other. There are some rules regarding performance of reciprocal promises like promise is ready and willing to perform his promise, the order in which reciprocal promises must be performed may be fixed by the contract and one cannot be performed or its performance cannot be claimed unless the other party performs his promise in the first place.

Contract must be performed by promisor, agent, and representative and by joint promisors.

Appropriation of Payments is that the debtor has, at the time of payment, right or choice of appropriations the payment; in default, the creditor has the right to appropriate; in default of either, the law will allow appropriation of debts in order of time.

## 8.9 Key Terms

- Performance of the contract means performing all the promises and fulfilling all the obligations by all the parties required by the contract.
- Actual performance takes place when both the parties to a contract perform their respective promises and nothing remains to be performed in future by them.
- Tender means tendering or offering performance of obligations under the contract to the other party of the contract.
- Attempted performance means when a valid tender is not accepted or rejected by the promise.
- Joint promise means, promise may compete any of the joint promisors to perform the contract unless otherwise agreed by the parties.
- Reciprocal promises are promises which form the consideration or part of the consideration for each other.
- Appropriation of payments means when a debtor, owing several debts to any one person makes payments of these debts to the creditor, how the payment so received may be appropriated against which particular debt.

## 8.10 Self Assessment Questions

**Very short Questions:**

1. What do you mean by Performance of Contract?
2. Who can demand Performance?
3. What is actual performance of contract?
4. What do you mean by reciprocal promise?
5. Explain, the proposal for performance should be unconditional?
6. The parties to a contract must perform their promises. Why?
7. What is the effect of non- performance of contract in specified time?
8. What is appropriation of payment?
9. What do you understand by in absence of any instruction for appropriation?
10. What is appropriation of payment according to circumstances?

**Short Questions:**

1. Appropriation is a right primarily of the debtor and for his benefit. Comment.
2. "Tender is attempted performance". Comment.
3. When joint promisors are liable under the Indian Contract Act?

   Is it required that parties to the contract must perform the contract personally?
4. How the devolution of joint liabilities takes place?
5. When the time is treated to be the essence of contract?

6. What are the effects of failure to accept a valid tender of goods and money?

**Essay Type Questions:**

1. State by whom contract should be performed? Is the promises bound to accept performance from persons other than the promisor?
2. What do you mean by performance of a contract? Under what circumstances a contract need not be performed?
3. What are the essential requisites of a valid tender of performance? What is the effect of refusal by promise to accept a valid tender of goods and money?
4. What do you understand by reciprocal promises? Discuss the provisions of the Indian Contract Act relating to the performance of reciprocal promise.
5. Describe the rules regarding appropriations of payments as stated in the Indian Contract Act.
6. Summaries the rules laid down in the Act as to the appropriation of payments made by debtor?

## 8.11 References


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# Unit - 9 : Discharge of a Contract

**Structure of Unit:**



## 9.0 Objectives

After completing this unit, you would be able to:

- Meaning of Discharge of a Contract
- Different Modes of Discharge of Contract
- By performance
- By agreement or mutual consent
- By operation of law
- By impossibility of performance
- By lapse of time
- By breach of contract

## 9.1 Introduction

A contract has always been considered a compact between two or more parties. Many contracts have been made and many have been broken. Law has always stood to help the innocent. Discharge is a general legal term describing the termination or completion of a contract. This word is much broader than 'performance', which denoted only one of several ways in which a contract is brought to an end. Discharge means termination or completion of a contract.

**Meaning of Discharge of Contract:** This is the last stage of contract. Discharge of contract means termination of the contractual relationship between the parties. A contract is said to be discharged when the right and liabilities created by such contracts come to an end. In some cases, other rights and obligations may arise as a result of discharge of contract, but they are altogether independent of original contract.

## 9.2 Different Modes of Discharge of Contract

Contract may be discharged or terminated by the following ways:

A contract may be discharged in various modes.

### 9.2.1 Discharge by Performance

Performance means doing of that which is required by a contract. When parties to a contract fulfill their obligations and promises arising under the contract with in the time and in the manner prescribed, discharge by performance takes place. Section 37 of Contract Act provides that the parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispenced with or excused under the provision of Indian Contract Act, or any other law.

Example: X contracts to sell his car to Y for Rs. 500,000, as soon as the car is delivered to Y and Y pays the agreed price for it, the contract comes to an end by performance.

Performance of a contract is the most obvious mode of its discharge. It may be:

**(a) Actual Performance:** A contract is said to be discharged by actual performance when the parties to the contract perform their promises according to the terms of the agreement. Most of the contracts are discharged by performance in this way.

**(b) Attempted Performance or Tender:** The tender or offer of performance has the same effect as performance. If a promisor tenders performance of his promise but the other party refuses to accept, the promisor stands discharges of his obligations and may sue for breach of contract if he so wishes. This is called discharge by tender.

To be valid, a tender must fulfill the following conditions:

(a) It must be unconditional,
(b) It must be made at a proper time and place.
(c) It must be made under circumstances enabling the other party to ascertain that the party by whom it is made is able and willing then and there to do the whole of what he is bound to do, by his promise.
(d) If the tender relates to delivery of goods, the promise must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.
(e) Tender may to one of several joint promises has the same effect as a tender to all of them.

**Activity A:**

1. What is the difference between actual and attempted performance of a contract?

### 9.2.2. Discharge by Agreement or Mutual Consent (Sections 62 and 63)

Since a contract is created by mutual consent, it can also be discharged by mutual consent. The methods stipulated under Section 62 and 63 for discharging a contract by mutual consent are:

**(a) Novation (Section 62):** Novation means the substitution of a new contract for the original contract. It may be novation by change in terms and conditions of the contract or novation by change in the parties to the contract.

In *Evans v Drummond*, two partners of a partnership firm executed a bill in the favour of third person. On the retirement of one of the partners, the other one took back the bill given and issued a new bill signed by him for the original amount, which was accepted. It was held that as the third person had relied on the sole security of the other partner; he had impliedly discharged the original partner from liability.

Example: X owes money to Y under a contract. It is agreed between X,Y and Z that Y shall hence

forth accept Z as his debtor instead of X. The old debt of X to Y is at an end and a new debt from X to Y has been contracted.

Following are certain essentials which need to be fulfilled in case of novation:

(1) It can take place only with the consent of all the parties, including the new one (s) if any.

(2) The contract which is replaced must be valid and enforceable by law.

(3) Novation must take place before the expiry of the time of the performance of the original contract.

Example: X who owes Y Rs. 5, 00,000 enters into an arrangement with him thereby giving Y a mortgage of his estate for Rs. 4, 00,000. This arrangement constitutes a new contract and terminates the old one.

**(b) Rescission (Section 62):** Rescission means cancellation of all or some of the terms of the contract, where parties mutually decide to cancel all or some of the terms of the contract, the obligation of the parties there under terminates.

Example: X and Y enter into a contract that X shall deliver certain goods to Y by the 19th of this month and Y shall pay the price on the 3rd of the next month. X does not supply the goods. Y may rescind the contract and need not pay the price. Rescission may be total or partial. Total rescission is the discharge of the contract as a whole and the partial rescission is the variation of the original contract by (i) rescinding some of the terms and conditions of the contract or (ii) substituting new terms and conditions for the contract which was rescind or (iii) by adding new terms without rescinding any of the terms of the existing contract.

While novation leads to dissolution of the contract and replacement of the same, rescission involves only dissolution of the original contract.

**(c) Alteration (Sec.62):** A contract is said to be altered, when the terms and conditions of a contract are changed. It can take place only with the consent of all the parties to the contract. However, where an alteration of written contract is made by one party to the contract without the consent of other and of a material fact so that the legal effect of instrument is changed, the contract is discharged and the other party is also discharged from his obligations under the contract.

It should be noted that, in alteration only some of terms and conditions of the contract are changed but no change in the parties to the contract, whereas in case of novation, a new contract replaces the old contract and the parties may also change.

Example: A promises to sell and deliver 100 bags of sugar on 1st January and B promises to pay for goods on mist February. Afterwards A and B mutually decide that the goods shall be delivered in five equal installments at C's godown. Here, original contract has been discharged and a new contract has come into effect.

**(d) Remission [Section 63]:** Remission means accepted by the promisee of a lesser fulfillment of the promise made may be acceptance of a lesser sum than what was contracted for in discharge of the whole of the debt. [Case: Hari Chand Madan Gopal Vs State of Punjab A.I.R.(1973)] S.C.381] According to section, 63 "promisee may dispense with or remit, wholly or in part, the performance of the promise made to him or may extend the time for such or may accept instead of it any satisfaction which he thinks fit".

The law applicable to remission is different in England and India. In English Law Remission must be supported by a fresh consideration. But in India, the promise may give up a part of his claim and such a promise is binding even if there is no consideration to support this promise.

Example: X owes Y Rs. 5,000. X pays to Y and Y accepts, in satisfaction of the whole debt, Rs. 2,000 paid at the time and place at which Rs. 5000 were payable. The whole debt is discharged.

**(e) Merger:** Merger takes place when an inferior right accruing to a party under a contract merges into a superior right accruing to the same party under the same or some other contract. In other words, where a party to a contract takes a better security than the one he has already have, it is known as merger. A merger to be valid, three conditions must be fulfilled, namely (a) the two securities must be different in their legal operation; one is inferior and the other superior. (b) the subject matter must be same and (c ) the parties must be same.

Example: A holds a property under a lease. He later buys the property. His right as a lessee merges into the rights as an owner.

**(f) Waiver:** Waiver deliberate abandonment or giving up of a right which a party is entitled to under a contract, where upon the other party to the contract is released from his obligation. Consideration is not necessary for waiver. Under English Law, Waiver is possible only by agreement under seal.

**Activity B:**

1. What do you mean by novation? Explain it with suitable example.
2. Distinguish between novation and recession with the help of example.

### 9.2.3 Discharge by Operation of Law

A contract may be discharged by the operation of law in any of the following ways:

**(a) Death:** Where a contract involving personal skills or ability and in other words that performance of the contract should be made by the promisor in person, the contract will be discharged on the death of the promisor.

**(b) Insolvency:** When a person is adjudged insolvent, he is discharged from all liabilities incurred prior to his adjudication.

**(c) Merger:** When the parties agree to include the previous inferior contract in a superior contract, it is known as merger. In such a case the inferior right as merger. In such a case the inferior right available to a party under an earlier contract will automatically disappear.

**(d) Unauthorised Alteration of Terms of Agreement:** Law does not permit any unauthorized alteration of terms of a written agreement. Where a party to a contract makes any material alteration in the contract without the consent of the other party, the other party can avoid it. A material alteration is one which changes, in a significant manner, the legal identity or character of the contract or the rights and liabilities of the parties to the contract. An alteration which is not material or which is made to carry out the common interest of the parties does not affect the validity of the contract.

**(e) Same Identity:** When the promisor becomes the promisee, the other parties are discharged.

Example: A draws a bill receivable on B who accepts the same. A endorses the bill in favour of B who is in turn endorses in favour of A. Here, A is both promisor and promisee and hence the other parties are discharged. This is to avoid circuity of action.

**Activity C:**

1. What are the various ways in which a contract may be discharged by the operation of law?

### 9.2.4 By Impossibility of Performance

A contract which is entered into to perform something that is clearly impossible is void. For example, X agrees with Y to discover treasure by magic. The agreement is void as per Section 56 which lays down the principle that an agreement to do an act impossible in itself is void. According to Sec. 56, impossibility of performance comes under the following categories:

**(a) Initial Impossibility:** Impossibility existing may be of following two types:

(i) **Known to the Parties:** This is also known as absolute impossibility. In this type of case, the agreement is void ab initio.

Example: A agrees to pay Rs. 10,000 and B promises to bring stars for A from heaven. The agreement is void on account of absolute impossibility.

(ii) **Unknown Impossibility:** Where both the parties of the contract are ignorant of the impossibility of performance at the time of making the contract, as in the case of destruction of the subject matter to the ignorance of both the parties, the contract is void on the ground of mutual mistake.

Illustration: A sold to B certain goods supposed to be on a voyage. The goods had ceased to exist due to the perils of the sea. Held, the contract was void. [Couturier V. Hastie, (1856) ]

**(b) Supervening or Subsequent Impossibility:** Impossibility which arises subsequent to the formation of a contract is called post contractual or supervening impossibility. In such a case, the contract becomes void when the act becomes impossible. The impossibility must be either legal or physical but not commercial.

Impossibility of performance of a contract; as a general rule, is no excuse for the non- performance of contract; but where this impossibility is caused by the conditions beyond the control of the parties; the parties are discharged from further performance of the obligation under the contract.

A contract may be discharged by supervening impossibility through any of the following cases:

**(i) Destruction of Subject Matter:** When the subject matter of a contract, is destroyed without any fault of the parties to the contract, the contract is discharged.

**Illustration (a) :** Caldwell let a music hall to Taylor for a series of concerts for certain days. The hall was accidently burnt down before the date of the first concert. So, the contract was void. [Taylor v. Caldwell, (1863) 3B & 826).

**Illustration (b)** A contracted to sell a specified quantity of potatoes to be grown on his farms. The crop largely failed. Held, the contract was discharged. [Howell v. Coupland, (1876) Q.B.D. 258].

**(ii) Non –existence of a State of Things:** When a contract is made between two parties on the basis of a continued existence or occurrence of a particular state of things. If there has been a change in the state of the things after the contract is entered into or state of things which ought to have occurred did not occur, then the contract is discharged.

**Illustration:** H hired a flat from K for two days for viewing a coronation procession of King Edward VII. K knew of H's purpose though the contract contained no reference to this. The procession was however abandoned because of the illness of the king. So, H was excused from paying the rent, as the existence of the procession was the basis of the contract. Its cancellation discharged the contract. [Krell v. Henry, (1903) 2 K.B. 740].

This kind of failure of the object of a contract is often called 'frustration of the contract'.

**(iii) Death or Personal Incapacity:** The contract is discharged on the death or incapacity or illness of a person if the performance of a contract depends on his personal skill or ability.

**Illustration:** An artist undertook to perform at a concert on a specific day. Due to his illness he was not able to sing on that day. It was held that the contract was discharged and the promisor was not liable to pay damages.

**(iv) Declaration of War:** The pending contract at the time of declaration of war are either suspended or declared as void by the government. If they are suspended, they may be performed after the war is over.

**Illustration:** X contract to take in cargo for Y at a foreign port. X's government afterwards declares war against the country in which the port is situated. The contract becomes void when the war is declared.

**(v) Change of Law:** The contract is discharged if the performance of the contract becomes impossible or unlawful due to change in law or the Government takes some power under some ordinance or special act like the Defence of India Act, after the formation of the contract.

**Examples:**

(a) D leased some land to B and agreed to erect a building on the adjoining land. After some time, the adjoining land was acquired under statutory powers by a railway company which built a railway station on it. Held, D was excused from performance of the contract. Baily v. De Crespigny, (1869).

(b) A sold to B a specific parcel of wheat in a warehouse. The wheat was requisitioned by the Government under statutory power, before the delivery was given. Held the contract was discharged. Shipton Anderson & Co., Re (1915).

**Impossibility of Performance – Not an Excuse:** "Impossibility of performance" is as a rule, not an excuse from performance, observed Scrutton, L.J. in RAlli Bros. V. Compania Naviera, etc. (1920) 2 K.B. 287. It means that when a person has promised to do something, he must perform it unless its performance becomes absolutely impossible. A contract is not discharged by the supervening impossibility in the following cases:

**(a) Difficulty of Performance:** A contract is not discharged simply on the ground that contract becomes difficult to perform due to unforeseen changes like more expensive or less profitable than that agreed at the time of its formation.

**Examples:**

(i) A sold a certain quantity of Finland timber to B to be supplied between July and September. Before any timber was supplied, war broke out in the month of August and transport was disorganized so that A could not bring any timber from Finland. Held, the difficulty in getting the

timber from Finland did not discharge A from performance. [Blackburn Bobbin Co. v. Allen & Sons (1918) 1 K.B. 540].

(ii) In Keshav Lal v Dewan Chand, one of the parties to the contract agreed to supply coal within a certain time. Due to Government's restrictions on transport of coal from collieries, there was a failure to make delivery in time. It was held that this could not be treated as a case of impossibility of performance. The coal was available in the open market and could be supplied from there.

**(b) Default of a Third Party:** A contract is not discharged if a contract could not be performed because of the default of a third party on whose work the promisor relied.

**Example:** In Ganga Sarans v Ram Saran, an agreement to sell certain goods as and when the same was received from the mills where orders were placed could not be carried out due to failure by the mills to supply the same.

**(c) Commercial Impossibility:** Commercial impossibility do not discharge the contract. A contract is not discharged on the ground that the higher profits are not realized or the necessary raw material is available at a higher price because of the outbreak of war, or there is a sudden depreciation of currency.

**Example:** A promised to send goods from Bombay to Antwrep in September. Before the goods were sent, war broke out and the shipping space was not available except at very high rates. The contract was not discharged. [ Karl Ettlinger v Chagandas & Co. , (1915) ]

**(d) Strike, Lock-outs and Civil Disturbances:** Strikes, lockouts and civil disturbance like riots do not terminate contracts unless there is a clause in the contract providing for non-performance in such-cases.

**Examples:**

**(i)** The unloading of ship was delayed beyond the date agreed with the ship owners owing to a strike of dock workers. It was held, that the ship owners were entitled to damages, the impossibility of performance being no excuse. [ Budget v. Binnington, (1891) 1 Q.B. 35].

**(ii)** A agreed to supply to B certain goods to be produced from Algeria. The goods could not be produced due to riots and disturbances in that country. It was held, that there was no excuse for non-performance of the contract. [Jacobs v Credit Lyonnais, (1814) 12 Q.B.D. 589].

**(E) Failure of One of the Objects:** Failure of one of the objects of the contract will not terminate the entire contract.

Example: X agreed to let a boat to H (i) to 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 canceled 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. [Herne Bay Steamboat Co. v. Hutton, (1903) 2K.B. 683).

**Effects of Supervening Impossibility:** There are three effects of supervening impossibility:

(a) A contract to do an act which, after the contract is made, becomes impossible or by reason of some event which the promisor could not present, unlawful, becomes void when the act becomes impossible or unlawful. [Sec. 56, para 2].

(b) Where one person has promised to do something which he knew or with reasonable diligence, might have known and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non performance of the promise. [Sec. 56. Para3].

(c) 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].

Example: A promises to sing for B at a contract for Rs. 5000 which are paid in advance. Due to his illness 'A' was not able to perform. Thus, A must refund to B Rs. 5000.

**Doctrine of Frustration:** In England the doctrine of frustration is the parallel concept of 'supervening impossibility'. It comes into play when the common object of a contract can no longer be achieved or when the contract, after it is made, become impossible of performance due to circumstances beyond control or contemplation of the parties. It is really an aspect or part of the law of the discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done and hence comes within the purview of Sec. 56. (Boothaliga Agencies v. U.T.C. Poriaswami, 1969)

In Satyabarta Ghose v. Sugnuram, 1954, the Supreme Court interpreted the term 'impossible' appearing in second paragraph of Section 56. The court observed that the word 'impossible' not been used here in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view; and if untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain; it can very well be said that the promisor found it impossible to do the act which he promised to do. In this case, A undertook to sell a plot of land to B but before the plot could be developed, war broke out and the land was temporarily requisitioned by the Government. A offered to return earnest money to B in cancellation of contract. B did not accept and sued A for specific performance. A pleaded discharge by frustration. The court held that Section 56 is not applicable on the ground that the requisition was of temporary nature and there was no time limit within which A was obliged to perform the contract. The impossibility was not of such a nature which would strike at the root of the contract.

**Activity D:**

1. "Impossibility of performance is, as a rule, not an excuse or non-performance of a contract". Discuss.
2. Describe 'Doctrine of Frustration'.

### 9.2.5 By Lapse of Time

Every contract must be performed either with in the period fixed or within a reasonable time of the contract. A contract is discharged if it is not performed or enforced within a specified period, called period of limitation. The Limitation Act, 1963 has prescribed the different periods for different contract; like period of limitation for exercising right to recover a debt in 3 years and to recover an immovable property is 12 years. The contractual parties cannot exercise their rights after the expiry of a period of limitation.

**Activity E:**

1. Explain the discharge of a contract by lapse of time.

### 9.2.6. Discharge by Breach of Contract

Breach of contract is often referred as the easiest way of discharging a contract. When any of the party does not fulfill the duties and liabilities prescribed by the contract, the contract is said to be breached. If the promisor has not performed his promise in accordance with the terms of the contract or where the performance is not excused by tender, mutual consent or impossibility or operation of law, then this amounts to breach of contract on the part of promisor. The effect of this is that the promise becomes entitled to certain remedies. A breach of contract may occur in the following two ways:

**(a)** **Actual Breach of Contract:** Actual breach of contract may take place in two instances:

**(i) At the Time When the Performance is Actually Due:** If any party to a contract refuses or fails to perform his part of the contract at the time fixed for performance, it is called actual breach of contract on due date of performance.

Example: A promises to supply certain goods to B on a particular date and he fails to do so on that date, he is said to have committed an actual breach of contract. In this contract, the breach has taken place when the performance is actually due.

**(ii)During the Performance:** If any party has performed a part of the contract and then refuses or fails to perform his obligation under it by express or implied act. It is called an actual breach of contract during the course of performance.

**(b)** **Anticipatory Breach of Contract:** Anticipatory breach of contract is stated to have occurred when the party declares his intention of not performing the contract or does some definite act which makes the performance impossible, before the performance is due. The other party, on such a breach being committed, has a right of action for damages. The party may either sue for breach of contract immediately after repudiation or wait till the actual date when the performance is due and then sue for breach.

In Hochester vs. De. La. Tour, A hired B in April to act as a courier commencing employment from 1st June, but wrote B in May repudiating the agreement, B sued A for breach of contract immediately after repudiation. A contended that there could not be breach of contract before June 1st. Held, B was immediately entitled to sue and need not wait till the 1st June for his right of action to accrue. (1853).

A hired B's ship to carry a cargo from Russia. Later on B repudiated the contract. A delayed taking action hoping B would change his mind before the performance date war broke out between Russia and Britain before the date of performance, frustrating the contract. Held, A lost his right to sue B for damages by his delay.

The above explanation clarifies that it occurs when a party to an executor contract declares his intention of not performing the contract before the performance is due. This may be by:

**(a) Express Repudiation:** In this, one party refuses to continue to perform his obligation by his word or act. The other party can treat the contract as no longer binding on him and sue for breach of contract.

Example: A undertakes to supply certain goods to B on 1st January. Before this date, he informs B on 1st January. Before this date, he informs B that he is not able to supply the goods. This is anticipatory breach of contract by express repudiation.

**(b) Implied Repudiation:** If a party makes by his own act the complete performance of the contract impossible, the effect is as if he has breached the contract.

**Example**: P, a British subject, was engaged by the Captain of a warship owned by the Japanese Government to act as a fireman. Subsequently, when the Japanese Government declared war with China, P was informed that the performance of the contract would bring him under the penalties of the Foreign Enlistment Act. He consequently left the ship. Held, he was entitled to recover the wages agreed upon . [ O' Neil v. Armstrong, (1895) 2 Q.B 418].

**Activity F:**

1. Explain Anticipatory Breach of Contract.

**Measure of Damages in Case of Anticipatory Breach of Contract:** If the contract is ended by the promisee at once, he can sue the promisor for damages. The measure of damages will be corresponding to the difference between the price prevailing on the date of breach and the contract price.

However, if the contract is kept operative till the date of performance of the contract, then the damages will be the difference between the price prevailing on the date of the performance and the contract price.

## 9.3 Summary

A contract is said to be discharged when the obligations created by it come to an end. Contracts may be discharged or terminated by following ways:

1. **Discharge by Performance:** Discharge of a contract by performance takes place when the parties to the contract fulfill their obligations arising under the contract with tin the time and the manner prescribed.
2. **Mutual Consent:** A contract rests on the agreement of the parties. As it is agreement which binds them, so by their agreement or consent they may be discharged. The discharge by consent may be express or implied. Discharge by implied consent takes place by- *(a)Novation:* Novation means the substitution of a new contract for the original contract. It may be novation by change in terms and conditions of the contract or novation by change in the parties to the contract. (b)*Rescission:*Rescission means cancellation of all or some of the terms of the contract, where parties mutually decide to cancel all or some of the terms of the contract, the obligation of the parties there under terminates. (c)*Alteration:* A contract is said to be altered, when the terms and conditions of a contract are changed. It can take place only with the consent of all the parties to the contract. However, where an alteration of written contract is made by one party to the contract without the consent of other and of a material fact so that the legal effect of instrument is changed, the contract is discharged and the other party is also discharged from his obligations under the contract. *(d)Remission:* Remission means accepted by the promisee of a lesser fulfillment of the promise made may be acceptance of a lesser sum than what was contracted for in discharge of the whole of the debt. (e) *Merger:* Merger takes place when an inferior right accruing to a party under a contract merges into a superior right accruing to the same party under the same or some other contract.
3. **Discharge by Operation of Law:** This includes discharge by (a) death (b) merger (c ) insolvency (d) unauthorized alteration of the terms of a written agreement and ( e) rights and liabilities becoming vested in the person.

4. **Discharge by Impossibility of Performance:** Section 56 states that a contract which is made impossible to perform due to subsequent changes is taken as void and hence discharged. This is known as 'supervening impossibility'. There are several cases where discharge by supervening impossibility is not permitted such as when the contract becomes difficult to perform or expectations of higher profits is not realized.

5. **Discharge by Lapse of Time:** Every contract must be performed either with in the period fixed or within a reasonable time of the contract. A contract is discharged if it is not performed or enforced within a specified period, called period of limitation.

6. **Discharge by Breach of Contract:** There are two types of breach of contracts- actual breach of contract and anticipatory breach of contract.

   Actual breach of contract may occur (a) at the time when the performance is due or (b) during the performance of the contract.

   Anticipatory breach of contract occurs when a party repudiates his liability or obligation under the contract before the time for performance arrives.

## 9.4 Self Assessment Questions

1. What are the various ways in which a contract may be discharged?
2. "Impossibility of performance is as a rule, not an excuse for non-performance of a contract. Discuss.
3. Distinguish between novation and alteration.
4. What is 'Supervening Impossibility'? What are its effects upon the contract?
5. What do you understand by 'anticipatory breach of contract'? State the rights of the promisee in such cases.

## 9.5 Practical Problems

1. A owned a room in a hotel which was hired to B for watching the coronation procession of King Edward II at £ 141 payable at the time of contract. £100 were paid in cash. But the before the balance was paid, the procession was cancelled. B filed a suit for the recovery of amount he had already paid. Decide.

   (Hint: B can recover £100 paid in cash and is not bound to pay the balance £ 41. But if A has incurred some expense in partial performance of the contract, he can claim compensation from B).

2. A contract between X and Y provided that "100 bales are to be given to you by me; I shall go on supplying goods of the Z mills to you soon as they are supplied to me by the said mill". Y failed to deliver the goods as agreed. In a suit for damages for non-delivery of goods, Y pleaded impossibility on the ground that the goods were not supplied to him by the mill. Advise X.

   (Hint: X is entitled to claim damages for no-delivery of goods by Y.).

3. X was due to perform a contract on 1st April 2000, but on 23rd March he repudiated his obligation, on 28th March the contract become illegal through a change in law. Y, the other party to the contract, filed a suit for breach of contract on 29th March, 2000. Discuss.

   (Hint: Y has no remedy against X as, when Y files a suit for breach of contract, the contract has

already been discharged by supervening illegality.)

4. A contracted to make and deliver 500 chairs to B by December. A strike of A's employees prevented him from fulfilling his contract. In a suit by B for breach of contract, A claimed that the contract was terminated by impossibility of performance. Was his defence justified?

   (Hint: No. Further A is liable to B in damages).

## 9.6 Reference Books


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# Unit - 10 : Remedies for Breach of Contract

**Structure of Unit:**



## 10.0 Objectives

After completing this unit, you would be able to:

- Remedies For Breach Of Contract
- Rescission of contract
- Suit for damages
- Suit for specific performance
- Suit for injunction
- Suit upon quantum meruit

## 10.1 Introduction

A contract, being a fountainhead of a correlative set of rights and obligations for the parties, would be of no value, if there were no remedies to enforce the rights arising there under. A legal remedy is a court order that seeks to uphold a person's rights or to redress a breach of the law. When one party breaches a contract, the other party may ask a court to provide a remedy for the breach. The court may order the breaching party to pay money to the non-breaching party. This remedy is called damages. Alternatively, the court may order the party to do what they promised to do under a contract.

## 10.2 Remedies for Breach of Contract

When someone breaches a contract, the other party is no longer obligated to keep its end of the bargain. From there, that party may proceed in various ways:

(i) the other party may urge the breaching party to consider the breach
(ii) if it is a contract with a merchant, the other party may get help from consumer's associations
(iii) the other party may bring the breaching party to an agency for alternative dispute resolution.
(iv) The other party may sue for damages or
(v) The other party may sue for other remedies.

A contract gives rise to correlative rights and obligations. A right accruing to a party under a contract would be of no value, if there were no remedy to enforce that right in a law court in the event of its infringement or

breach of contract. A remedy is the course of action which are available to an aggrieved party (i.e. the party not at default) for the enforcement of a right under a contract.

The following are the remedies provided in the Act:

(i) The Indian Contract Act, 1872 specifies the remedies available to the parties for the breach of contract in Section 73, 74 and 75;

(ii) Section 73 deals with the compensation for loss or damages caused by breach of contract,

(iii) Section 74 deals with the compensation of breach of contract where penalty is stipulated for; and

(iv) Section 75 provides that the party who is rightfully rescinding the contract is entitled to compensation.

The various remedies available to an aggrieved party are as follows:

**Activity A:**

1. Define remedy for breach of contract.

### 10.2.1 Rescission of Contract

Rescission means a right not to perform obligation. In case of breach of contract, the promise may put an end to the contract. In such a case, the aggrieved party is discharged from all the obligations under the contract and is entitled to claim compensation for the damage which he has sustained because of the non-performance of the contract.

Under Section 65, when a party treats the contract as rescinded, he makes himself liable to restore any benefits he has received under the contract to the party from whom such benefits were received. Under Section 75 of the Indian Contract Act, if a person rightfully rescinds a contract he is entitled to a compensation for any damage which he has sustained through the non-fulfillment of the contract by the other party. Section 64 deals with consequences of rescission of voidable contracts, i.e. where there is flaw in the consent of one party to the contract. Under this Section, when a person at whose option a contract is voidable rescinds, the other party there to need not perform any promise there in contained in which he is the promisor. The party rescinding avoidable contract shall, if he has received any benefit there under, from another party to such contract, restore such benefit so far as may be, to the person from whom it was received.

Example: A promises B to supply one bag of wheat to pay the price on receipt of the bag. A does not deliver the bag of wheat on the appointed day, B need not pay the price. A person who rightfully rescinds the contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract.

**Activity B:**

1. Describe the recession of contract with a suitable example.

### 10.2.1 Suit for Damages

Damages are monthly compensation allowed for loss suffered by the aggrieved party due to breach of a contract. The object of awarding damages is not to punish the party at fault but to make good the financial loss suffered by the aggrieved party due to the breach of contract. The foundation of the claim for damages is based on the judgment in English case of Hadelty v. Baxendale. The facts of the case were: There was a breakdown of a shaft in A's mill. He delivered the shaft to B, a common carrier to be taken to a manufacturer to copy and a make a new one. A did not make know to B that delay would result in loss of profits. By some

neglect on the part of B, the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill was idle for a longer period than it would otherwise have been. It was held, B was not liable for the loss of profits during the period of delay as the circumstances communicated to B did not show that the delay in the delivery of the shaft would entail loss of profits to the mill. In the course of judgment it was observed that where two parties 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, on 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 contains three important rules: (i) compensation as general damages will be awarded only for those losses that directly and naturally result from the breach of contract. (ii) Compensation for losses indirectly caused by breach may be paid as special damages if the party in breach had knowledge that such losses would also follow from such act of breach. (iii) The aggrieved party is required to take up reasonable steps to keep his losses to the minimum. It is the duty of the injured party to the minimum loss. (British Westinghouse & Co. V Underground Electric etc. Co. (1915) A.C. 673). He cannot claim to be compensated by the party in default for loss which is really not due to the breach but due to his own neglect to minimize loss which is really not due to the.

Thus, the loss or damages caused to the aggrieved party must be such that either (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to rise. Such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of contract.

**Different types of Damages:**

Following are the various types of damages:

**(i) Ordinary Damages**: These damages are those which naturally arise in the usual course of things from such breach. These damages can be recovered if the following two conditions are fulfilled:

**(a)** The aggrieved party must suffer by breach of contract, and

**(b)** The damages must be proximate (i.e direct) consequences of the breach of contract and not the indirect consequences.

The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retains the goods after the breach; he cannot recover from the buyer any further loss if the market falls, nor is he liable to have the damages reduced if the market rises.

In a contract for the sale of goods, the measure of damages on the breach of a contract is the difference between the contract price and the market price of such goods on the date of the breach. If, however, the thing contracted for is not available in the market, the price of the nearest and best available substitute may be taken into account in calculating damages. In the absence of market at the place of delivery, market price of the nearest place or prevailing in the controlling market is to be considered. Where the subject matter of a contract is goods specially made to order and which are not marketable, the price of the goods is measure of damages 9Punjab State Electricity Board v. A.T.T.T. Agencies, 1986)

**Example (a)** A contracts to pay a sum of money to B on a specified day. B in the consequence of not receiving the money on that day, is unable to pay his debts, and is totally ruined. A is not liable to make good to B anything except the principal sum; he contracted to pay together with interest upto the day of payment.

(b) A contracts with B to repair his house. B neglects or refuses to point out to A the places in which his house requires repair. A is excused for the non-performance of the contract, if it is caused by such neglect or refusal. General Damages are usually assessed based on the actual loss suffered. The main aim of providing general damages is to compensate the aggrieved party and not to punish the party which is at fault.

(c) On 1st December, A contracted to sell and deliver 50 tons of rice @ 8000 per ton to B on 1st January. On 20th December B, afterwards, contracted to sell those goods to C at Rs. 10,000 per ton. A failed to deliver goods on 1st January. Whern the price of rice war Rs. 9500 per ton. B is entitled to recover Rs. 75,000 [ i.e. (Rs. 9500-Rs. 8000) X 50 ]. B is entitled to recover Rs. 100,000 as profit which would have arisen to Y from the sale to C because the profit is the indirect consequence of the breach of contract.

**(c) Special Damages:** Special damages are those which may reasonably be supported to have been in the contemplation of both parties as the probable result of the breach of a contract. These damages can be recovered if the special circumstances which would result in a special loss in case of breach of contract are communicated to the promisor.

In Madras Railway Company v. Govind Ram, a tailor delivered a sewing machine and some cloth to a railway company to be sent to a place, where he expected to earn profits in view of the forthcoming festival. The railway company was unaware of this fact and the goods reached the destination after the festival. The tailor could not claim damages for loss of profits.

In Simpson V London and N.W. Rail Co., Simpson entrusted a few specimens of his goods to an agent of a railway company in order that the same be delivered at New Castle where an agricultural show was to be held. The consignment note clearly specified that the delivery was to be made in time. Because of default by railway company, the samples arrived late for the show. It was, held that Simpson could claim damages for loss of profits.

X's mill was stopped due to the breakdown of a shaft. He delivered the shaft to Y, a common carrier, to be taken to a manufacturer to copy it and make a new one. X did not make known to Y that delay would result in a loss of profits. By some neglect on the part of Y the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill remained idle for a longer time than otherwise would have been, had the shaft been delivered in time. Held, Y was not liable for loss of profits during the period of delay as the circumstances communicated to Y did not show that a delay in the delivery of the shaft would entail loss of profits to the mill. [Hadely v Baxendale].

**(d) Vindictive Damages or Exemplary Damages:** These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff. These have been awarded:

(i) for breach of a promise to marry;

(ii) for wrongful dishonor of a cheque by a banker possessing adequate funds of the customer.

In a breach of promise to marry, the amount of the damages will depend upon the extent of injury to the party's feelings. In the banker's case, the smaller the amount of the cheque dishonoured, larger will be damages as the credit of the customer would be injured in a far greater measure, if a cheque for a small amount is wrongfully dishonoured.

**(e) Nominal Damages:** Nominal damages are those which are awarded where there is only technical violation of a legal right but the aggrieved party has not in fact suffered any loss because of breach of contract. These damages are called nominal because they are very small, say, one rupee. The court may or may not award these nominal damages.

**Example:** A firm consisting of four partners employed B for a period of two years. After six months two partners retired, the business being carried on by the other two. B declined to be employed under the continuing partners. Held, he was only entitled to nominal damages as he had suffered no loss. [Brace V Calder, (185) 2 Q.B. 253].

**(a) Liquidated Damages and Penalty:** Sometimes parties themselves at the time of entering into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of 'liquidated damages' or it may be by way of 'Penalty'.

(i) Liquidated Damages if the specified sum represents a fair and genuine pre-estimate of the damages likely to result due to breach,

(ii) Penalty if the specified sum is disproportionate to the damages likely to result due to breach.

In Indian Law, there is no such difference between liquidated damages and penalty. Section 74 provides for 'reasonable compensation' upon the stipulated amount whether it is by way of liquidated damages or penalty.

Example: A borrows Rs. 500 from B and promises to pay Rs. 1000 if he fails to repay Rs. 500 on the stipulated date. On A's failure to repay on the given date, B is entitled to recover from A such compensation, not exceeding Rs. 1000 as the court may consider reasonable. (Union of India V Raman Iron Foundry, 1974).

**Activity C**

1. What are the various types of damages?

2. State the principles on which damages are assessed for breach of contract.

3. Examine critically the rule in *Hadely V. Baxendale*, and indicate to what extent the said rule is applicable in India.

### 10.2.3 Suit for Specific Performance

Specific performance means doing exactly what had been intended to be done by the parties in the contract. Specific performance is the remedy granted by the courts to the aggrieved parties in equity only in cases where it is absolutely essential to grant it. Specific performance is a rare remedy at law, but sometimes available where the subject of the breached contract is special and irreplaceable. The court orders the guilty party to actually perform his obligation only when monetary compensation will not be an adequate remedy. Specific remedies direct the party in default to do or to bear for the very thing, which he is bound to do or make declaration of rights, which the nature of the case may require.

Specific performance is usually granted in contracts connected with e.g. purchase of a particular plot or house, or to take debentures in a company. In case of a sale of goods, it will only be granted if the goods are unique and cannot be purchased in the market, e.g. a particular race horse, or one of the special value to the party suing by reason of personal or family association, e.g. heirloom.

Specific performance will not be ordered:

(a) where monetary compensation in an adequate remedy,

(b) where the court cannot supervise the execution of the contract, e.g. a building contract.

(c) where the contract is for personal service; and

(d) where one of the parties is a minor,

(e) where the contract is made by a company in excess of its powers as laid down in its Memorandum of Association.

**Example:** X agreed to sell an old painting to Y for Rs. 50,000. Subsequently, X refused to sell the painting. Here, Y may file a suit against X for the specific performance of the contract.

**Activity F**

1. In which circumstances specific performance will not be orderd?

### 10.2.4 Suit for Injunction

An injunction is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of a negative term of the contract, (i.e. where he is doing something which he promises not to do so), the Court may in its discretion issue an order to the defendant restraining him from doing what he promised not to do, Injunction may be prohibitory or mandatory. In prohibitory it is the order of the court restraining the commission of a wrongful act whereas in mandatory, it restrains continuance of wrongful commission.

Example: W agreed to sing at L's theater only during the contract period. During the contract period, W made contact with Z to sing at another theater and refused to perform the contract with L. It was held that W could be restrained by injunction from singing for Z [Lumely V Wagner (1852)].

**Activity G**

1. Describe suit for injunction.

### 10.2.5 Suit upon Quantum Meruit

Quantum Meruit means simply 'as much as earned'. A right to sue on a quantum meruit arises where a contract, partly performed by one party has become discharged by the breach of the contract by the other party. The right is founded not on the original contract which is discharged or is void but on an implied promise by the other party to pay for what has been done.

Even where there is no contract per se, there may because of action where a person gives value to another under circumstances that would cause the first person (if reasonable) to believe the second person will give fair market value for what he received. Quantum meruit offers recovery of 'whatever the thing was worth' or right to claim the compensation for the work already done.

Quantum meruit recovery is appropriate where the parties, by their conduct, have formed a relationship which is contractual in nature, even though an enforceable contract may never have been created. For example, where a written agreement between an owner and a contractor is deemed unenforceable as a result of technical deficiency or because it violets public policy, the contractor may still recover in quantum meruit. As a general rule, one should not look to recover in quantum meruit unless there have been direct dealings between the parties that create the basis for the contract to be 'implied in fact'.

C an owner of a magazine engaged P to write a book to be published by installments in his magazine. After a few installments were published, the publication of the magazine was stopped. It was held that P could claim payment for the part already published. [Planche v Calburn].

## 10.3 Summary

- Breach of contract is often referred to as the easiest way of discharging a contract. When either of the parties does not fulfill the duties and liabilities prescribed by the contract, the contract is said to be breached.

- In case of breach of a contract, the injured party has one or more of the following remedies:

  **(i) Recession:** When there is breach of contract by a party, the injured party may sue to treat the contract as rescined. He is also absolved of all his obligations under the contract.

  **(ii) Damages:** Damages are monetary compensation awarded to the injured party by court for the loss or injury suffered by him. Sec. 73 of the Indian Contract Act which deals with 'compensation for loss or damage caused by breach of contract' is based on the judgment in the case of Hadely v. Baxendale. Damages may be of following types:

  **(a) Ordinary Damages**: These damages are those which naturally arise in the usual course of things from such breach.

  **(b) Special Damages:** Special damages are those which may reasonably be supported to have been in the contemplation of both parties as the probable result of the breach of a contract.

  **(c) Vindictive Damages or Exemplary Damages:** These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff.

  **(d) Nominal Damages:** Nominal damages are those which are awarded where there is only technical violation of a legal right but the aggrieved party has not in fact suffered any loss because of breach of contract.

  **(e) Liquidated Damages and Penalty:** Sometimes parties themselves at the time of entering into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of 'liquidated damages' or it may be by way of 'Penalty'.

  **(iii) Specific performance:** In certain cases the Court may direct the party in breach of a contract to actually carry out the promise, exactly according to the terms of the contract. This is called specific performance of the contract.

  **(iv) Injunction:** It is a mode of securing the specific performance of the negative terms of a contract.

  **(v) Quantum meruit:** Quantum Meruit means simply 'as much as earned'. A right to sue on a quantum meruit arises where a contract, partly performed by one party has become discharged by the breach of the contract by the other party. The right is founded not on the original contract which is discharged or is void but on an implied promise by the other party to pay for what has been done.

## 10.4 Practical Problems

1. A contracts to repair B's house in a certain manner and receives payment in advance. A repairs the house but not according to the contract. B incurs Rs. 1000 to remedy the defect. Can B recover Rs. 1000 from A.

   (Hint: Yes because he suffered the loss which naturally arose in the usual course of things from such breach. [Sec. 73].

2. B was an employee in a partnership firm for a certain period. The firm was dissolved before the expiry of the period for which he was employed. Two of the partners continued the business and offered to employ B. B refused. What damages can he claim from the firm for breach of contract?

(Hint: B is entitled to claim only nominal damages as the continuing partners were willing to employ B who refused to accept the employment. [ Brace V. Calder].

3. X bought a horse with a warranty that it was free from any disease. The horse was suffering from a disease at the time of sale. As result, not only that horse died but infected other horses also. Discuss the legal position.

   (Hint: X is entitled to claim not only the loss occasioned by the death of the horse bought but the entire loss which occurred as a result of the breach of warranty. (Section 73) [Smith v. Green].

4. A commenced a periodical publication called, the 'Armour' and engaged B to write a volume on ancient armour for it. For this B was to receive the sum of Rs. 10,000 on completion of the work. When he had completed a part, but not the whole of his volume, A abandoned the publication. B sued A for recovery of the amount contracted for. Advise B.

   (Hint: B is entitled to claim compensation on quantum meriut).

## 10.5 Self Assessment Questions

1. What remedies are available to an aggrieved party on the breach of a contract?
2. "if the contract is broken, the law will endeavor, so far as money can do it, to palce the injured party in the same position as if the contact had been performed". Comment
3. State the circumstances under which a party is not entitled to specific performance.
4. When does a claim on quantum meruit arise?
5. State the importance of time in case of actual breach of a contract.
6. Explain and illustrate the circumstances in which a party may maintain action for breach of a contract without having himself fully performed his own obligation under the contract.

## 10.6 Reference Books


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- Tulsian, P.C., Business Law, Tata Mc Graw Hill Publishing Company Limited, New Delhi
- Mathew, M.J., Commercial Law RBSA Publishers, Jaipiur.
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# Unit - 11 : The Sale of Goods Act, 1930 (I)

**Structure of Unit:**



## 11.0 Objectives

After Completing this unit you will be able to:

- Explain the meaning and essential elements of Contact of Sale,
- Identify and understand the distinction between Terms involved in Sale of Goods Act,
- Discuss the meaning and types of 'Goods' ,
- Identify and discuss the rules applicable to effects of destruction of goods,
- Understand the meaning and different modes of fixing price in a contract of sale,
- Get acquainted with information about different provisions related to stipulation of time, delivery of goods as well as conditions and warranties in Contract of Sale.

## 11.1 Introduction

For all commercial contracts the sale of goods is most common and knowledge of its principles is important for all the segment of community. The law of sale of goods is based on the basic principles of mercantile law which defines the duties and obligations of buyer and seller. The law relating to sales of goods or movables in India is contained in the Sale of Goods Act, 1930, contains sixty six Sections, which came into force on 1st July 19360, and extends to the whole of India except the State of Jammu and Kashmir. The Sale of Goods Act, 1930 was amended as Sale of Goods (Amendment) Act, 1963, where few minor amendments were made. Prior to Sales of Goods Act, 1930, the sale of goods was contained in chapter VII of the Indian Contract Act, 1872. The general provisions of the Indian Contract Act, 1872 are continue to be applicable to the contract of sale of goods provided they are not inconsistent with the express provisions of Sale of Goods Act )Sec. 3). Thus, for example, the provisions of the Contract Act relating to offer made and its acceptance, the capacity of the parties, free consent, consideration, agreements in restraint of trade, wagering agreements, and measure of damages and legality of object are continue to be applicable to a contract of Sale of Goods. But to some extent the definition of consideration stands modified that in a contract of Sale of Goods consideration must be way of price i.e. only money consideration [Sec. 2 (10) and 4].

The transaction is not a contract of sale when there is no money consideration. It is, therefore, necessary that goods should be exchanged for money. If goods are exchanged against goods, the transaction would not become a sale and considered as barter. However, if consideration for the transfer of property consists partly of payment of money and partly of goods, the transaction becomes sale.

## 11.2 Meaning and Essential Elements of Contract of Sale

**Meaning:** If not inconsistent with the express provisions of the Sale of Goods Act, 1930, the general rules applicable to contract are also applicable to contract of Sale of Goods as sales of goods takes into account basic principles of contract and makes a clear introspection of the commercial transaction.

### 11.2.1 Definition

The contract of sale of goods is defined under section 4 (1) of the Indian Sale of Goods Act, 1930 as follows.

"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".

A contract of sale includes (a) transfer of property (sale) or (b) agreement to transfer the property (Agreement to sell). 'Sale' includes transfer of ownership rights to the buyer immediately on making contract where as an 'agreement to sell includes transfer of ownership rights to be passed on some future time or subject to some conditions thereafter to be fulfilled. For example, Manu sells his bike to Kanu for Rs. 10000/-. It is a sale because the ownership of the bike has been transferred to Kanu by Manu for a price. When Manu agrees with Kanu to sell his bike after two months for Rs. 10000/-. It is an agreement to sale as the bike is to be transferred on a future date.

As per Section 4 (2) a contract of sale may be absolute or conditional. When the property in goods passes immediately to the buyer and nothing remaining to be done by seller is called 'absolute contract of sale'. For example, goods sold on counter of a shop. When the property in goods does not pass to the buyer immediately, but it passes on the fulfillment of certain conditions is called 'conditional' contract of sale'.

### 11.2.2 Essential Elements of Contract of Sale:

In a contract of sale there should be presence of following elements.

(a) A contract
(b) Existence of two Persons/Parties (buyer and seller)
(c) Goods
(d) Price
(e) Transfer or agree to transfer property (ownership)
(f) From seller to buyer

The essential elements / characteristics of a contract of sale can be summarized as follows.

**(a) A Contract:** All the essential elements of a valid contract must be present as contract of sales means an agreement enforceable by law. No particular form is necessary for making of a contract of sale. According to sec 5 (1), contract of sale may provide for immediate delivery of the goods, or immediate payment of the price or both, or the delivery or payment by installments or that the delivery or payment or both shall be postponed.

According to section 5 (2), a contract of the sale may be made in writing or by words of mouth or partly in writing and partly by words of mouth or may be implied from the conduct of the parties. However, if any particular mode is prescribed by any law, then the contract of sale must be made in that particular mode.

Contract of sale is called a Consensual, Bilateral and Commutative contract. Consensual means there must be free consent, some consideration and the object must be lawful. Where ownership

rights are given to another person without any consideration, then it is not a contract of sale but a transaction of gift.

Bilateral means the property in goods has to pass from one person to another (the seller and buyer). Commutative contract means the things given or act done by one party are regarded as equivalent of money paid or act done by the others.

**(b) Existence of Two Persons/ Parties (Buyer/ Seller):** To constitute a valid contract of sale, there must be two parties i.e. there must be a transfer or agreement to transfer the property in goods by the seller to the buyer. The seller and buyer must be two different persons, as a person cannot buy his own goods.

For example, students in a college run mess on a cooperative basis and take meals is not considered as contract as students are undivided joint owners of the meals they are consuming. Another example of State of Gujarat vs. Ramlal & co. (1965). On dissolution of a partnership firm, the surplus assets including some goods were divided among the partners. The Sales Tax officer wanted to tax this transaction but the court observed that the partners were themselves the joint owners of the goods and they could not be both sellers and buyers. Moreover no money considerations was promised or paid by any partner to the firm as consideration for the goods allotted to him.

**(c) Goods:** The subject matter of contract of sale should obviously be goods as in contract of sale property in the goods is required to be transferred by the seller. According to section 2 (7), "goods mans every kind of movable property, other than actionable claims, immovable property and money (current money), and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale". The trade marks, Copy rights, Patent rights, Gas, water, Electricity are all regarded as goods.

Actionable claims and money are excluded from goods. Actionable claims are defined by the Transfer of Property Act and such claims can be enforced only by a legal action or suit. For example, a debt can be enforced by legal action. Money (current money) is also excluded from the definition of goods because it constitutes the price for exchange of goods sold, and is governed by a different principles, law due to its being currency. Old coins which are not current money can be treated as goods.

**(d) Price:** According to section 2 (10) price is the money consideration for sale of goods. The transaction is called barter and not a sale of goods if goods are sold or exchanged for other goods. The basic requirement is that the goods must be sold for a definite sum of money. But if goods are sold partly for goods and partly for money, the contract is called sale. For example, when a person returned his old bike and ask dealer to deliver new bike by paying the difference in cash would also be called as sale.

**(e) Transfer or Agree to Transfer Property (Ownership):** Property means ownership which seller must either transfer or agree to transfer to the buyer. Section 2 (11) of the Act defines property to mean general property in goods, and not merely, a special property. The property in goods means the general property i.e. all ownership right of the goods. Where a person owns goods, he is said to have general property in goods. In the case where person has special property, he is merely Pawnee of the goods. For example, if Ganesh who owns certain goods pledges them to Dinesh, here Ganesh has general property in the goods, where as Dinesh (the Pawnee) has special property or interest in the goods to the extent of the amount of advance Dinesh has made to the Ganesh. The pledge

(Dinesh) gets a special property in the goods pledged, but the general property remains with the pledger (Ganesh).

**(f) From Seller to Buyer:** The another important aspect is that the transfer of property I goods should be from the seller to the buyer. There will be no contract if the seller has no right to sell the goods, and then the buyer is not entitled to receive the same.

**Activity A:**

1. Make an attempt to relate the essential elements of the sale of goods with real life experience and some actual decision of court of law.

## 11.3 Distinction between Important Terms of Contract of Sale

The distinction between following will help to understand the terms involved in Sale of Goods Act.

### 11.3.1 Distinction between Sale and Agreement to Sale

The following are the main areas of distinction between Sale and Agreement to Sale which helps in determining the rights and liabilities of the parties to the contract.

**(a) Nature of Contract of Sale of Goods:** A sale is a executed contract coupled with conveyance of the property in goods, the seller sells the goods to the buyer for a price. An agreement to sale is an executor contract, the seller agrees to sell and buyer agrees to buy the goods for a price.

**(b) Transfer of Property:** In a sale the property in goods passes from the seller to the buyer immediately with contract and it implies immediate conveyance of property so that the seller is no more the owner of goods sold. For example, Manoj buy a motor bike from Vinod and the price to be paid after a week. Manoj becomes owner though the price is yet to be paid. Payment of prices and delivery of goods are no conditions for transferring the property in the goods.

In agreement to sell the transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled. The conveyance of property takes later and the seller continues to be the owner until the agreement to sell becomes a sale either by the fulfillment of some condition or by the expiry of time. For example, if Manoj agrees to buy a motor bike from Vinod, on the condition that if it is approved by Manoj's father, then it is considered as an agreement to sell. Property in goods will pass from Vinod only when Manoj's father approved the motor bike.

**(c) Risk of Loss:** In contract of Sale risk follows ownership because the ownership of property passes immediately to the buyer with sale. In sale loss fall on the buyer in case the goods gets destroyed even though the goods may never have come in to his possession because the property in the goods has already passed to the buyer. For example, Mr. X has purchased Television form a shop and agrees to take delivery on next day and in the same night there was a fire in shop and television gets destroyed. Here Mr. X shall be liable to pay the price and bare loss since the ownership had already passed to him.

In case of agreement to sell the loss in case of goods gets destroyed, loss has to be borne by the seller as the ownership in the goods is yet to pass from seller to buyer even though the goods are in possession of the buyer.

**(d) Consequence of the Breach:** In case of contract of sale, if the buyer refuses to pay price for the goods or accept the goods, the seller can sue for the price, even though the goods are still in his possession.

In an agreement to sell, if buyer does not follow his promise, then the seller can only sue for damages and not for the price, even though the goods are in the possession of the buyer. In contract of sale, if the seller refuses to deliver the goods, the buyer can sue for the recovery of the goods as well as for damages.

In an agreement to sell, if the seller refuses to sell the goods the buyer's right is to only claim damages and cannot compel the seller to deliver the goods to him.

**(e) Right to Resale:** In case of sale, the property is with the buyer and therefore the seller cannot resale the goods. If seller does so, the original buyer can recover the goods even from third party i.e. subsequent buyer and third party does not acquire a title to the goods. In case of agreement to sell, the property in the goods remains with the seller and he can dispose of the goods as he likes although seller may thereby commit a breach of his contract. The original buyer can sue the seller only for the breach of contract, and subsequent buyer gets a title of the goods.

**(f) Insolvency of the Buyer:** In case of sale, where ownership is passed to buyer and if the buyer becomes an insolvent before paying the price for the goods, the seller in the absence of lien over goods, will have to deliver the goods to the official receiver or assignee and the seller have the right to claim only ratable dividend for the price of the goods. In case of agreement to sell if the buyer who is declared insolvent and has not paid the price, the seller may refuse to deliver the goods to official receiver or assignee as ownership has not passed to the buyer.

**(g) Insolvency of the Seller:** In case of sale, if the seller is adjudged an insolvent after the payment of price for the goods by the buyer, the buyer will be entitled to claim the identical goods from the official receiver. In case of an agreement to sell, if the buyer has already paid the price and the seller is adjudged insolvent, the buyer can only claim a ratable dividend (as if he is creditor) and not the goods as property in goods is still rests with seller.

**(h) General and Particular Property Right:** A sale creates right against whole world (jus in ram), as the buyer becomes the absolute owner of the goods and can use the same in any manner he likes. An agreement to sell creates right against an individual (jus in personam). Here the buyer's right are only personal and he can sue the seller for damages for breach but not for the recovery of the goods by specific performance.

**(i) Performance:** In case of sale the performance of contract of sale is absolute and without any condition. In case of agreement to sell the performance is conditional and is made in future.

### 11.3.2 Distinction between Sale and Hire-Purchase Agreement

In a modern commercial transaction the contract of hire- purchase is prevailing in practice in which the main objective is of selling goods as one can observe in contract of sale. Under hire purchase agreement the owner of the goods agrees to transfer the property in goods to the higher purchaser when a certain fixed number of installments of price are paid by the hirer. The installments paid by hirer are regarded as the hire-charges for the use of goods and till he pay all the installments the hirer remains the bailee. The owner (bailer) has a right to resume the possession of the goods immediately without refunding the amount received till date from refunding bailee if there is a default by the hire-purchaser in paying an installment. This is because ownership rests with ownership till all the installments are paid by hire-purchaser. The hirer may return the goods at any time without any obligation to pay the balance installments. The essence is that hire-purchase agreement is not a contract of sale because there is no agreement to buy but only a bailment and the property in the goods remains with the owner during the continuance of the bailment of goods, which

coupled with an option to purchase them which may or may not be exercised. For example, Ramu hires a sewing machine and agreeing to pay Rs. 200 per month with the condition that if he pays monthly installments regularly up to 36 months the Ramu becomes owner of the machine at the end of the 36 months. This is called hire purchase agreement and Ramu will not become owner till all installments are paid.

The main points of distinction between the sale and hire purchase are as follows.

**(a) Mode of Agreement:** In case of sale the contract may be made either orally or in writing where as in hire-purchase agreement must be in writing.

**(b) Ownership:** In case of sale the property in goods or ownership is transferred to the buyer from the seller as soon as the contract is entered into. In hire-purchase the property in the goods or ownership is transferred to the higher purchaser only when a certain agreed number of installments is paid by the hire-purchaser.

**(c) Position of Buyer:** In a contract of sale the position of the buyer is that of the owner of the goods where as in hire purchase the position of the hirer is that of a bailee till all the installments are paid by him.

**(d) Termination of Contract:** The buyer in sale cannot terminate the contract and is bound to pay the price of the goods. In case of hire purchase, the hire purchaser has an option to terminate the contract at any stage by returning the goods to its owner without any liability to pay or can't be forced to pay the remaining installments of the goods.

**(e) Installment Payment:** In case of sale if payment is made by the buyer in installments, the amount paid is considered as payment made towards price of the goods and the amount payable by the buyer to the seller is reduced.

**(f) Resell the Goods:** In case of sale, the buyer can resell the goods whereas in case of hire purchase the hire purchaser cannot resell till he has not paid all the installments of hire.

**(g) Risk of Loss:** In the case of sale, the seller takes the risk of any loss resulting from the insolvency of the buyer. In the case of hire purchase, the owner takes no such risk, or if the hirer fails to pay an installments the owner has the right to take back the goods.

**(h) Governing Act:** The sale is governed by the sale of Goods Act, 1930, whereas hire purchase is governed by Hire-Purchase Act,1972.

**(i) Passing of Title of Goods:** In case of sale, the buyer can pass a good title to a bona fide purchaser from him but in a hire-purchase, the hirer cannot pass any title even to a bona fide purchaser.

**(j) Levy of Tax:** In case of sale, the buyer can pass a good title to a bona fide purchaser from him but in hire-purchase the hirer cannot pass any title even to a bona fide purchaser.

### 11.3.3 Sale and Contract for Work and Labour

Considering the sales tax law in the different states of India it is necessary to understand the distinction between sale of goods and contract of work and skill because sales tax is leviable on sale of goods under certain circumstances but sales tax is not leviable on the remuneration received for work and labor rendered. For example, a dentists agreed to make a set of artificial teeth to fit it in to the mouth of a customer. Held, it is a contract for the sale of goods (Lee vs. Griffin, 1861). Another example is a contract with an artist who agreed to paint a picture for sum agreed on the canvas and with the material to be supplied by the other party, was had to be a contract for work and skill and not one for sale of goods (Robinson vs Graves,

1935). One more example in which a person has given order for making and fixing some curtains in a house is considered as contact of sale of goods though it involves some work and labour in fixing the same [Love vs Norman Wright (Builders) Ltd., 1944).

An agreement is considered to be a sale when the property in the goods is intended to be delivered to the buyer, even though some labour on the part of the seller of the goods may be necessary. An agreement is considered to be a contract of work and labour and not a contract of sale, where the essence of the contract is rendering of service and exercise of skills and no goods are delivered.

**Activity B:**

1. Refer different real cases registered under contract of sale and make a different list of them by differentiating cases as (a) sale and agreement to sale (b) sale and hire-purchase agreement (c) sale and contract for work and labour.

## 11.4 Goods- Meaning and Types

### 11.4.1 Meaning

Goods form the subject matter of sale. As defined in Section 2 (7) of Sale of Goods Act, "Goods mean every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be served before sale or under the contract of sale". Trade marks, Copy rights, Patent right, Goodwill, Electricity, Water and Gas are all goods. The definition of Goods includes stocks and shares, growing crops, grass and things attached to or forming part of land, which are agreed to be served from land before sale. Not only growing crops and grass but trees are also called goods because they are agreed to be served before sale or under the contract of sale [Badri Prasad vs State of M.P., A. I. R.(1970) S. C. 706].

Actionable claims and money have been excluded from the definition of goods. An actionable claim means a claim or right which can be enforced by filling a suit in the court of law. For example, a debt due from one person to another is an actionable claim and cannot be bought and sold.

### 11.4.2 Types/Classification of Goods

According to section 6, goods which form the subject matter of a contract of sale may be either existing goods, or future goods [Sec. 6 (1)], or contingent goods [Sec., 6 (2)].

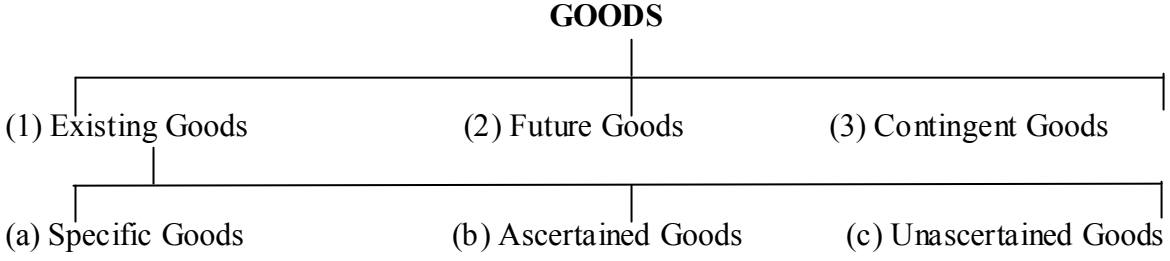


**Figure - 11.1**

**(1) Existing Goods:** In case the goods are not in existence, there can be no contract of sale. The goods which physically exists and which are owned and\or possessed by the seller at the time of making contract of sale, are known as existing goods. That is where the seller is the owner, he has general property in them and where seller is in possession, say as an agent or a pledge, he has a right to sell them. Sometimes, the seller may be in possession of goods, but may not be the owner, as it

happens when goods are sold by mercantile agent. It is only the existing goods which can be the subject matter of sale. Existing goods may either be specific goods or ascertained goods and unascertained goods.

**(a) Specific Goods or Ascertained Goods:** According to Section (14), goods identified and agreed upon at the time of contract of sale are called 'Specific Goods'. Where there is a contract for specific goods, the seller would not fulfill his contract by delivering any goods other than those agreed upon. For example, kanu owns a number of horses, and promises to sell his black horse to Janu. Here, horse to be said is identified and separated and therefore called specific goods. If Mahesh agrees to sell to Jignesh a particular DVD player bearings a distinctive number, there is a contract of sale of specific or ascertained goods. Here the point to be noted is that in actual practice the term 'Ascertained Goods' is used in the same sense as ' Specific Goods'.

Ascertained Goods has not been defined in the act. These are the goods which are ascertained to the formation of contract of sale. As contrasted with specific goods which are identified at the time of sale, ascertained goods means goods identified in accordance with the agreement after the contract of sale is made. The identification takes place at a later date.

**(b) Unascertained Goods**: The goods which are not separately identified or ascertained at the time of the making of the contract are known as generate or unascertained goods such goods re defined or indicted by description or by sample. For example, Jayesh has many horses and he agrees to sell one of the horse to Ganesh, the goods are unascertained. As soon as the horse to be sold is identified, it becomes ascertained goods. Another example, if Mr. Joy agrees to sell 1 bag of 20 kg of wheat to Mr. Tom out of 200 bags lying in his warehouse, it is a sale of uncertain goods because it is not known which bag of wheat is to be delivered. As soon as the particular bag is separated from the lot for delivery, it becomes ascertained or specific goods.

**(2) Future Goods:** As defined by Section 2 (6) 'Future Goods' are the goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. At the time of contract of sale future goods may be either not in existence or be in existence but not yet acquired by the seller. This is because a person may agree to sell goods in anticipation of their production or acquisition. A contract of present sale of future goods, though expressed as an actual sale, purports to operate as an agreement to sell the goods and not a sale [Section 6 (3)]. This is because the ownership of the goods cannot be transferred before goods come into existence. For example, if John agrees to sell to Robinson the rice which will be grown in his field in the current season, it is a sale of future goods, amounting to an agreement to sell. Another example Ganesh agrees to sell to Jayesh all the mangoes which will be produced in his garden in next year mango season. It is a contract of sale of future goods, amounting to an agreement to sell.

**(3) Contingent Goods:** Contingent goods are a type of future goods as its acquisition by the seller depends upon a contingency which may or may not happen. A contract for the sale of contingency goods also operates as an agreement to sell and not a sale so far as the question of passing of property to the buyer is concerned. In a contract of sale of contingent goods, the contract can be enforced only when the event on the happening of which the performance depends happens, otherwise the contract becomes void. Such contracts give no right of action if the contingency does not happen. For example, Sanjeev agrees to sell to Rajeev specific goods which are in transit and will

arrive through ship which is on the way from Australia to India, on the condition that if the ship carrying the goods arrives safely. But if the ship is sunk or ship arrives but with no such goods on Board, the contract becomes void and the seller is not liable. The distinction between future goods and contingency goods is that the procurement of contingent goods depends upon a contingent whereas it is not so in case of future goods. In case of non-acquisition of contingent goods, the parties who made an agreement are discharged where as non-acquisition or non-production of future goods the parties are not discharged.

## 11.5 Effects of Destruction of Goods

The section 7 and 8 of the Sale of Goods Act, 1930 lay down the rules applicable to the cases where the subject matter of contract of sale (Goods) is destroyed before or after the contract.

### 11.5.1Meaning

It deals with the effect of perishing of goods on the rights and obligations of the parties to a contract of sale. The word perishing means not only physical destruction of the goods but it also covers damage in commercial sense. Commercial loss means though goods are not physically destroyed but goods lose their merchantable character. For example, where cement is spoiled by water and becomes almost stone. It also covers loss of goods by theft [Barrow Ltd., vs Philips Ltd., (19290, 1 K.B. 574] and where the goods have been lawfully requisitioned by the Government [Re Shipton, Anderson & Co., (1915), 3 K. B. 676].

The effects of perishing of goods may be discussed as (a) goods perishing before making of the contract (b) goods perishing before sale but after agreement.

1. **Goods Perishing Before Making of the Contract (Section 7):** As given in the section 7 of the act, where there is a contract for sale of specific goods, the contract is void if the goods without the knowledge of seller have, at the time when the contract was made perished or became so damaged as no longer to answer to their description in the contract. When specific goods form the subject matter of the contract of sale and they without the knowledge of the seller perish, at or before the time of contract, the contract is void. This provision is based on the ground of mutual mistake or impossibility of performance. For example, Ganpat agrees to sell to Mahesh a specific black horse. It turns out that the horse was dead at the time of bargain, though neither party was aware of the fact, the agreement is void. Another example is Kamlesh agrees to sell Mrugesh, a specific cargo which supposed to be on way US to Bombay. If turns out that, before the day of bargain the ship carrying the cargo has seen cast away and the goods lost. Neither party was aware of the facts the agreement is void.

   Under this section certain conditions must be fulfilled to make contract void includes (a) the contract must be for the sale of specific goods (b) the goods must have been perished before the contract is made (c) the seller must not have the knowledge of the destruction of the goods. When in a contract for the sale of specific goods, only part of the goods are destroyed or damaged, the effect of perishing will depend upon whether the contract is entire or divisible. If it is entire (indivisible) and only part of the goods has perished, the contract is void. If the contract is divisible it will not be void and the party available in good condition must be accepted by the buyer. For example, X sold to Y 500 bags of Chinese groundnuts identified by marks and lying in a named warehouse. X is not aware that bag has stolen at the time of the sale. X tendered delivery of 391 bags. Held, the sale was void and Y could not be compelled to take the remainder [Barrow, Lane and Ballard Ltd. Vs Philips & Co. (1929) 1 K.B. 574].

2. **Goods Perishing Before Sale but After Agreement (Section 8):** According to Sale of Goods Act which reads as "Where there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish or become so damage as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided and both parties are excused from the performance of the contract. In such a cases, the contract of the sale becomes void if the contract is for the sale of specific goods and the goods are destroyed without any fault of the seller or buyer. The provision in this act is based on the ground of supervening impossibility of performance which makes a contract void. In case where some part of the goods agreed to sold gets perished, and if it is indivisible the contract becomes void. But ion case where goods are divisible in nature then parties are absolved from their obligation only to the extent of perishing of the goods, that is, the contract remains valid as regards the part available in good condition.

   Further, according to section 26, it is important to note that due to the fault of either party causes the destruction of the goods, and then the default party is liable for non-delivery or pay for the goods as the case may be. In some cases the risk has passed to the buyer at the time of the contract, that is, the buyer has expressly or impliedly undertaken the responsibility to suffer the loss of the goods. In such cases, the buyer will be liable to pay the damages to the seller for the loss of the goods even if the goods have not been delivered to him. For example, a buyer took a horse from the seller on a trial for 8 days and made a condition that if buyer found horse suitable for his purpose the bargain would become absolute. The horse died on 3rd day without any fault of either party. Held, the contract, which was in the form of an agreement to sell, becomes void and the seller should bear the loss [Elphick vs Bame, (1880), 5 C.P.D. 321)].

   Certain conditions must be satisfied includes (1) the contract is an agreement to sell and not an actual sale (2) the contract should be for specific good and not for unascertained goods (3) the goods must have been perished without the fault of seller or buyer. (4) the goods must have perished or damaged before the property or the risk passes to the buyer.

**Effects of Perishing of Unascertained Goods:** The section 7 and 8 of contract act are applicable to only specific goods, but in case of unascertained goods the contract shall not become void even if the entire stock of goods is destroyed, and the parties remain liable to fulfill their obligation. For example, out of 100 bags of 20 kg each of wheat lying in warehouse Shri Ramesh agrees to sell Ganesh 10 bags of wheat. The warehouse had been destroyed by fire at the time of contract and both the parties are unaware of the fact. The contract is not void as the contract is made to sell certain quantity of unascertained goods and not specific goods. It is the responsibility of Ramesh to supply 10 bags of wheat or pay damages for the breach of contract.

**Effects of Perishing of Future Goods**: we have understood earlier that a present sale of future goods always operates as an agreement to sell and the question arises as to whether section 8 applies to a contract of sale of future goods. The answer is where in an agreement to sell it has been held that future goods if sufficiently identified, are to be treated as specific goods, the destruction of which makes the contract void. For example, Gopal agreed to sel to Krunal 200 tons of potetos to be grown on Gopal's land. Gopal sowed sufficient land to grow the required of potatoes but without any fault on his part, a disease attacked the crop and he could deliver only about 10 tons. The contract was hald to have become void.

**Activity C:**

1. Identify and list out various situation where contract of sale is applied classify them in terms of contract for Existing goods, Future goods and Contingent goods.

## 11.6 Price of Goods

### 11.6.1 Meaning

According to Section 2 (10), the essential part of the contract is the price which is the money consideration for a sale of goods. Price is expressed as money and is the consideration for the transfer or agreement to transfer the property in goods from the seller to buyer. It is only essential that price should be fixed at the time of sale, but however must be payable though it may not have been fixed. The price may money actually paid or promised to be paid depending on whether the agreement is for cash or credit sale. The price in a contract of sale may be fixed by the contract or left to be fixed in a manner thereby agreed or may be determined by the course of dealing between parties [Section 9 (1)]. Where the price is not determined in accordance with the foregoing provisions, the buyer shall pay the seller a reasonable price and what is reasonable price is question of fact dependent on the circumstances of each particular case [Section 9 (2)].

### 11.6.2 Models of Fixing the Price

According to Section 9, the price may be fixed by one or the other of the following model.

(a) Price may be fixed by the contract
(b) Price ma y be fixed in a manner agreed upon
(c) The fixation of price by course of dealing
(d) Fixation of reasonable price

**(a) Fixed by the Contract:** The most usual mode of fixing the price is that parties may fix the price for the goods which they like and its adequacy will not be challenged by the court. The price may be expressly stated in the contract and its inadequacy does not affect sale.

**(b) Fixed in a Manner Agreed upon:** the price may be fixed in a manner provided in the contract. The buyer and seller agreed that price is to be fixed by a third party for which both has given consent or buyer would pay the market price prevailing on a particular date.

**(c) The Fixation of Price by Course of Dealings:** Price can be determined in the course of dealings between the parties. For example, if in earlier contract the buyer has agreed to pay price prevailing on the date of placing order, such a dealings suggest that in subsequent transactions also the price will be determined as on the date of order.

**(d) Fixation of Reasonable Price:** If above given modes of fixing price does not work, the buyer shall pay to the seller a reasonable price. What is a reasonable price is a question of fact depending upon the circumstances of each case. In normal situation the prevailing price on the date of supply is considered as reasonable price.

### 11.6.3 Agreement to Sell at Valuation of Third Party

According to Section 10 (1) of Contract Act, where there is an agreement to sell goods on the terms that the price is to be fixed by the third party and such third party cannot or does not make such valuation, the agreement is avoided. But if the goods or any part thereof have been delivered to and appropriated by the buyer, he shall pay a reasonable price. The Section 10 (2) states that where such party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.

## 11.7 Stipulation Relating to Time

**Meaning:** In a contract of sale the time of payment and delivery of goods must be given due weightage, the stipulation as to time in a contract fall under two heads.

**(a) Stipulation Relating to Time of Delivery of Goods:** The time fixed for the delivery of goods is usually held to be the essence of the contract. In case the seller makes delay in delivering the goods as per time fixed for the delivery, the contract is voidable at the option of the buyer. The buyer may refuse to accept the delivery and may put an end to contract where the seller has made late delivery.

**(b) Stipulation Relating to Time of Payment of the Price:** According to Section 11, considering the fixed time for the payment of the price, the general rule is that time is not deemed to be the essence of the contract if different intention does not appears form the terms of the contract. The seller cannot avoid the contract on the ground that the agreed piece is not paid by the buyer. Seller has to deliver the goods, however, seller may claim compensation for the loss incurred to him due to failure on the part of buyer to pay on the appointed time.

## 11.8 Conditions and Warranties

### 11.8.1 Stipulation – Meaning

While selling the gods, a seller usually makes certain statements or representations with a view to induce the intending buyer to purchase the goods. Stipulation means a requirement or a specified item in an agreement. In a contract of sale of goods, stipulation refers to representation made by the buyer and the seller reciprocally as a part o negotiation between them before they enter in to contract. Such representations are generally about the nature and quality of the goods, price, mode of payment, delivery of goods etc. But all of the representation are not equally important, some items are considered to be major terms and become fundamental root of the contract, and the breach of this representation may frustrate the very purpose of and have legal consequences on the contract, while some other representations may be minor terms which are not so important that their breach may seem to be not a relevant and have no legal effect on the contract. All representations are not stipulations, and only such representations are stipulations which have been finally accepted by the parties.

According to Section 12 (1) of the Act, "A Stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or warranty". Some stipulations may be essential to the contract while some may be essential collateral or incidental to the contract. A stipulation essential to contract is called a "Condition" and stipulation which is a collateral or incidental to the contract is called warranty.

### 11.8.2 Condition

According to Section 12 (2), "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". The aggrieved party may maintain an action for damages for lost suffered in him on the ground that the whole contract is broken. For example, the buyer asked the seller of horse to give him a horse which can run at a speed of 60 k.m. per hour. The dealer gives a particular horse and buyer finds that horse can run only at a speed of 30 k.m. per hou. This is a breach of condition as the stipulation made by the buyer is essential to the contract.

### 11.8.3 Warranty

According to Section 12 (3) "A warranty is a stipulation collateral to the main purpose of the contract the breach of which gives rise to claim for damages but not to a right to reject the goods and treat the contract

as repudiated". The aggrieved party can sue for damages only and not to avoid the contract. For example, the buyer asked the seller of horse to give him a good horse and seller points put that a particular horse which seller is giving to buyer is good horse and can run at a speed of 60 k. m. per hour, Buyer later on finds that the horse can run only at a speed of 30 k. m. per hour, is considered as breach of warranty.

### 11.8.4 Conditions and Warranty" Distinction:

The distinction between Conditions and warranties is given below.

(a) In a condition the stipulation which is essential to the contract becomes main purpose of the contract where as in a warranty stipulation is only subsidiary or collateral to the main purpose of the contract.
(b) A contract of some cannot be fulfilled if the condition to it is not fulfilled, whereas the main contract can be fulfilled even if the warranty is not fulfilled.
(c) The breach of condition gives the aggrieved party the right to repudiate the contract and also claim damages, whereas the breach of warranty gives the aggrieved party a right to claim damages only.
(d) A breach of condition may be treated as a breach of warranty, whereas a breach of warranty cannot be treated as breach of condition.

There is no standard rule that which stipulation in a contract of sale is a condition and which one is a warranty. Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. To determine whether the stipulation is a condition or warranty it is necessary to look in to the intention of the parties by referring to the terms and construction of contract as well as the surrounding circumstances in which contract was entered in to. The main distinction between condition and warranty is that when a breach would bw fatal to the rights of the aggrieved party, then such a stipulation is a condition and where it is not fatal to the rights of the aggrieved party the stipulation is only a warranty.

### 11.8.5 When Conditions to be Treated as Warranty

In some cases a condition may become a warranty and the aggrieved party has the right to claim damages only and not to repudiate the contract. It may, however, be noted that conditions converted into warranty only for remedial purpose and not to exclude the rights of the other parties. In fact once a condition is always a condition. Section 13 of the sale of goods act lays down the following situations when conditions become a warranty.

(a) Voluntary waiver of condition [Section 13 (1)]
(b) Acceptance of goods by the buyer [Section 13 (2)]
(c) By impossibility of performance [Section 13 (3)]

**(a) Voluntary Waiver of Condition:** According to Section 13 (1), where a contract of sale involve a condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty. The option is available to buyer to accept the goods and claim damages from the seller. Once a buyer have decided to waive the condition, he cannot afterward insist on its fulfillment. For example, Kartik agrees to buy form Ramesh 20 bags of rice as per the sample. Ramesh delivers the rice, but it was not according to the sample of rice shown to buyer while entering in to a contract. Kartik has right to reject the goods, but he may decide to accept the goods treat this breach of condition as a breach of warranty.

**(b) Acceptance of Goods by Buyer:** Under Section13 (2) "Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, or where the contract is for specific gods, the property in which has passed to the buyer, the breach of any condition to be fulfilled by the seller

can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, if there is not such term of the contract, expressed or implied, to that effects". Where the buyer has accepted the goods and subsequently he comes to know of the breach of condition, he cannot reject them, but only maintain and take action for damages. If the buyer has accepted only part of the goods and the contract is indivisible, he will have to accept the remaining part of the goods also. But in case of divisible contract, buyer can repudiate as regards remaining goods if he has accepted only part thereof. For example, Kartik purchased 20 bags of rice from Ramesh according to sample. When the goods were delivered, Kartik resold the 10 bags of rice to Ganesh. The Ganesh found that rice are not according to sample, hence, rejected the goods. Now Kartik wants to avoid the contract, but will not succeed because by reselling the goods to Ganesh, the Kartik has accepted the goods. So Kartik has treat this breach of condition as a breach of warranty and be content with damages only.

Merely taking possession or delivery of the goods does not by itself amount to acceptance. According to Section 42 the buyer is deemed to have accepted the goods (i) when buyer intimates to the seller that he has accepted the goods; (ii) when buyer does any act in relation to goods (consumes, Uses, Pledges or resell etc.) which is inconsistent with ownership of seller' or (iii) when after the lapse of a reasonable time, buyer retains the goods without intimating to the seller that he has rejected the goods.

**(d) By Impossibility of Performance:** According to Section 13 (3) "Nothing in this section shall affect the case of any condition or warranty fulfillment of which is excused by law by reason of impossibility or otherwise". Where the performance of the contract becomes impossible subsequent to the formation of contract, performance will be excused. However, this rule will not be applicable (i) where the performance was made impossible owing to the negligence or default of any of the parties to contract; (ii) when the parties expressly contract with reference to the occurrence of the supervening event; (iii) where the promise is capable of being performed in itself, the promise cannot be excused from his obligation to perform by stating that the inability to perform was due to circumstances beyond his control and so on.

### 11.8.6 Express and Implied Conditions and Warranties

1. **Meaning:** as given in Section 14 to 17 the conditions and warranties may be expressed or implied. 'Express' conditions and 'Warranties' are those which have been expressly agreed upon by the parties at the time of the contract of sale. Conditions and warranties are said to be express when that are at the will of the parties inserted in the contract, i. e. express conditions and warranties are those which are entered in clear words in the contract. 'Implied conditions and warranties' are those which law incorporates in to the contract unless the parties stipulate to the contrary. Conditions and warranties are said to be implied when the law presumes their existence in the contract automatically though they have not been put into in express words. According to Section 62, Implied conditions and warranties may be cancelled or varied by the express agreement or by the course of deadlines or by usage and custom.

   For example, Kamlesh wants to buy a washing machine of a specific model number. Here the model number is an express condition.

2 **Implied Conditions and Warranties:** Section 14 to 17 of the contract act lay down the implied conditions in a contract of sale. Though it is agreed or not agreed, the following **implied conditions**.

(a) Condition as to Title [Sec. 14 (a)]
(b) Sale by Description [Sec. 15]
(c) Sale by Sample [Sec. 17]
(d) Sale by sample as well as Description [ Sec. 15]
(e) Condition as to Quality or Fitness [Sec. 16 (1)]
(f) Condition as to Merchantability [Sec. 16 (2)]
(g) Condition as to Wholesomeness

Subject to the contract to the contrary, following are the **implied warranties** in a contract of Sale of goods.

(a) Warranty of Quiet Possession [Sec. 14 (b)]
(b) Warranty of Freedom from Encumbrance [Sec. 14 (c)]
(c) Warranty to Disclose Dangerous Nature of goods

**Implied Conditions:**

**(a) Condition as to Title [Sec. 14 (a)]:** According to Section 14 (a) an implied condition on the part of the seller is that, in the case of a sale, seller 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 is to pass. This is called condition as to title. The object of ale is to transfer the legal ownership or property from one person to another. Divall obtained the car by theft. Rowland could recover the full price from Divall. So in this case, there was a breach of condition as to title as Divall had no right to sell the car.

**(b) Sale by Description [Sec. 15]:** According to Section 15 where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description. The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods. For example, buyer may give description of the goods in terms of physical appearance of the goods he requires, or gives brand name or a particular trade mark etc. Another example, where there was a contract for the supply of 'New car' and one of the car supplied by the seller was run a considerable mileage was not new, there was a breach of condition on the part of the seller and the buyer was held entitled to reject the car [Andrews Bros. vs Singer & co. (1934), 1 K. B. 17].

**(c) Sale by Sample [Sec. 17]:** According to Section 17, a contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect, where seller shows the sample to the buyer, it does not amount to a sale by sample, i.e. when under a contract of sale, goods are to be supplied according to a sample agreed upon, the implied conditions are:

(i) that the bulk shall correspond with the sample in quality;

(ii) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(iii) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

For example, in Wood vs Michaaud, there was a contract for sale of cane Corn. The buyer was shown a sample of corn, which was supposed to have been grown in the previous year. This was not a sale by sample, as it was likely that there would be a difference in quality between the Corn grown in two different years.

**(d) Sale by Sample as Well as Description [Sec. 15]:** The implied condition according to Section

15 of contract act is that goods shall correspond with both, the sample as well as description. If the sale is by sample as well as by description it is not sufficient that the bulk of the goods correspond with the sample if the goods do not also correspond with the description. For example, there was a sale of 'foreign refined rape oil' warranted only equal to sample. The oil tendered was the same as the sample, but it was not 'foreign refined rape oil', being a mixture of it and other oil. It was held that the seller was liable, and the buyer could refuse to accept [Nichol vs Godts (1854)].

**(e) Condition as to Quality or Fitness [Sec. 16 (1)]:** It is not necessary that every contract contain an implied condition as to quality or fitness of the goods for a particular purpose. It is the duty of buyer to examine whether the goods purchased by him will be suitable for the purpose for which he is buying before he buy goods. According to Section 16 (1) "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 judgment and the goods are of a description, and it is in the course of the seller's business to supply, whether seller is the manufacturer or producer or not, there is an implied condition that the goods shall reasonably fit for such purposes.

If the goods or article is fit for one particular purpose alone, and turns out to be unsuitable for the purpose when used, it is easy to see that condition as to fitness has been broken. But in case, if the goods or article is fit for variety of purposes it is the duty of buyer to notify his specific purpose. The implied condition as to quality and fitness operates only if following conditions are satisfied.

(i) The buyer requires the goods for a particular purpose and buyer lets the seller know about his purpose.
(ii) The buyer relies upon the skill and judgment of the seller.
(iii) The seller's business is to sell goods of the type required by buyer.

For example, Shri grant purchased two woolen underpants from a retailer manufactured by the 'Defendant' after wearing one of them, he contracted skin disease which was due to chemical irritant which had negligently omitted to remove in the process of manufacture. It was held that the implied condition of fitness for the buyer's purpose was broken [Grant vs Australian knitting Mills (1936)]. Another example is that a buyer does not have special knowledge of hot water bottles and he asked chemists for hot water bottle. Buyer was shown an American rubber bottle which the chemists said would not stand boiling water but was meant for hot water. After a few days, while being used, if burst and injured buyer's wife. It was found that the bottle was not fit for use as a hot water. It was held that since the bottle could be used only for one particular purpose, there was breach of implied condition as to fitness and the seller was liable to pay damages [Priest vs Cast (1903) 2 K.B. 148].

**(f) Condition as to Merchantability:** Where there is a sale by description the condition is considered as implied. The term merchantability has not been defined in the Act. According to Section 16 (2) "where goods are bought by description from a seller who deals in goods of that description, whether seller is the manufacturer or producer or not, there is an implied condition that the goods shall be of merchantable quality; provided that, if the buyer has examined the goods, there shall be no implied condition as regards defects which such condition examination ought to have revealed. In order to apply the implied condition as to merchantability the following requirements must be satisfied viz., (i) Whether the seller is the manufacturer or not, he should be a dealer in goods of that description. (ii) The goods should have been bought by description. (iii) The buyer must not have any opportunity of examining the goods or there must be some latent defect in the goods which would not be apparent on reasonable examination of the same.

Though opportunity provided, buyer avoids examining goods or if he has examined the goods, there is no implied condition as to merchantability as regards defects which was revealed during examination. For example, the buyer bought some underwear, which contained some chemical which could cause skin disease. It was held that goods were not of merchantable quality and the buyer could reject the goods and claim damages [Grant vs Australian Knitting Mills Ltd, (1936) A. C. 85].

**(g) Condition as to Wholesomeness:** In case of contract of sale of eatables and provisions condition of unwholesomeness is implied. In such cases the goods supplied must not only answer to description and be merchantable but must also be wholesome i.e. goods must be pure, unadulterated and suitable for consumption at the time of sale. Goods must be free from any defect which render them unfit for human consumption. For example, the bought milk which he found contaminated with germs of typhoid fever. The buyer's wife became infected on talking the milk and died. The buyer was held liable for damages [Frost vs Aylesbury Dairy Co. Ltd., (1905), 1 K. B. 608].

**Implied Warrnties:** Following are the implied warranties in a contract of sale of goods, subject to the contract to the contrary.

**(a) Warranty of Quiet Possession:** According to Section 14 (b) of contract of sale, there is an implied warranty that the buyer shall have enjoyed quiet possession of the goods. It is an implied assurance to the buyer that he shall have the possession and enjoyment of the goods sold to him without disturbance by the seller or any other person. In case the buyer in any way disturbed in the enjoyment of the goods because of the seller's defective title, he can claim damages from the seller. Since disturbance of quiet possession is likely to arise only where the seller's title to goods is defective, this warranty may be regarded as an extension of the implied condition of title provided for by section 14 (a). For example, buyer has made purchase of second hand computer and spends some money on getting the computer repair. Buyer used it for some time and was subsequently the true owner had disposed of the computer after six months. It was held that buyer was entitled to recover from owner not only the price paid but also the cost of repair.

**(b) Warranty of Freedom from Encumbrance:** In some cases the buyer needs to pay some charge for the goods purchased by him. According to Section 14 (c) the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer or at the time when the contract is made. This warranty will not apply where such encumbrances are declared to the buyer when the contract is made or buyer has notice of such charges. If the possessions of the buyer are disturbed due to such charge in favour of third party, he can claim damages from the seller. For example, Kanu pledges his bicycle with Manu for a loan of Rs. 100 and promises him to give its possession the next day. Soon after, Kanu sells the bicycles to Tanu, an innocent buyer being pledged. Tanu may either ask Kanu to clear the loan or may himself pay the money and then file a suit against Kanu to recover this money with interest.

**(c) Warranty to Disclose Dangerous Nature of Goods:** Where the goods are dangerous and the seller knows the buyer is ignorant about the dangerous nature of the goods, the seller should warn the buyer about the probable danger, otherwise he will be liable for damages for the injury caused to the buyer because of the dangerous quality of the goods. For example, Clark purchases a tin of disinfectant powder from Army and Navy Cooperative Society. The Cooperative Society knew that it was likely to be dangerous to Clark, if it was opened without special care being taken, but tells nothing to Clark. Buyer opened the tin in the normal way whereupon the disinfectant powder

flies into buyer's eyes and causes injury. Cooperative Society is liable in damages to Clark as Cooperative Society should have warned Clark of the probable danger.

**Activity D:**

1. Conduct a survey of consumers for measuring their experience of real life for warranty and conditions of sale and based on the findings give your comment on the provisions made by law for conditions and warranty in the contract of sale.

## 11.9 Summary

The knowledge and understanding of sale of goods help not only to business but also to community. This unit provides understanding about basic concepts and illustrations related with various provisions of Sale of Goods Act, 1930. The students will able to understand elements of contract of sale and will also be able to distinguish the important terms viz., sale and agreement to sale, sale and hire-purchase, and sale and contract for work and labour. This unit provides clear understanding of legally what is to be called as goods, the concept of existing, future and contingent goods as well as the rules applicable to cases where the subject matter of a contract of sale (Goods) is destroyed before and after the contract. It also gives the idea about various provisions related to stipulation of time and delivery of goods as well as stipulation relating to payment of price, and conditions or warranties in a contract of sale may be negotiated or varied by express agreement between the parties or course of dealing between them or the custom or usage of trade.

## 11.10 Self Assessment Questions

1. What is contract of sale? Discuss the essential elements of contract with illustration.
2. Distinguish between (a) Sale and Agreement to Sell (b) Specific and Unascertained Goods (c) Sale and Hire-Purchase Agreement.
3. How the price is fixed in a contract of sale? What are the different modes of determination of price?
4. What is the meaning of 'Perishing' of goods under the Sale of Goods Act? What is the effect of perishing of goods on a contract of sale?
5. What is goods in terms of contract sale of goods? What are the different types of goods?.
6. "Conditions and Warranties under contract of sale are same". Discuss with illustration. Under what circumstances a breach of condition is to be treated as breach of Warranty?
7. List out and discuss the implied condition with suitable example?
8. Write Short Notes on following;
   (a) Goods.
   (b) Stipulation as to Time.
   (c) Document of Time to Goods.
   (d) Future Goods.
9. List out and discuss the implied warranties with suitable illustration.

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# Unit - 12 : The Sale Of Goods Act, 1930 (II)

**Structure of Unit:**



## 12.0 Objectives

After Completing this unit you will be able to:

- Explain the meaning and exception to the doctrine of caveat emptor,
- Understand the meaning and significance of passing or transfer of property,
- Discuss the rules regarding transfer of property and reservation of right of disposal,
- Identify and discuss the how the risk prima facie passes with property,
- Understand the meaning of sale by non owners and different provisions of delivery of goods,
- Get acquainted with information about rights of an unpaid seller and rights of buyer, and auction sale.

## 12.1 Introduction

In a Sale of Contract the buyer is also responsible for his own purchase decision and his requirement. When ownership of the goods is transferred to the buyer, he becomes the owner of the goods, and the seller ceases to be the owner. The time of transfer of property in the goods decides various rights and liabilities of the seller and the buyer. The precise moment of time at which property in goods passes from the seller to the buyer is of importance from various important points of view such as, risk passes with property, action against third party, suit for price and insolvency of the seller or the buyer etc. in order to understand such aspects this unit-12 focuses on providing understanding about various provisions related to doctrine of caveat emptor and its exceptions; meaning, rules and significance of passing or transfer of property from seller to buyer; reservation of right of disposal; the passing of risk prima facie with property; sale by non owners; delivery of goods; rights of an unpaid seller; rights of buyer and provisions related with auction sale.

## 12.2 Meaning and Exception to the Doctrine of Caveat Emptor

### 12.2.1 Meaning

The fundamental principle of law embodied in the case of a sale of goods is the “Caveat Emptor”. The

meaning of term 'Caveat Emptor' is 'let the buyer be aware'. The doctrine of Caveat Emptor is universally applicable as far as quality is concerned in sale of goods. The doctrine of Caveat Emptor means that the seller is not bound to disclose the defects in the goods which seller is selling. The seller is not expected to give to the buyer an article suitable for a particular purpose if such purpose is not made known to the seller by the buyer. According to the doctrine of Caveat Emptor it is the duty of the buyer to be careful while purchasing goods of his requirement and in the absence of any enquiry from the buyer, the seller is not bound to disclose every defect in the goods of which he may be cognizant. A buyer purchases at his own risk and must thoroughly examine the goods in order to satisfy before buying the goods that the goods will serve the purpose for which they are being bought.

If the goods turn out to be defective or do not suit the purpose or depend upon buyer's own skills and judgment and makes a bad selection, he cannot blame anybody except himself. The buyer has to bear the consequences of his wrong selection of goods. Section 16 of the Sale of Goods Act has enunciated the rule of Caveat Emptor as "subject to the provisions of this act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". For example, Ganesh purchased a Dehradun Basmati rice from Kamlesh. The Kamlesh erroneously thought that the rice was not new, but in reality the rice were new. In this case Kamlesh cannot avoid the contract because he has depended on his own skill and judgment and therefore the rule of Caveat Emptor will be applicable.

### 12.2.2 Exceptions to the Doctrine of Caveat Emptor

In earlier days mostly the goods were sold in an open market where the buyer was in a better position to get the opportunity to inspect the goods in terms of quality and fitness of the gods for the purpose and satisfy himself. So considering such availability of opportunity to buyer for satisfying himself this principle was originated. But now a days trade has spread at global level and it makes difficult for the buyers to examine the goods thoroughly as the purchases are made through mail order or online etc. in such cases it is only the seller who can assure the quality of the goods and their fitness for buyer's purpose. Due to such reasons, the application of Caveat Emptor has been restricted, thus, the doctrine of caveat emptor is subject to following exceptions.

(a) Fitness for Buyer's Purpose [Sec., 16 (1)]
(b) Sale under a Patent or Trade Name [Sec., 16 (1)]
(c) Goods Sold by Description [Sec., 15]
(d) Merchantable Quality [Sec., 17]
(e) Sale by Sample [Sec., 16 (1)]
(f) Sale by Sample as well as by Description [Sec., 15]
(g) Custom or Conditions Implied by Trade Usage
(h) Goods Sold by Misrepresentation

These exceptions to Caveat Emptor are discussed in brief as follows.

**(a) Fitness for Buyer's Purpose:** In this buyer makes known to the seller the particular purpose for which the goods are required and buyer relies upon the seller's skill and judgment, but the goods supplied are unfit for the specified purpose, the seller is not protected by Caveat Emptor.

According to Section 16 (1) "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 judgment, 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". In such case, the doctrine of Caveat Emptor does not apply.

**(b) Sale under a Patent or Trade Name:** According to proviso of Section 16 (1), in case where the goods are purchased under its patent name or brand name, there is no implied condition that the gods shall be fit for any particular purpose. For example, a car was described as 'Herald Convertible' 1961 Model, was put to sale. The buyer purchased the car and later he discovered that the real part of the car was part of a 1961 model but the front half was a part of an earlier model. The buyer could reject the car and recover the amount paid [Beale vs. Taylor (1967) All E. R. 253].

**(c) Goods Sold by Description:** According to Section 15, where there is a contract for sale of goods by description, there is an implied condition that the goods shall correspond with the description. In such cases, the doctrine of Caveat Emptor does not apply. For example, the buyer and seller have made a contract for 3000 tins of canned fruit from Australia to be packaged as 30 tins in each case. In reality the buyer has received the goods and substantial part of goods was packed as 24 tins in each case. The buyer could reject the goods as it is not as per description [Moore & Company vs. Landever & Company (1921) 2 K. B. 519].

**(d) Merchantable Quality:** According to Section 16 (2) whether the seller is the manufacturer or not, where the goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be of merchantable quality, the doctrine of Caveat Emptor does not apply. However, the doctrine of Caveat Emptor applies if the buyer has examined the goods, as regards defects which such examination ought to have revealed. For example, buyer bought some undergarments, which contained some chemical, which could cause skin diseases. It was held that goods were not of merchantable quality and the buyer could reject the goods and claim damages.

**(e) Sale by Sample:** According to Section 17, where the goods are bought by sample, the doctrine of caveat Emptor does not apply if the bulk does not correspondence with the sample, or if the buyer is not provided an opportunity to compare the bulk with the sample, or if there is any hidden or latent defect in the goods. For example, if buyer has bought wheat as per sample shown by the seller and if the purchased gods were not according to the sample buyer can claim for damages and the rule of Caveat Emptor does not apply.

**(f) Sale by Sample as Well as Description:** According to Section 15, where the goods are bought by buyer from the seller considering the sample as well as description, the rule of Caveat Emptor does not apply if the goods supplied by seller do not correspond with both sample as well as description, the buyer can reject the goods. For example, the buyer has purchased seeds and he found that supplied seeds were not as per quality specified by buyer and the defect also existed in the sample also. The discrepancy in quality was discovered only after the seeds were sworn. The buyer could recover damages, as there was a breach of condition.

**(g) Customs or Conditions Implied by Trade Usages:** According to Section 16 (3) an implied warranty or conditions as to quality or fitness for a particular purpose may be annexed by the usage of trade and if the seller deviates from that, this rule of Caveat Emptor is not applicable. However, custom should not be unreasonable and should not be inconsistence with the terms of the contract. For Example, in case of Jones vs. Bowden (1813, 4 Tount 847) where drugs were sold by auction and where it is a usage of trade to disclosure must be made beforehand about any sea-damage. In case no such disclosure has been made and the goods are found to be defective, it will be taken as a breach of warranty.

**(h) Goods Sold by Misrepresentation:** The doctrine of Caveat Emptor will not apply where the seller has made a false representation relating to the goods and buyer has relied upon it, i.e. when sell activity conceals some defect in the goods so that the same could not be discovered but the buyer on a reasonable examination, then the rule of Caveat Emptor will not apply. In such a case the buyer has a right to avoid the contract and claim damages.

**Activity A:**

1. Make an attempt to identified the cases of Caveat Emptor in real life experience and classify them according to exceptions of Caveat Emptor. .

## 12.3 Meaning and Significance of Passing or Transfer of Property

### 12.3.1 Meaning of Transfer of Property

The main purpose of a contract of sale is the transfer of ownership of the goods from a seller to a buyer. When the ownership of the goods is transferred to the buyer, the seller is no more the owner of the goods. The time of transfer of property in the goods decides various rights and liabilities of the seller and the buyer.

The term 'transfer of property' in goods means transfer of ownership of goods. The term 'property' in the goods may be defined as the legal ownership of the goods. The term 'property in goods' must be distinguished from the term 'possession of the goods'. The ownership of the goods refers to the term 'property in goods' whereas the custody or physical control over the goods called 'possession of the goods'. A person may have the possession of the goods but may not be the owner of the same. For example, the servant and agent possess goods to deliver either their boss or customer. So the property in goods may pass from the seller to the buyer but the goods may be in possession of the seller either as unpaid seller or as a bailee for the buyer. In other cases the property in goods may still be with the seller although the goods may be in the possession of the buyer or his agent or a carrier for transmission to the buyer.

### 12.3.2 Significance/Importance of Time at Which the Property in Goods Passes from the Seller to the Buyer

The moment of time at which the property in goods passes from the seller to the buyer is of great significance from various viewpoints. The following points are significant for the transfer of ownership of the goods.

(a) Risk Follows Ownership (Section 26)
(b) Action against Third Party
(c) Suit for Price
(d) Insolvency of the Seller or the Buyer

**(a) Risk Follows Ownership (Section 26):** As a general rule the risk of the loss of goods is with the person who has property right. 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." The risk of destruction or loss of goods sold falls on the buyer and not on the seller though the goods may still be in the possession of seller. Risk of loss is to be decided not on the basis of possession of goods but on the basis of ownership of goods as risk passes with transfer of ownership.

**(b) Action Against Third Party:** In contract of sale, when the goods are in any way damaged or destroyed by the action of the third parties, it is only the owner of the goods can take action against them. It means the right to proceed against a third party for destruction or damage to the goods depends not on possession but on the transfer of property.

**(c) Suit for Price:** The seller can sue the buyer for price only if the goods have become the property of the buyer. It means transfer of property in goods confers upon the seller the right to sue the buyer for the price.

**(d) Insolvency of the Seller or the Buyer:** in the event of insolvency of either buyer or seller, the answer to the question whether the official receiver or assignee can take over the goods or not, shall depend upon whether the property in goods was with the party who has become insolvent. If official assignee finds that insolvency (buyer or seller) is the owner of the goods at the time of his insolvency, the official assignee can take over the goods and if official assignee finds that insolvent is not the owner at the time of his insolvency, he cannot take over the goods.

## 12.4 Rules Regarding Transfer of Property

### 12.4.1 Meaning

The rules relating to transfer of property are given in Sections 18 to 25 of the Sale of Goods Act.

According to Sec. 18, (focuses on goods to be ascertained) "Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained." According to Sec. 19 (1), (focuses on parties intension) "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." According to Sec. 19 (3), (focuses in a situation when no intension is expressed) if a different intention does not appears, the rules contained in Sections 20 to 24 of the Sale of Goods Act are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

It is clear from the earlier topics of the sale of goods that sale differs from an agreement sell by the fact that in the sale property is transferred while in the agreement to sell property not transferred immediately. If the property has passed to the buyer the risk of loss, destruction or deterioration of the goods sold, falls on the buyer and not on the seller, even if the goods are remaining in the seller's possession. The rules regarding transfer of property can be classified in following two heads.

(i) Transfer of property in Specific or Ascertained Goods
(ii) Transfer of property in Unascertained and Future goods

### 12.4.2 Transfer of Property in Specific or Ascertained Goods

For specific goods or ascertained goods the property in them is transferred to the buyer under the contract for sale at such time when the parties to the contract intend it to be transferred. For the purpose of knowing the intension of the parties to the contract the regard should be given to terms of contract, conduct of the parties and the circumstances as the case may be. According to Section 18, where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

In the case of specific goods, the transfer of property takes place when the parties intend to pass it at once at the time of making the contract or when goods are delivered or when the goods are paid for. So in case it is not possible to judge the intension of parties from their contract, conduct or other circumstances, the rules laid down in section 20, 21, 22 can be apply.

Such provisions under section 20, 21, 22 and 24 are summarized as follows.

(a) **When Goods are in Deliverable State (Section 20):** According to Section 20 "Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passed to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed." The goods are said to be in a `deliverable state', when they are in such a state that the buyer would, under the contract, be bound to take delivery of them immediately. When the goods are ready for delivery and there remains nothing to be done to them, they are said to be in a deliverable state. For example, there is a contract for the sale of a machine, weighing 20 tons and embedded in a concrete floor. A part of the machine is destroyed while being removed. The buyer is entitled to refuse to take the machine as it is not in a deliverable state [Underwood Vs. BC Cement Syndicate (1922)].

(b) **When Goods have to be Put in Deliverable State (Section 21):** According to Sec. 21 of 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 deliverable state, the property does not pass until such thing is done and the buyer has notice thereof". in order to put the goods in deliverable state, the basic condition in contract is the seller must do something. For example, such includes the act may be painting, polishing, loading, packing, filling in containers etc. When buyer comes to know that seller has put the goods into deliverable state by performing such act in such a case the ownership is transferred. It means merely putting the thing in a deliverable state would not result in the transfer of property in goods from seller to the buyer but it is necessary that buyer must have notice the same. For example, in case of Underwood vs. Burgh Castle Cement Syndicate, contract for sale of fixed condensing engine was made. The engine was to be served and delivered free of rail at a specified price. However, the engine was damaged before it reached the railway. It was held that the property in goods did not pass as the gods were not in a deliverable state when it reached the railway.

(c) **When Goods have to be Measured etc., to Ascertain Price (Section 22):** According to Sec. 22, "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 the 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." The ownership is transferred to the buyer as soon as the seller has done such act and the buyer comes to know about it. Passing of property is conditional upon the performance of some act with reference to the goods for the purpose of ascertaining the price. For example, in case of Zagury Vs. Fur'nell (1809), The contract was for the sale of 289 bales of goat skins. Each bale marked as containing 5 dozen skins. It was the duty of the seller to count the goat skin in each bale. Before he could count the skins, the bales were destroyed by fire. It was held that the property in the goods had not passed to the buyer as something still remained to be done by the seller for ascertaining the price. As such the loss caused by fire had to be home by the seller.

### 12.4.3 Transfer of Property in Unascertained and Future Goods

The rule relating to transfer of properly in unascertained and future goods is contained in Sections 18 and 23. According to Sec. 18, where there is a contract for the sale of unascertained goods, property in the goods is not transferred to the buyer unless and until the goods are ascertained. Sec. 23 (1) states that "where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by

the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made. It must be noted that the above rule is a fundamental rule and it applies irrespective of what the parties intended. Until goods are ascertained or appropriated there is merely an agreement to sell.

Ascertainment means establishing the identity of the goods and appropriation means selection, setting at par or any other act with the intention of using the goods for the performance of the contract. Ascertainment is the process by which the goods answering the description are identified and set at par. Appropriation is generally made by the seller by putting the goods into boxes or bags with the assent of the buyer which may be express or implied. For example, in case of Rhode Vs. Thwaires (1827), there was a contract for the sale of 20 hog heads of sugar out of a larger quantity. 4 hog heads, which were filled in, were taken away by the buyer. Later, the seller filled 16 more hog heads and informed the buyer asking him to take them away. The buyer says he will take them as soon as he can. But before he could do so, the goods were lost. Held, the property had passed to the buyer at the time of the loss.

**Activity B:**

1. Refer different real cases registered under contract of sale and make a different list of them by differentiating cases (a) Goods have to be put in deliverable State (b) Goods have to be Measured or any other act, to Ascertain Price or any other aspect of contract.

## 12.5 Reservation of Right of Disposal

The section 25 of the Sale of Goods Act, 1930 lay down the rules applicable to the cases where the Reservation of Right of Disposal is available to seller.

### 12.5.1Meaning

Reservation of the right of disposal means reserving it right to dispose of the goods until certain conditions, like payment of the price, are fulfilled. When the seller reserves such a right the property in the goods does not pass until those conditions are fulfilled.

According to Sec. 25 (1), "Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract. The seller may, by the terns of the contract or appropriation reserve the right of disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to a buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled."

According to Sec. 25 (2), "Where goods are shipped and by the bill of lading the goods are

deliverable to the order of seller or his agent, the seller is prima facie deemed to reserve the right of disposal." In such cases, the goods are said to be deliverable to the order of the seller or his agent.

According to Sec. 25 (3), "Where the seller of goods draws on the buyer for the price, and transmits the bill of exchange and bill of lading to the buyer together, to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honour the bill of exchange and if he wrongfully retains the bill of lading the property in the goods does not pass to him."

For example, Mayank placed an order with Saurabh requesting his to send the goods by sea. Saurabh took a bill of lading in the name of Mayank and sent it to his own agent. The goods were destroyed in the course of voyage. Saurabh had to suffer the loss as the ownership had not passed to Mayank.

**Activity C:**

1. Identify and list out various situation where contract of sale is applied and where the reservation of right of disposal is available to seller.

## 12.6 Risk Prima Facie Passes with Property

**Meaning:** 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.". Sec. 26 lays down the general rule the risk prima jade passes with the ownership, i.e., the risk and the ownership of the goods go together. This means that in case of loss of the goods, the loss shall be borne by the party who has the ownership of the goods at the time of loss. Thus, question of finding the owner of goods is important when there is some loss of the goods. The loss is to be borne by the person who is the owner of the goods at the time of loss. For example, For example, Amit buys goods form Bhavesh and goods remain in Bhavesh's warehouse. Before delivery of goods to Amit, there is a fire in Bhavesh's warehouse and all the goods are destroyed. Amit must pay the price of goods to Bhavesh, if he has not paid so far. Another example, Ankit agrees to purchase Bapu's Refrigerator for Rs. 12,000. The ownership from Bapu to Ankit is to pass on 15th January, 1985, while the price is paid in advance on 10th January, 1985. On 11th January 1985, the Refrigerator burned due heavy voltage and Bapu will have to bear loss.

But there are certain exceptions to the above Rule. When the risk and the ownership may be separated by an agreement between the seller and the buyer, as to when the ownership shall be transferred and who shall suffer the loss, the above rules does not apply. Another situation is related with delay of goods i.e. where delivery has been delayed through the fault of the buyer or the seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault. Sometimes the trade custom also held the buyer responsible for risk. We know that the "trade custom" is the customary rule prevalent in a particular trade which is generally followed by the parties, for example, the trade custom may proved that the goods shall be at the risk of the buyer whether or not the ownership has been transferred to him.

## 12.7 Sale by Non Owners

### 12.7.1 Meaning

The seller, generally, sells only such goods of which he is the absolute owner. But sometimes a person may sell goods of which he is not the owner, and then the question arises as to what is the position of the buyer who has bought the goods by paying price.

According to Section 27 "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 or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods, is by his conduct precluded from denying the seller's authority to sell."

The general rule is that "no one can give that which one has not got". This general rule is expressed by the maxim, "nemo dal quod non habet". This means that "no one can transfer a better title than he himself has." The seller cannot give to the buyer of the goods a better title to the goods than he himself. If the title of the seller is defective, the buyer's title will also be subject to the same defect. If the seller

has no title to the goods, the buyer does not acquire any title although he might have acted honestly and might have paid the value of the goods. This is to protect the true owner. If a thief disposes of stolen property, the buyer acquires no title though he may have purchased the goods bonafide for value, and the real owner of the goods is entitled to recover possession of goods without paying anything to the buyer. Thus a buyer cannot get a good title to the goods unless he purchases the goods from a person who is the owner thereof or who sells them under the authority or with the consent of the owner. For example, Anil finds a ring of Bijoy and sells it to Collin, who purchases it for value and in good faith. The true owner i.e., Bijoy can recover the ring from Collin, for A having no title could pass none the better. Another example is Atul was a hirer of certain goods under the hire purchase agreement. He sold the goods to Bishnu, who bought them in a good faith. In this case, Bishnu will not become the owner of the goods because Atul was only a hirer and not the owner.

### 12.7.2 Exception to Sale by Non Owners

A person although he is not the owner of the goods, may sell the goods and pass a better title than he himself has. The following are the various exceptions to the rule.

**(a) Sale by Mercantile Agent:** Sec. 2 (9) provides that. "Mercantile agent" means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale or to buy goods, or to raise money on the security of goods. Where a mercantile agent is, with the consent of the owner. in possession of the goods or of documents of title to the goods, any sale made by him when acting in the ordinary course of the business of a mercantile agent shall be binding on the owner and be as valid as if he were expressly authorized by the owner of the goods to make the same. The essential conditions are that the agent is in possession of the goods or of the document of title to the goods; the possession is in his capacity as a mercantile agent; the mercantile agent sells the goods in the ordinary course of his business as an agent; the buyer acts in good faith and he should presume that the agent has full authority to sell. For example, Ajit the owner of the car entrusted his car to a mercantile agent for sale at a stated price and not below that. The agent sold car to Pradip below the reserve price and misappropriated the money. Pradip subsequently sold the car to Raju. Ajit cannot recover the car Raju. The mercantile agent was able to convey a better title in this case.

**(b) Title by Estoppel:** In certain cases the true owner is prevented by his conduct form denying the seller's authority to sell. The principle of estoppels applies when the owner by his words or conduct has led the buyer to believe that the seller was the owner of the goods or had the owner's authority to sell them and induced the buyer to buy, he cannot afterwards deny the seller's authority to sell. In such a case the buyer gets a title. In other words when someone makes another person to believe that a particular thing or fact is true, then afterwards he cannot be allowed to deny the truth of that thing or fact. In a contract of sale, estoppel may arise where the owner by any act or omission leads the buyer to believe that the seller has the right to sell. Thus, when the owner of the goods by his conduct or by statement, willfully leads the buyer to believe that the seller has the authority to sell, then he is prevented from denying the seller's authority to sell. If a buyer buys goods in such belief, latter on the owner cannot say that the seller had no authority to sell. The basis of estoppel is that it would be unfair or unjust to allow a party to depart from a particular state of affairs which he has permitted another person to believe to be true. For example, Axit is selling Bijoy's goods in his presence to Manoj. Bijoy does not object to sale. Manoj gets a better title because the true owner Bijoy is estoppel from denying Axit's authority.

(c) **Sale by a Joint Owner:** According to Sec. 28, "If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them of such joint owner in good faith and has not at the time of the contract of sale notice that the seller has not authority to sell." Joint owner may be defined as a person who owns the goods jointly with some other persons. It is essential to point out that a co-owner can sell his own share even without the application of the provisions of this section. However, according to this section, that the co-owner should be in possession of the same with the consent of the other co-owners and the buyer should act in good faith and without notice that the seller has no authority to sell. Thus it is essential to point out that a co-owner can sell his own share even without the application of the provisions of this section. However, according to this section, that the co-owner should be in possession of the same with the consent of the other co-owners and the buyer should act in good faith and without notice that the seller has no authority to sell. Anil, Biju and Collin are joint owners of a poultry farm having one thousand chickens. The farm was being managed by Biju with the consent of Anil and Collin. Biju sells all the chickens to Yogesh who buys in good faith. Yogesh gets a better title. This exception is applicable only when the buyer buys goods in good faith. If it can be proved that the buyer had the knowledge about the defective title of the seller, then the buyer will not get a better title.

(d) **Sale under a Voidable Contract:** When a person has obtained possession of the goods under a voidable contract and he sells those goods before the contract has been rescinded, the buyer of such goods acquires a good title to there provide the buyer acts in good faith and without notice of the seller's defect of title. A person who has obtained possession of goods under a contract which is voidable on the ground of fraud, misrepresentation, coercion or undue influence, can convey a good title provided the sale takes place before the voidable contract is avoided.

According to Section 29 "When the seller of goods has obtained possession thereof under a contract voidable under Section 19 or 19 (A) of the Indian Contract Act, but the contract has not been rescinded at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title." However, the buyer gets a valid title only if the seller must have obtained the possession of the goods under a voidable contract and not under void contract; the contract must not have been rescinded at the time of sale; and the buyer must act in good faith and he should not have any knowledge about seller's defective title. For example, Joy, by misrepresentation induces Mithun to sell and deliver to him a cow. Joy sells the cow to Amit before Mithun has rescinded the contract. Amit purchases the cow in good faith and without notice of the seller's defective title. Amit acquires a good title.

(e) **Sale by Seller in Possession After Sale:** According to Section 30 (1), where a seller, having sold goods, continues to be in possession of goods or the documents of' title to the goods and sells them either himself or through his mercantile agent to another person, who buys in good faith and without notice of the previous sale, the buyer gets a good title. For the application of this exception it is essential that the possession of the seller must be as seller and not as a hirer or bailee.

(f) **Sale by Buyer in Possession, After Sale:** According to Section 30 (2), where a buyer has agreed to buy the goods and has obtained possession of the same or the documents of title to them with the consent of the seller, resells or pledges the goods either himself or through a mercantile agent, he will convey a good title to the buyer or pledgee provided the person

receiving the goods acts in good faith and without notice of any line or other right of the original seller in respect of those goods. Here second buyer gets a better title.

**(g) Resale by Unpaid Seller:** According to Section 54 (3) "where an unpaid seller who has exercised his right or lien or stoppage in transit resells the goods, the buyer acquires a good title there o as against the original buyer, notwithstanding that no notice of the re-sale has been given to the original buyer."

**(h) Sale in Market Overt:** English law provides an additional exception to the general rule. Market overt is an open, public and legally constituted market. Where a person buys goods in market overt, according to usage of the market, the buyer acquires a good title to the goods. This rule does not apply in India.

**(i) Sale by a Finder of Goods:** According to Section 169 of Indian Contract Act, Sometimes, the finder of lost goods sells the goods to a buyer. In such cases, the buyer gets a valid title to the goods if the finder sells the goods under the permitted circumstances such as if the owner cannot with reasonable diligence be found, or if found, he refuses to pay lawful charges to the finder, or if the goods are losing the greater part of their value, or if the lawful charges of the finder, in respect of goods found, amount to 2/3rds of their value.

## 12.8 Delivery of Goods

### 12.8.1 Meaning

After the formation of a valid contract of sale, the next stage is its performance. Contract of sale imposes some duties on the seller and the buyer. It also confers some rights to the seller and the buyer. The seller's main duty is to deliver the goods to the buyer. Similarly, the buyer's main duty is to accept the goods and pay the price to the seller as per the terms of the contract.

According to Sec. 2(2), "delivery means voluntary transfer of possession from one person to another". Delivery is a bilateral act. It requires two parties to act. If transfer of possession of goods is not voluntary i.e. possession is obtained by theft etc., there is no

delivery. The performance is mutual and is laid down in Sec. 31 of the Act states that. "It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale."

### 12.8.2 Modes of Delivery

According to sec. 33 "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 the buyer or of any person authorized to hold them on his behalf." Thus delivery need not mean transfer of physical possession of goods. Delivery of goods may be made in any of the following ways:

**(a) Actual Delivery:** Where the goods are physically handed over by the seller (or his authorized agent) to the buyer (or his authorized agent), the delivery is said to be actual. For example, the seller of a car hands over the car to the buyer, there is actual delivery of the goods.

**(b) Symbolic Delivery:** Here the goods remain where they are, may be because they are bulky, but the means of obtaining possession of goods is delivered. For example, the seller hands over to the buyer the key of the godown where the goods are stored, or transfers a document of title (i.e., bill of lading or railway receipt) to the buyer which will entitle him to obtain the goods.

**(c) Constructive Delivery:** Such a delivery takes place when the person in possession of the goods of the seller acknowledges, in accordance with the seller's order that he holds the goods on behalf of the buyer and the buyer has assented to it. Note that in such a delivery all the three parties, namely, the seller, the person holding the seller's goods and the buyer, must concur. For example, where the Baler hands over the 'delivery order' to

### 12.8.3 Rules Regarding Delivery of Goods (Sec. 33 to 40)

The provisions related to rules regarding delivery of goods are given under Section 33 to 40 which includes provisions related to giving possession and full control of goods to buyer; delivery and payment are concurrent conditions; delivery of goods as demanded; conditions related to time, place of delivery; consent of third person to deliver if he possess the goods; effect of part delivery; expenses of delivery; installment delivery; delivery of wrong quantity; short delivery; excess delivery; delivery to a carrier; delivery at a distant place etc.

**Activity D:**

1. Refer various cases fall under contract act and indentify and discuss the cases were sales made by non owner, and also comment on what should have been done to overcome the problems involved in these cases.

## 12.9 Rights of an Unpaid Seller and Rights of Buyer

### 12.9.1 Meaning

A seller who has not received the whole of the price of the goods sold to known as unpaid seller. The seller of goods is deemed to be an 'unpaid seller' (a) when the Whole of the price has not been paid or tendered; or (b) where a bill of exchange or other negotiable instrument has been received as a conditional payment, i.e., subject to the realization thereof, and the same has been dishonored.

Rights of an Unpaid Seller against Goods can be studied under the two conditions i.e. where the ownership of the goods is transferred to the buyer and where the ownership of the goods is not transferred to the buyer. According to Sec. 46 of the Act, the unpaid seller has three distinct rights even though property in the goods is transferred to the buyer. These rights are: (a) Right of lien, (b) Right of stoppage in transit and (c) Right of resale.

**(a) Right of Lien:** The word 'lien' means 'to retain possession of'. According to Sec. 47 (1) "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 cases, namely, where the goods have been sold without any stipulation as to credit; where the goods have been sold on credit, but the term of credit has expired and where the buyer becomes insolvent."

The right of lien is one of the unpaid seller's right against the goods, the property in which is transferred to the buyer. It is the unpaid seller's right to retain the goods until the whole of the price is paid or tendered. Lien can be exercised only for non-payment of the price, and not for any other charges due against the buyer. For instance, the seller cannot claim lien for godown charges for storing the goods in exercise of his lien for the price. The lien of an unpaid seller's particular lien, it is a personal right which can be exercised only by him and not by his assignees or his creditors. The unpaid seller may exercise his lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer. The right of lien is linked with the possession of

the goods and not with the title of the goods.

The right of lien depends only upon the possession of the goods. Thus, the right of lien is lost as soon as the possession of the goods is lost. The circumstances, in which the unpaid seller's lien is lost includes following cases:

(i) Sec. 49 (1) (a) "When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods"

(ii) Sec. 49 (1) (b) "when the buyer or his agent lawfully obtains possession of the goods"

(iii) Sec. 49 (1) (c) "by waiver thereof Waiver may be express or implied. The express waiver is the waiver when the contract of sale provides in express terms that the seller shall not retain the possession of the goods even if the price is not paid. Implied waiver is the waiver where the conduct of the seller shows that he will not exercise his right of lien.

(iv) Where he assents to a sub-sale by the buyer.

**(b) Right of Stoppage in Transit (Sec. 50 to 52)**: The right of stoppage in transit means the right of stopping future transit of the goods while they are with a carrier for the purpose of transmission to the buyer, resuming possession of them and retaining possession until payment or tender of the price. According to Sec. 50, "Subject to the provisions of this Act, when the buyer of the 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 price." The second right which is available to an unpaid seller is the right to stoppage in transit. This right can be exercised if certain conditions are satisfied such as the seller must be unpaid; the buyer must be insolvent; property in the goods must have passed; seller has parted with the possession of the goods and buyer has not got the possession of the goods.

Considering the duration of transit according to Section 51 "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 in that behalf takes delivery of them from such carrier or other bailee." The carrier may hold the goods as Seller's agent; Buyer's agent; Independent contractor.

The important question is how Stoppage in Transit is affected? According to Section 52, an unpaid seller may exercise his right of stoppage of goods in transit by following some ways includes by taking actual possession of the goods; or by giving notice of his claim to the carrier or other bailee, who possesses the goods.

In case where there exists the need for withholding Delivery, according to Section 46 (2), "Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive, with his rights of lien and stoppage in transit where the property has passed to the buyer."

In addition to his rights against the goods, as discussed above, an unpaid seller has the following rights against the buyer personally:

**(i) Suit for Price (Sec. 55):** On transfer of the ownership of the goods to the buyer, he becomes bound to pay the price to the seller. When he does not pay the price in terms of the contract, legal action can be taken against the buyer by the unpaid seller.

(a) Sec. 55 (1) states, "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."

(b) Sec. 55 (2) states, "Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract."

**(ii) Suit for Damages for Non-acceptance (Sec. 56)**: Sec. 56 states, "Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance."

This section deals with general damages. As such, the seller can recover the estimated loss arising directly and naturally, in the course of events, from the buyer's breach of the contract. Such damages are measured as per provisions contained in Sec. 73 of the Indian Contract Act. They are:

(i) Where there is an available market for the goods in question, the difference between the contract price and the market price on the date of breach will be the measure of damages.

(ii) Where there is no such market, the measure will be the estimated loss directly or indirectly resulting in the ordinary course of events from such breach.

In the same way, when the seller is ready and requests the buyer to take the delivery of the goods and the buyer wrongfully neglects or refuses to take the delivery within a reasonable time, the seller is entitled to recover from the buyer: (a) any loss by the buyer's neglect or refusal to the seller; and (b) reasonable charges for the care and custody of goods (Sec. 44).

**(iii) Suit for Repudiation of the Contract Before Due Date (Sec. 60):** Sometimes, the buyer puts an end to the contract before the due date of delivery of goods. Sec. 60 states, "Where either party to a contract of sale repudiates the contract before the date of deliver the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach." Thus the seller may (a) treat the contract as subsisting and wait till the date of delivery or (b) treat the contract as rescinded and sue the buyer for damages for breach.

**(iv) Suit for Interest (Sec. 61):** Where there is a specific agreement between the parties as to interest on the price of the goods from the date on which the payment becomes due. The seller may recover such- interest from the buyer. Further, Sec. 61 (2) states, "In the absence of a contract to the contrary, the Court may award interest at such rate, as it thinks ft, on the amount of price to the seller in a suit by him for the amount of the price, from the date of the tender of the goods or from the date on which the price was payable:"

**(c) Right of Resale (Sec. 54)**: An unpaid seller who has exercised his right of lien and stoppage in transit is also empowered to effect resale of the goods. This resale right is a valuable right given to an unpaid seller. Section 54 of the Act has given the right of resale to an unpaid seller, in the following circumstances:

**(i) Where the Goods are Perishable:** Sometimes, the goods are of perishable nature. The unpaid seller, who has exercised the right of lien or stoppage in transit, can resell the goods. The unpaid seller need not give a notice to the buyer of his intention to resell the goods. Perishable goods may include those goods which are apt to deterioration in a mercantile sense.

**(ii) Where Unpaid Seller Gives Notice of His Intention:** When the goods are not of perishable nature and buyer does not pay or tender the price, the seller can resell the goods. However, he should give a notice to the buyer of his intention to resell the goods.

**(iii) Where the Seller Expressly Reserves His Right of Resale:** Where the seller expressly reserves a right of resale in case the buyer makes default, and, on the buyer making default, resells the goods, the original contract of sale is thereby rescinded. This rescission, however, does not affect the seller's right to claim damages for loss.

The seller is entitled to recover from the original buyer damages caused to him by the resale. But if any profit accrues, such profit shall belong to the seller. However, the seller shall not be entitled to recover damages from the buyer or retain surplus if he fails to give reasonable notice to the buyer. In case of perishable goods, such notice is not necessary.

The right of resale is a very valuable right given to an unpaid seller. In the absence of this right, the unpaid seller's other rights against the goods, namely, 'lien' and 'stoppage in transit,' would not have been of much use because these rights only entitle the unpaid seller to retain the goods until paid by the buyer.

## 12.10 Auction Sale

In an auction sale, the auctioneer invites bids from prospective purchasers and sells the goods to the highest bidder. Section 64 lays down the following rules relating to an auction sale:

(a) According to Section 64 (1) where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale.

(b) According to Section 64 (2) the sale is complete when the auctioneer announces its completion by the fall of hammer or in other customary manner; and until such announcement is made, an bidder may retract his bid. .

(c) According to Section 64 (3) a right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly so reserved but not otherwise, the seller or any one person on his behalf may, subject to the provisions hereinafter contained, bid at the auction. .

(d) According to Section 64 (4) where the sale is not notified to be subject to a right of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale or for the auctioneer knowingly to take any bid from the seller of any such person; and any sale contravening this rule may be treated as fraudulent by the buyer. .

(e) According to Section 64 (5) The sale may be notified to be subject to a reserved or upset price. (Sec. 64(5)).

(f) According to Section 64 (6) If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

## 12.11 Summary

There are three stages in the performance of a contract of sales of goods by a seller viz., the transfer of property in goods, the transfer of possession of the goods (i.e. delivery) and the passing of the risk. The knowledge and understanding of sale of goods helpful to business and community. This unit provides understanding about important topics related with various provisions of Sale of Goods Act, 1930 viz., meaning and exception to the doctrine of caveat emptor; meaning and significance of passing or transfer of property; rules regarding transfer of property; reservation of right of disposal; risk prima facie passes with property; sale by non owners; delivery of goods; rights of an unpaid seller and rights of buyer, and rules related to auction sale.

## 12.12 Self Assessment Questions

1. State the rules in regard to the passing of property from a seller to a buyer in a contract for the sale of goods.
2. Why it is important to know the exact time the property in goods passes from a seller to buyer? Explain with examples the rules regarding the transfer of ownership of goods from seller to buyer.
3. What are the rules as to passing of property from a seller to a buyer in a contract for the sale of unascertained and future goods?
4. "A seller cannot convey a better title to the buyer than he himself has." Discuss this rule of law and point out the exceptions.
5. Discuss the various provisions of law under which a non-owner can convey a good title to a buyer.
6. Who is an unpaid seller of goods and what are his rights against the goods? How he apply any remedy against the buyer personality?
7. Define Unpaid Seller and discuss his rights under sale of goods act.
8. Write Short Notes on following;
   (a) Auction sale.
   (b) Modes of Delivery.
   (c) Risk Prima Facie Passes with Property.
   (d) Doctrine of Caveat Emptor.
9. Distinguish between an unpaid seller's right of lien and right of stoppage of goods in transit. When can the unpaid seller resell the goods? Explain.

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# Unit - 13 : The Negotiable Instruments Act, 1881 (Part – I)

**Structure of Unit:**



## 13.0 Objectives

After completing this unit, you would be able to:

- Understand meaning and essential characteristics negotiable instruments;
- Describe various types of negotiable instruments i.e. Promissory Note, Bill of Exchange and Cheque;
- Explain various essential features of Promissory Note, Bill of Exchange and Cheque;
- Differentiate between Promissory Note and Bill of Exchange;
- Differentiate between Bill of Exchange and Cheques;
- Explain different kinds of cheques.

## 13.1 Introduction

For a commercial transaction, it is always not possible for a businessman to carry huge cash. Businessman, therefore adopt a new method of exchanging documents as bill of exchange, cheques etc, in place of money. These documents, which are used as a substitution for money, are known as negotiable instruments. Advent of cheques in the market have given a new dimension to the commercial and corporate world, its time when people have preferred to carry and execute a small piece of paper called cheque than carrying the currency worth the value of cheque. Dealings in cheques are vital and important not only for banking purposes but also for the commerce and industry, and the economy of the country.

The history of the Negotiable Act is a long one. The Act was originally drafted in 1866 by the India Law Commission and introduced in December, 1867 in the Council and was referred to a Select Committee. Objections were raised by the mercantile community to the numerous deviations from the English Law which it contained. The Bill had to be redrafted in 1877. After the lapse of a sufficient period for criticism by the Local Governments, the High Courts and the chambers of commerce, the Bill was revised by a Select Committee. In spite of this Bill could not reach the final stage. In 1880 by the Order of the Secretary of State, the Bill had to be referred to a new Law Commission. On the recommendation of the new Law Commission the Bill was re-drafted and again it was sent to a Select Committee which adopted most of the additions recommended by the new Law Commission. The draft thus prepared for the fourth time was

introduced in the Council and was passed into law in 1881 being the Negotiable Instruments Act, 1881 (26 of 1881). The Act came into force on 1st March, 1882. The latest amendment to the Act was made in the year 2002. Now the Act contains 147 sections. . This amendment Act inserts five new sections from 143 to 147 touching various limbs of the parent Act and Cheque truncation through digitally were also included and the amendment Act has been recently brought into force on Feb. 6, 2003. It deals with Promissory Notes, Bills of Exchange and Cheques, the three kinds of negotiable instruments in most common use. The Act applies to the whole of India and to all persons resident in India, whether foreigners or Indians. The provisions of this Act is also applicable to Hundies, unless there is local usage to the contrary and on the other native instruments like Treasury Bills, Bearer debentures etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

## 13.2 Meaning and Definition of Negotiable Instrument

To understand the meaning of negotiable instruments let us take a few examples of day-to-day business transactions.

Suppose Kaushal, a book publisher has sold books to Jhanvi for Rs 1,00,000/- on six months credit. To be sure that Jhanvi will pay the money after six months, Kaushal may write an order addressed to Jhanvi that she is to pay after six months, for value of goods received by her, Rs.1,00,000/- to Kaushal or anyone holding the order and presenting it before her (Jhanvi) for payment. This written document has to be signed by Jhanvi to show her acceptance of the order. Now, Kaushal can hold the document with him for six months and on the due date can collect the money from Jhanvi. He can also use it for meeting different business transactions.

For instance, after a month, if required, he can borrow money from Sunil for a period of two months and pass on this document to Sunil. He has to write on the back of the document an instruction to Jhanvi to pay money to Sunil, and sign it. Now Sunil becomes the owner of this document and he can claim money from Jhanvi on the due date. Sunil, if required, can further pass on the document to Amit after instructing and signing on the back of the document. This passing on process may continue further till the final payment is made.

In the above example, Jhanvi who has bought books worth Rs. 1,00,000/- can also give an undertaking stating that after six month she will pay the amount to Kaushal. Now Kaushal can retain that document with himself till the end of six months or pass it on to others for meeting certain business obligation (like with sunil, as discussed above) before the expiry of that six months time period.

You must have heard about a cheque. What is it? It is a document issued to a bank that entitles the person whose name it bears to claim the amount mentioned in the cheque. If he wants, he can transfer it in favor of another person. For example, if Mr Ramju issues a cheque worth Rs. 5,000/ - in favor of Mr Mugal, then Mr Mugal can claim Rs. 5,000/- from the bank, or he can transfer it to Mr Ali to meet any business obligation, like paying back a loan that he might have taken from Mr Ali. Once he does it, Ali gets a right to Rs. 5,000/- and he can transfer it to Pawan, if required. Such transfers may continue till the payment is finally made to somebody.

In the above examples, we find that there are certain documents used for payment in business transactions and are transferred freely from one person to another. Such documents are called Negotiable Instruments. Thus, we can say negotiable instrument is a transferable document, where negotiable means transferable and instrument means document. To elaborate it further, an instrument, as mentioned here, is a document used as a means for making some payment and it is negotiable i.e., its ownership can be easily transferred.

Thus, negotiable instruments are documents meant for making payments, the ownership of which can be transferred from one person to another many times before the final payment is made.

### 13.2.1 Definition of Negotiable Instrument

The term "Negotiable Instrument" means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or cheque payab1e either to order or to bearer. [Negotiable Instruments Act, 1881, Section 13(1)]

According to **Thomasb**, "An instrument is negotiable when it is, by a legally recognized custom of trade or by law, transferrable by delivery or by indorsement and delivery, without notice to the party liable in such a way that (a) the holder of it for the same being may sue upon it in his own name, and (b) the property in it passes to a bona fide transferee for value free from any defect in the title of the person from whom he obtain it

In the words of Justice, **Willis**, "A negotiable instrument is one, the property in which is acquired by anyone who takes it bona fide and for value notwithstanding any defects of the title in the person from whom he took it".

Thus, the term, negotiable instrument means a written document which creates a right in favor of some person and which is freely transferable. Although the Act mentions only these six instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

1. The instrument should be freely transferable (by delivery or by indorsement. and delivery) by the custom of the trade; and

2. the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and indorsements, yet they are not able to give better title to the bona fide transferee for value than what the transferor has.

## 13.3 Features of Negotiable Instruments

Following are the important features of negotiable instruments:

1. **In Writing -** It is the basic condition of the negotiable instrument that it is always in writing. It cannot be verbal. This includes handwriting, typing, computer printout and engraving, etc.
2. **Signature -** Negotiable instrument must bear the signature of its maker. Without the signature of the drawer or the maker, the instrument shall not be a valid one.
3. **Unconditional -** It is an unconditional instrument if any condition is attached, then it cannot be called negotiable instrument.
    a. ***Example:*** Avadhesh promises to pay Rs. 10,000 to Vijay Mohan, provided that Vijay Mohan delivers goods as per his order. This is a conditional negotiable instrument and, hence, invalid one.

4. **Transferable -** It can easily transferable from one person to another. In these instruments right of ownership passes either by delivery or by indorsement. Usually, when we transfer any property to somebody, we are required to make a transfer deed, get it registered, pay stamp duty, etc. But, such formalities are not required while transferring a negotiable instrument. The ownership is changed by mere delivery (when payable to the bearer) or by valid indorsement and delivery (when payable to order). Further, while transferring it is also not required to give a notice to the previous holder.

5. **Payable on Demand** - The amount of the instrument is payable on demand or at any predetermination future time.

6. **Payable in Money -** The amount must be written on the instrument and it is always payable in terms of money. It can never be payable in commodity or chattel such wheat, rice, apple etc. if it is payable other than money or something in addition, it becomes invalid

7. **Payable to the Bearer -** The amount written on it is payable to the bearer or to a specified person. The payee must be a certain person. It means that the person in whose favor, the instrument is made must be named or described with reasonable certainty. The term 'person' includes individual, body corporate, trade unions, even secretary, director or chairman of an institution. The payee can also be more than one person.

8. **Payment of Debt -** It can be very easily used for the payment of debt. It is very simple and convenient method of payment.

9. **Right of Recovery -** A cheque or Note gives the right to the creditor to recover the written amount from the debtor. He can recover this amount by himself or he can transfer this right to another.

10. **Absolute and Good Title -** If there is a defect in the title of the previous holder it does not affect the holder in due course. So it is a better little than others. Negotiability confers absolute and good title on the transferee. It means that a person who receives a negotiable instrument has a clear and undisputable title to the instrument. However, the title of the receiver will be absolute, only if he has got the instrument in good faith and for a consideration. Also the receiver should have no knowledge of the previous holder having any defect in his title. Such a person is known as holder in due course.

    a. ***Example:*** Rajiv issued a bearer cheque payable to Ajay. It was stolen from Ajay by a person, who passed it on to Pradeep. If Pradeep received it in good faith and for value and without knowledge of cheque having been stolen, he will be entitled to receive the amount of the cheque. Here Pradeep will be regarded as 'holder in due course'.

11. **Exception of General Law -** In case of transfer of property the general concept of law is that "Nobody can transfer a better title than that of his own." But in case of instrument this law does not apply. A negotiable instrument even got in good faith from thief is better title.

12. **Specified Amount -** It is also a characteristic of negotiable instrument that specified and definite amount is written on the instrument. Without specified amount a negotiable instrument cannot be freely negotiated.

13. **Payment Time -** The time of payment must be certain. It means that the instrument must be payable at a time which is certain to arrive. If the time is mentioned as 'when convenient' it is not a negotiable instrument. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.

14. **Stamp -** Stamping of Bills of Exchange and Promissory Notes is mandatory. This is required as per the Indian Stamp Act, 1899. The value of stamp depends upon the value of the note or bill and the time of their payment.

15. **Presumptions**: Certain presumptions apply to all negotiable instruments e.g., a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words 'for value received' or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration. These presumptions are being explained under a separate head.

## 13.4 Presumptions as to Negotiable Instruments

For deciding cases in respect of rights of parties on the basis of a bill of exchange, the Court is entitled to make certain presumptions. These are briefly stated as follow:

1. **As to Consideration-** Every negotiable instrument was made or drawn for consideration, and that every such instrument, when it has been accepted, indorsed, negotiated or transferred, was accepted, indorsed, negotiated or transferred for consideration

2. **As to Date-** That every negotiable instrument bearing a date was made or drawn on such date;

3. **As to Time of Acceptance-** That every accepted bill of exchange was accepted within a reasonable time after its date its date and before its maturity

4. **As to Time of Transfer -** That every transfer of a negotiable instrument was made before its maturity

5. **As to Order of Indorsements** - That the indorsements appearing upon a negotiable instrument were made in the order in which they appear thereon

6. **As to Stamps**-That a lost promissory note, bill of exchange or cheque was duly stamped;

7. **Holder is Holder in Due Course -** That the holder of a negotiable instrument is a holder in due course; provided that, where the instrument has been contained from its lawful owner, or form any person in lawful custody thereof, by means of an offence or fraud, or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon him.

8. **Proof of Dishonor -** If a suit is filed upon an instrument which has been dishonored, the Court shall, on proof of the protest, presume the fact of dishonor unless it is disproved. (Section 119)

All above presumptions hold for all negotiable instruments until the contrary is proved by evidence.

## 13.5 Payee in a Negotiable Instrument

All three kinds of negotiable instruments mentioned under section 13 of the Act could be made payable in any of the following ways – Payable to bearer or Payable to order.

**Payable to Bearer:** The expression "bearer instrument" signifies an instrument, be it promissory note, bill of exchange or a cheque, which is expressed to be so payable or on which the last indorsement is in blank. This character of the instrument can be altered subsequently e.g. an indorsee can convert an 'Indorsement in blank' into an 'Indorsement in full'. In such a case, the holder of the instrument would not be able to negotiate the instrument by mere delivery. He will be required to indorse the instrument before delivering it.

**Payable to Order:** An instrument is payable to order when it is payable to:

(i) The order of a specified person, or

(ii) A specified person or his order, or

(iii) A specified person without the addition of the words "or his order" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable.

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty

## 13.6 Types of Negotiable Instrument

Section 13 of the Negotiable Instruments Act states that a negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. The Act does not affect the custom or local usage relating to an instrument in oriental language i.e., a Hundi

**Negotiable instruments recognized by statute are:**

**(i)** Promissory notes
**(ii)** Bills of exchange
**(iii)** Cheques

**Negotiable instruments recognized by usage or custom are:**

**(i)** Hundis
**(ii)** Share warrants
**(iii)** Dividend warrants
**(iv)** Bankers draft
**(v)** Circular notes
**(vi)** Bearer debentures
**(vii)** Debentures of Bombay Port Trust
**(viii)** Railway receipts
**(ix)** Delivery orders.

This list of negotiable instrument is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

## 13.7 Promissory Note

The term Promissory note has been defined under Section 4 of the Negotiable Instruments Act 1881, as under:

"A promissory note is an instrument (not being a bank note or a currency-note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of a, certain person, or to the bearer of the instrument". Provided that 'no person other than RBI or the Central Government can make a promissory note payable to the bearer' (Section 21 of the RBI Act)

**Illustrations:** Kaushal signs instruments in the following terms

(a) "I promise to pay Sunil or order Rs. 1500".

(b) " I acknowledge myself to be indebted to Sunil in Rs. 1,500 to be paid on demand, for value received."

(c) "Mr. Sunil, I O U (I Owe You) Rs. 1,500".

(d) "I promise to pay Sunil Rs. 1500 and all other sums which shall be due to him".

(e) "I promise to pay Sunil Rs. 1500; first deducting there out any money which he may owe me".

(f) " I promise to pay Sunil Rs. 1500 seven days after my marriage with Seema".

(g) "I promise to pay Sunil Rs. 1500 on Chaturbhuj's death, provided Chaturbhuj leaves me enough to pay that sum".

(h) "I promise to pay Sunil Rs. 1500 and to deliver to him my black horse on 1st January next".

The instruments respectively marked (a) and (b) are promissory notes. The instruments respectively marked (c), (d), (e), (f), (g) and (h) are not promissory notes.

**Specimen of a Promissory Note**

| | |
|---|---|
| Rs. 1,00,000/- | Ajmer<br>November 1, 2012 |
| On demand, I promise to pay Ramesh, s/o Ramlal of Meerut or order a some of Rs 1,00,000/- (Rupees Ten Thousand only), for value received. | |
| To, Ramesh<br>Navgraha Colony, Pushkar<br>Road, Ajmer – 305001 | <br>Sd/ Sanjeev<br>Stamp |

### 13.7.1 Parties to a Promissory Note

There are primarily two parties involved in a promissory note. They are:

**i.** **The Maker–** the person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker.

**ii.** **The Payee –** the person to whom the amount is payable. In the above specimen it is Ramesh.

In course of transfer of a promissory note by payee and others, the parties involved may be -

**a.** **The Indorser –** the person who indorses the note in favor of another person. In the above specimen if Ramesh indorses it in favor of Ranjan and Ranjan also indorses it in favor of Puneet, then Ramesh and Ranjan both are indorsers.

**b.** **The indorsee –** the person in whose favor the note is negotiated by indorsement. In the above, it is Ranjan and then Puneet.

### 13.7.2 Essentials of a Promissory Note

1. **It Must Be in Writing -** It is the basic condition of the promissory note that it is always in writing. It cannot be verbal. This includes handwriting, typing, computer printout and engraving, etc. An oral promise to pay does not become a promissory note
2. **It Must Certainly an Express Promise or Clear Understanding to Pay:** There must be an express undertaking to pay. A mere acknowledgment is not enough.

The following are not promissory notes as there is no promise to pay.

**If A Writes:**

(a) "Mr. B, I.O.U. (I owe you) Rs. 500"

(b) "I am liable to pay you Rs. 500".

(c) "I have taken from you Rs. 100, whenever you ask for it has to pay".

The following will be taken as promissory notes because there is an express promise to pay:

**If A Writes:**

(a) "I promise to pay B or order Rs. 500"

(b) "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received".

3. **The Promise to Pay Must Be Unconditional:** If a condition is attached to the 'promise to pay' then the instrument will not be construed as a promissory note. Suppose, A signs an instrument made out as follows, " I promise to pay to B Rs. 500 on D's death, provided D leaves me enough to pay the sum". The instrument will not be a promissory note. But if an instrument runs as: "I acknowledge myself to be indebted to B of Rs 500 to be paid on demand for value received". This instrument would be a promissory note.

   It may be noted that a promise to will not be conditional under section 4, where it depends upon an event which is certain to happen but the time of its occurrence may be uncertain.

   ***For example:-*** Where a promissory note is in this form : "I promise to pay to A Rs. 2000, 15 days after the death of B", it is not conditional as it is certain that B will die though the exact time of his death is uncertain (Section 4).

4. **The Amount Promised Must be Certain and a Definite Sum of Money:** Certainly is one of the essential characteristics of a promissory note. Certainly must be as to the amount and also as to the person by whose order and to whom payment is to be made.

   ***For example:***-The following instruments are invalid as promissory notes because of uncertainly of the sum of money payable:

   *(i)* "I promise to pay Sunil Rs. 10000 and all other sums which shall be due to him", it is not a valid

   *(ii)* "I promise to pay Sunil Rs 10000 first deducting there out any money which he may owe me".

   *(iii)* "I promise to pay Sunil Rs. 15000 and all fines according to rules".

5. **It Must Be Signed By the Maker:** A promissory note is uncompleted till it is signed. Since the signature is intended to authenticate the instrument it can be on any part of the instrument

6. **The Maker Must Be Certain and Definite Person:** The maker of a promissory note must be certain. He may be ascertained by his name or designation. Where the name of the payee is not mentioned as a party, the instrument becomes invalid. But a promissory node cannot be made payable to the maker himself. Thus, a note which runs "I promise to pay myself" is not a promissory note and hence invalid.

A promissory note must point out with certainty the person who is entitled to receive the money. Where it is made payable to the bearer, the bearer is the definite person to whom payment is to be made. The words 'certain person' means a person who is capable of being ascertained at the time of making of the instrument. Therefore, if any person has not been named in the instrument but sufficient description of such person have been included therein by which such person may be ascertained, the requirement is fulfilled (*Ponnuswami V. Velliamuthu AIR 1957 Mad 355)*. If the payee is mentioned as 'you', it does not indicate any certainty about the person (*Naraindas V. Purnidas AIR 1959 Orissa 176)*.

It may be noted that a promissory note may be made by (i) one person; or (ii) be several persons jointly, or (iii) by several persons jointly and severally.

It may also be noted that certainty of the payee is not required if the promissory note is payable to bearer. But no person other than the RBI or the Central Government can make a promissory note payable to bearer. [Sec. 31 (2) of the Reserve Bank of India Act, 1934]

7. **Stamped:** All promissory notes are chargeable with stamp duty under the India Stamp Act. Therefore, all promissory note must be properly stamped in order to make them legally enforceable.

8. **Other Points:** The following points shall also be remembered in connection with promissory notes:

    a. Consideration need not be mentioned.

    b. Place and date of making it need not be mentioned. A promissory note on which date is not mentioned is deemed to have been drawn on the date of its delivery.

    c. An ante-dated or post dated instrument is not invalid.

    d. Place of payment also need not be mentioned in the promissory note. However, it can be made payable at any specified place.

    e. It cannot be made payable to bearer on demand or payable to bearer after a certain time. (Section 31 of the Reserve Bank of India Act)

    f. It may be made payable on demand or after a certain time. A demand promissory note becomes time barred on expiry of three years from the date it bears.

    g. It must be duly stamped as per the state laws in which it is executed, under the Indian Stamp Act. A promissory note which is not stamped is a nullity. Stamping may be before or after the execution.

    h. A promissory note cannot be made payable to the maker himself. Such a note is nullity. But, if it is indorsed by the maker to some other person, or indorsed in blank, it becomes a valid promissory note (*Gay V. Landal (1848) LT CP 286)*.

    i. Where two or more persons sign the promissory note, their liabilities will be joint as well as several. A note cannot be signed in alternative.

    j. It is usual to mention in a promissory note the words *'for value received'*, but such a statement is not essential for the validity of the note, because the note is presumed to be for consideration unless contrary proved.

k. A promissory note is not invalid by reason only that it contains any matter in addition to promise to pay e.g. a recital that the maker has deposited the title deeds with the payee as a collateral security.

## 13.8 Bill of Exchange

Before going into the definition, you must know how a bill of exchange ordinarily comes into existence. It comes into being, when a trader decides to sell goods on credit. Suppose, A sells goods worth Rs. 800 to B, and allows him three months' time to pay the price, A will then draw a bill on B in the following terms "three months after date pay to my order the sum of Rs 800 for value received". After signing the will, A will present it to B for acceptance. It B writes across the bill 'accepted', it will indicated that B undertakes the liability to pay a sum of Rs 800 within the time stipulated therein. Here A is the drawer, B is the drawee and after acceptance B will be the acceptor.

Section 5 of the Negotiable Instruments Act, 1881 defines "a bill of exchange is an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of certain person to the bearer to the instrument."

It should be noted that no person other than the RBI or the Central Government can draw a bill of exchange payable to bearer on demand. [Sec. 31 of the RBI Act. 1934]

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.

### 13.8.1 Specimen of a Bill of Exchange

| | | |
|---|---|---|
| Rs. 10000/- | | New Delhi |
| | | November 26, 2012 |
| Five month after date pay Tarun or (to his) order the sum of Rupees Ten Thousand only for value received. | | |
| To Sameer | Accepted | Stamp |
| Purani Mandi, Ajmer | Sameer | S/d |
| 305001 | | Rajiv |

Rs. 10000/- New DelhiNovember 26, 2012

### 13.8.2 Parties to a Bill of Exchange

There are three parties involved in a bill of exchange. They are

**i. The Drawer –** The person who makes the order for making payment. In the above specimen, Rajiv is the drawer.

**ii. The Drawee –** The person to whom the order to pay is made. He is generally a debtor of the drawer. It is Sameer in this case.

**iii. The Payee –** The person to whom the payment is to be made. In this case it is Tarun.

The drawer can also draw a bill in his own name thereby he himself becomes the payee. Here the words in the bill would be Pay to us or order. In a bill where a time period is mentioned, just like the above specimen, is called a Time Bill. But a bill may be made payable on demand also. This is called a Demand Bill.

### 13.8.3 Essentials of a Bill of Exchange

1. **It Must be in Writing:** The bill of exchange must be in writing.
2. **Order to Pay:** There must be an order to pay. It is of the essence of the bill that its drawer orders the drawee to pay money to the payee. The term 'order' does not mean command. Any request or direction or other words, which show an intention of the drawer to cause a payment being made by the drawee is sufficient. Politeness may be admissible but excessive politeness may prompt one to disregard it as an order.
3. **Unconditional Order:** This order must be unconditional, as the bill is payable at all events. It is absolutely necessary for the drawer's order to the drawee to be unconditional. The order must not make the payment of the bill dependent on a contingent event. A conditional bill of exchange is invalid.
4. **Signature of the Drawer:** The drawee must sign the instrument. The instrument without the proper signature will be inchoate (unclear or unformed or undeveloped) and hence ineffective. It is permissible to add the signature at any time after the issue of the bill.
5. **Drawee:** A bill, in order to be perfect, must indicate a drawee who should be called upon to accept or pay it.
6. **Parties:** The drawer, the drawee (acceptor) and the payee- the parties to a bill are to be specified in the instrument with reasonable certainty.
7. **Certainty of Amount:** The sum must be certain.
8. **Payment in Kind is Not Valid:** The medium of payment must be money and money only. The distinctive order to pay anything in kind will vitiate the bill.
9. **Stamping:** A bill of exchange, to be valid, must be duly stamped as per the Indian Stamp Act.
10. **Cannot Be Made Payable to Bearer on Demand:** A bill of exchange as originally drawn cannot be made payable to the bearer on demand.

### 13.8.4 Special Benefits of Bill of Exchange

Following special benefits associated with the bill of exchange:

**i.** A bill of exchange is a double secured instrument i.e. where the drawee fails to honor the order, the holder of the instrument may look to the drawer for payment.

**ii.** In case of immediate requirement a Bill may be discounted with a bank.

**iii.** The drawer or any indorser thereof may mention a person as 'drawee in case of need' to be resorted to for payment by the payee in case of dishonor of the bill by the drawee.

### 13.8.5 Distinction Between a Promissory Note and a Bill of Exchange

***Table-1 : Difference between Promissory Note and bill of exchange***

| | Promissory Note | Bill of Exchange |
|---|---|---|
| **1** | There are only two parties – the maker (debtor) and the payee (creditor) | There are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person |
| **2** | It contains a promise to pay. | It contains an order to pay. |
| **3** | The liability of the maker of a note is primary and absolute (S.32). | The liability of the drawer of a bill is secondary and conditional. He would be liable if the drawee, after accepting the bill fails to pay the money due upon it provided notice to dishonor is given to the drawer within the prescribed time (Section 30) |
| **4** | It is presented for payment without any previous acceptance by the maker. | If a bill is payable some time after sight, it is required to be accepted either by the drawee himself or by someone else on his behalf, before it can be presented for payment. |
| **5** | The maker of a promissory note stands in immediate relationship with the payee and is primarily liable to the payee or the holder. | The maker or drawer of an accepted bill stands in immediate relationship with the acceptor and the payee. |
| **6** | It cannot be made payable to the maker himself. The maker and the payee cannot be the same person. | The drawer and payee or the drawee and the payee may be the same person. |
| **7** | In the case of a promissory note there are only two parties, viz., the maker (debtor) and the payee (creditor). | There are three parties, viz, drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person. |
| **8** | A promissory note cannot be drawn in sets. | The bills can be drawn in sets. |
| **9** | A promissory note can never be conditional. | A bill of exchange too cannot be drawn conditionally, but it can be accepted conditionally with the consent of the holder. |
| **10** | In case of dishonor no notice of dishonor is required to be given by the Holder. | A notice of dishonor must be given in case of dishonor of Bills of Exchange. |

## 13.9 Cheque

A 'cheque' is a 'bill of exchange' drawn on a specified banker and not expressed to be payable otherwise than. It includes the electronic image of a truncated cheque and a cheque in the electronic form.

A cheque in the electronic form means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometric signatures) and asymmetric crypto systems.

A truncated cheque means a cheque which is truncated during the course if a clearing cycle, either by the clearing house or by the Bank whether paying or receiving payment immediately on generation of an electronic image for transmission substituting the further physical movement of the cheque in writing.

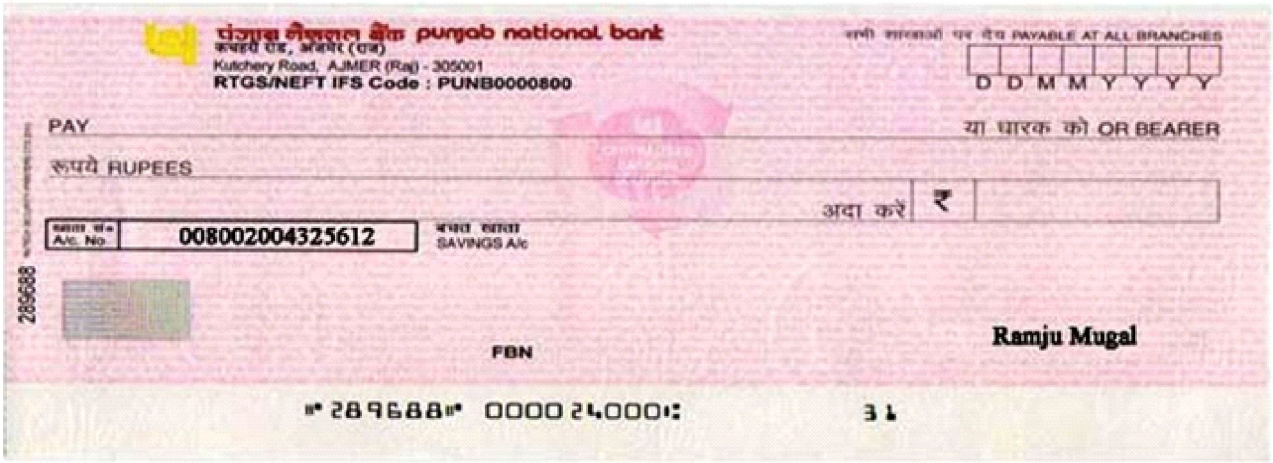
Clearing house means the clearing house managed or recognized by Reserve Bank of India.

A cheque is drawn on a banker only, while a bill of exchange can be drawn on any one. Like bill of exchange, cheque has three parties, viz., drawer, drawee and payee. A drawee in case of cheque is always a banker. A cheque is an unconditional order on the specified banker to pay on demand, a certain sum of money to the bearer of the cheque or to his order. A bill of exchange is wider than a cheque. Therefore all cheques are bills of exchange but all bills of exchange are not cheque. However, a cheque does not require acceptance. It the cheque is dishonored, the holder has no remedy against the banker, because cheque does not amount to assignment of deawer's funds in the hands of the banker in favor of the holder. Further, there is no privity of contract between the payee and the banker. The banker is liable only to the drawer. Drawing of a cheque is simply a direction to pay. A cheque is not invalid because it is post-dated or anti-dated. A cheque is payable only on demand and on presentation. Usually, a cheque is valid for a period of six months. It may be drawn on a Sunday or a Holiday.

### 13.9.1 Characteristics

1. A cheque is an unconditional order on a specified banker where the drawer has his account.
2. A cheque can be drawn for a certain sum of money.
3. Cheque is payable by the banker only on demand.
4. A cheque does not require acceptance by the banker as in the case of bill of exchange.
5. A cheque may be drawn up in three forms i.e.
    a. Bearer cheque is one which is either expressed to be so payable or on which the last or only indorsement is an indorsement in blank);
    b. Order cheque is one which is expressed to be so payable or which is expressed to be payable to a particular person without containing any prohibitory words against its transfer or indicating an intention that it shall not be transferable (Section 18); and
    c. Crossed cheque is a cheque which can be collected only through a banker.
6. The cheque is a revocable mandate and the authority can be revoked by countermanding payment.
7. The cheque is determined by notice of death or insolvency of the drawer.
8. All cheques are bills of exchange but all bills of exchange are not cheques.

### 13.9.2 Specimen of a Cheque




Every bank has its own printed cheque forms which are supplied to the account holders at the time of opening the account as well as subsequently whenever needed. These forms are printed on special security paper which is sensitive to chemicals and make any chemical alterations noticeable. Although, legally, a customer may withdraw his money even by writing his direction to the banker on a plain paper but in practice banker honors only those orders which are issued on the printed forms of cheque.

### 13.9.3 Essentials of a Cheque

1. **It Must Be in Writing -** It is the basic condition of the cheque that it is always in writing. It cannot be verbal. This includes handwriting, typing, computer printout etc.

2. **Unconditional Order -** A cheque must contain an unconditional order. It is, however, not necessary that the word order or its equivalent must be used to make the document a cheque. Generally the order to bank is expressed by the word "pay". If the word "please" precedes "pay" the document will not be regarded as invalid merely on this account.

3. **On a Specified Banker Only –** A cheque must be drawn on a specified banker. To avoid any mistake, the name and address of banker should be specified.

4. **A Certain Sum of Money –** The order must be only for the payment of money and that too must be specified. Thus, orders asking the banker to deliver securities or certain other things cannot be regarded as cheques. Similarly, an order asking the banker to pay a specified amount with interest, the rate of interest not specified, is not a cheque as the sum payable is not certain.

5. **Payee to Be Certain –** A cheque to be valid must be payable to a certain person. 'Person' should be understood in a limited sense including only human beings. The term infect includes 'legal persons' also. Thus, instruments drawn in favors of a body corporate, local authorities, clubs, institutions, etc., are valid instruments being payable to legal persons.

6. **Payable on Demand –** A cheque to be valid must be payable on demand and not otherwise. Use of the world 'on demand' or their equivalent is not necessary. When the drawer asks the banker to pay and does not specify the time for its payment, the instrument is payable on demand (Section 19)

7. **Amount of the Cheque –** Amount of the cheque must be clearly mentioned. The amount should be written both in words as well as figures so as to avoid mistakes. Moreover, the amount should be so written as to leave no blank space before or after the words and figures specifying the amount. In case a customer does so, though innocently and his banker pays the forged amount because the

forgery is not noticeable in spite of reasonable care, the banker would be justified in debiting his account with the amount actually paid.

8. **Dating of Cheques –** The drawer of a cheque is expected to date it before it leaves his hands. A cheque without a date is considered incomplete and is returned unpaid be the banks. The drawer can date a cheque with the date earlier or later than the date on which it is drawn. A cheque bearing an earlier date is antedated and the one bearing the late date is called post-dated. A post-dated cheque cannot be honored, except at the personal risk of the bank's manager, till the date mentioned. A post- dated cheque is as much negotiable as a cheque for which payment is due, i.e., the transferee of a post-dated cheque, like that of the cheque on which payment is due, acquires a better title than its transferor, it he is a holder in due course. A cheque that bears a date earlier than six months is a stale cheque and cannot be claimed for.

### 13.9.4 Difference Between Cheque and Bill of Exchange

***Table-2 : Difference between Cheque and bill of exchange***

| | Cheque | Bill of Exchange |
|---|---|---|
| **Drawee** | Cheque can be drawn only on a banker. | The drawee may be any person. |
| **Time of payment** | A cheque is payable on demand. | A bill may be drawn payable on demand or on expiry of certain period after date or sight. |
| **Grace period** | Cheque is payable on demand and no grace period is allowed. | While calculating maturity three day's grace is allowed |
| **Notice of dishonor** | Notice of dishonor is not necessary. | A notice of dishonor is required. |
| **Payee** | A cheque can be drawn to bearer and made payable on demand. | A bill cannot be made bearer if it is payable on demand. A bill drawn 'payable to bearer on demand' is void. |
| **Acceptance** | A cheque is not required to be presented for acceptance. It needs to be presented only for payment. | Bills sometimes, require presentment for acceptance and it is advisable to present them for acceptance even when it is not essential to do so. |
| **Stamping** | No stamp duty is payable on cheques. | Affixation of proper stamps is necessary in case of Bills of Exchange. |
| **Crossing** | A cheque may be crossed. | A bill of exchange cannot be crossed. |
| **Noting and protesting** | There is no system for noting and protesting in case of dishonor. | In case of dishonor of a bill proper noting and protesting is necessary. |
| **Discharge of drawer** | The drawer does not get discharged from his liability because of delay in presenting the cheque to the bank for payment. | The drawer of the bill stands discharged from his liability if it is not duly presented for payment. |
| **Liability of drawee for dishonor** | In case of dishonor of cheque the drawee is liable to the drawer and not to the payee. | In case of dishonor of the bill by non-payment on an accepted bill of exchange the drawee becomes liable to the payee. |
| **Validity period** | A cheque is usually valid for a period of six months. | A bill may be drawn for any period. |

### 13.9.5 Different Kinds of Cheques

1. **Customer's Sight Draft: -** The cheque which is an order upon a commercial bank by its client who has already deposited money with it is also called customers sight draft.
2. **Certified Cheque:-** These cheques are used where the drawer of the cheque is not trust worthy. It is that cheque on which the payment is guarantee to the payee by the drawee bank. When the cheque is presented to officer of the bank he writes certified or accepted on the face of the cheque. The cheque is honored whenever it is presented to the bank.
3. **Cashier's Cheque or Treasure's Cheque:-** It is drawn upon a bank by its own officer for meeting the expenses of the banks.
4. **Bank Money Orders or Registered Cheques: -** A person who wants to transfer a certain sum of money may use bank money order. The person has to pay the amount of the money order plus a bank fee and receives the registered cheque from the bank. He then signs the cheque, fill in the name of the person and then forward the cheque to the payee.
5. **Traveler's Cheque: -** These cheques enable the tourists to meet the expenses of their trip. These are not only acceptable by the issuing bank but also by the merchants and hotels inside and outside the country. The procedure is simply to pay the bank amount of the order and the bank commission. The bank will issue cheques on which the value is already printed. The guarantor has to sign all the cheques issued in the presence of issuing banker.
6. **Drafts: -** A draft is a cheque drawn by one bank upon another bank ordering to pay the payee. Bank drafts are commonly used inside and outside the country for the transfer of money. It has also helped in financing the foreign trade.
7. **Crossed Cheque:-** A crossed cheque is paid only through the bank. The paying bank is to make payment strictly according the instructions conveying by a crossing. Generally parallel lines are drawn on the face of the cheque.

## 13.10 Summary

The law of negotiable instrument in India is based almost entirely on the Principle of Mercantile Law of England. In India, law relating to negotiable instruments is contained in the Negotiable Instruments Act, XXVI of 1881. It mainly deals with only three types of negotiable instruments, viz., promissory note, bill of exchange and cheque. A negotiable instrument is a piece of paper which entitles a person to a sum of money and which is transferable from one person to another by mere delivery or by indorsement and delivery. The characteristics of a negotiable instrument are easy negotiability, transferee gets good title, transferee gets a right to sue in his own name and certain presumptions which apply to all negotiable instruments. There are two types of negotiable instruments (a) Recognized by statue: Promissory notes, Bill of exchange and cheques and (b) Recognized by usage: Hundis, Bill of lading, Share warrant, Dividend warrant, Railway receipts, Delivery orders etc. The parties to bill of exchange are drawer, drawee, acceptor, payee, indorser, indorsee, holder, drawee in case of need and acceptor for honor. The parties to a promissory note are maker, payee, holder, indorser and indorsee while parties to cheque are drawer, drawee, payee, holder, indorser and indorsee.

## 13.11 Self Assessment Questions

1. What do you mean by a negotiable instrument? Describe the essential characteristics of negotiable instruments

2. What is a promissory note? What are its essential elements?
3. How does Negotiable instrument differ from a bill of exchange?
4. What is a bill of exchange? Discuss its essential characteristics.
5. Define a Cheque. What are the various requisites/essentials of a cheque? Comment
6. Distinguish between a cheque and a bill of exchange?
7. Explain different kinds of Cheques.

## 13.12 Reference Books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- R L Nolakha (2009); 'Business Law'; Ramesh Book Depot, Jaipur
- K R Bulchandani (2009); 'Business Law for Management' Himalaya Publishing House Pvt. Ltd
- S S Gulshan (2006); 'Business Law'; Excel Books, New Delhi
- S B Mathur (2010); 'Business Law'; Tata Mcgraw Hill, New Delhi
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# Unit - 14 : The Negotiable Instruments Act, 1881 (Part – II)

**Structure of Unit:**



## 14.0 Objectives

After completing this unit, you would be able to:

- Understand the meaning of Holder and Holder in due course.
- Know the difference between Holder and Holder in due course.
- Classify the holder as 'who is a holder' and 'who is not a holder'.
- Describe the crossing of cheques and types of crossing of a cheque;
- Point out various issues related to crossing of cheques.
- Learn how a cheque is called dishonor and what actions can be taken.

## 14.1 Introduction

Exchange of goods and services is the basis of every business activity. Goods are bought and sold for cash as well as on credit. All these transactions require flow of cash either immediately or after a certain time. In modern business, large number of transactions involving huge sums of money takes place every day. It is quite inconvenient as well as risky for either party to make and receive payments in cash. Therefore, it is a common practice for businessmen to make use of certain documents as means of making payment. Some of these documents are called negotiable instruments. In this lesson let us learn about these documents and parties involving in it with basic and essential terminologies viz. holder and holder in due course. In this chapter an attempt is also made to describe the provision of law regarding crossing and dishonor of cheques and also the rights and obligations of banks and drawers of the cheques.

## 14.2 Holder

According to Section 8, Holder is defined as:

"*The holder' of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.*

*Where the note, bill or cheque is lost or destroyed, its holder is the person entitled at the time of such loss or destruction."*

From the above definition it is clear that for being a holder a person must be entitled to –

a. The possession of the instrument in his own name; and

b. Receive or recover the amount due thereon from the parties liable thereto.

'Possession' of the instrument by the holders refers to 'de factor' control and not the actual possession. The person must be named in the instrument either as a payee or as indorsee. Meaning of 'de facto' contract becomes clear in the event of death of the actual holder. The legal heir of a deceased holder does not have his name indorsed on the instrument but he becomes holder by operation of law.

Any person in wrongful possession of the instrument cannot be the holder. Therefore, the finder of a lost instrument payable to bearer, or a person in wrongful possession of such instrument, is not a holder.

Further, the possession of the instrument and being named in it as the payee does not make a person a 'holder' thereof. He shall also be entitled to receive payment and to give a valid discharge. Thus, a beneficiary cannot be termed as holder of the instrument and any payment by the drawer to the beneficiary cannot discharge him from his liability. *Bacha Prasad V. Janki Rai, 1957 BLJR 331 (FB).*

Any person who is in possession of the instrument as payee will not be a holder within the meaning of section 8 of the Act if he has been prohibited from receiving payment by an order of Court. The payee may authorize his agent to receive payment and to give a valid discharge for the same but this does not make the agent the holder of the instrument since he cannot bring an action for recovery of money in the instrument in his own name.

### 14.2.1 Characteristics

Following are the main characteristics of a holder:

1. **Entitled to Possession of an Instrument –** A holder is a person who is entitled to the possession of an instrument and that too in his own name. A person who has possession of an instrument but cannot possess it is his own name cannot be called a holder. Thus, a holder mean a *de jure* (legally) holder and not merely a *de facto* holder. A holder is always a owner at law.
2. **Entitled to Receive or Recover the Amount –** A holder is also entitled to receive or recover the amount on the instrument from the parties thereto. If a person possessing an instrument has no right to receive or recover the amount on it, cannot be called the holder.
3. **Holder of Lost or Destroyed Instrument –** In the case of lost or destroyed instrument, the law presumes that the person (i) who was entitled in his own name to the possession of the instrument, and (ii) who was entitled to receive or recover the amount due on the instrument from the parties thereto at the time of such loss or destruction, is its holder.

### 14.2.2 Who Can be a Holder?

A person who possesses the above characteristics is a holder of a negotiable instrument. The following persons are, therefore, usually the holders:

1. **Payees –** The payee is usually the original holder or *de jure* holder of an instrument. He remains holder till he indorses the instrument.
2. **Indorsee –** The person to whom an instrument is indorsed becomes holder of in place of the indorser. An order instrument, when indorsed and delivered, the indorsee becomes the holder. However, if an indorsee is prohibited by a court order from receiving the amount due on the instrument, is not a holder.

3. **Bearer –** In the case of bearer instrument, the person to whom the instrument is delivered becomes the holder. It is so because a bearer instrument can be negotiated be mere delivery.

   But every bearer of an instrument cannot become the holder. A thief or a finder of a bearer instrument or a servant possessing a bearer instrument on behalf of his employer cannot become holder. However, if a thief or finder of an instrument transfers it to another, the transferee becomes a holder of the instrument provided he obtained it in good faith and for consideration

4. **Legal Representative or Heir –** a legal representative or heir of a deceased person can become holder be operation of law even though he is not the payee or the bearer or the indorsee of the instrument.

   It may be noted that every person who can lawfully discharge an instrument can be deemed to be the holder of the instrument. [Lala Ram v. Ram Swarup, AIR (1964) All 495]

### 14.2.3 Who is Not a Holder?

Sometimes, a person apparently seems to be holder but actually he is not a lawful holder of an instrument. A few such persons are as follows:

1. **Agent –** An agent who possesses an instrument on behalf of his principal is not a holder. It is so because he is not entitled in his own name to possession of the instrument and cannot sue on the instrument in his own name.

2. **Servant –** A servant cannot be a holder for the above sated reasons.

3. **Beneficial or Real Owner –** A real or beneficial owner of an instrument is not a holder in the ground that the actual holder is only a *benamidar* or name lender. He is not a *de jure* holder. [Sarjoo Prasad v. Ramapyari, AIR (1950) Pat 493]

4. **Thief or Finder –** A thief or a finder of an instrument is not a holder because he does not derive the title in lawful manner. Such a person is not entitled to the possession of the instrument in his own name and claim to the amount of it.

5. **Forged Indorsee –** A person who acquires an instrument be forged indorsement, is not a holder. Such a person is not entitled to possess the instrument lawfully and cannot claim the amount due on it.

6. **indorsee for Collection –** An indorsee for collection of the instrument is not a holder as he does not acquire any interest in the instrument. [Irinjalakuda Bank Ltd. V. Poruthussery Panchayat, (1970) 40 Comp Cases 767]

### 14.2.4 Rights of a Holder

The holder of a negotiable instrument is a very important party to the instrument as such. He has the following rights:

(i) He is entitled in his own name to the possession of the instrument.
(ii) He can receive or recover the amount due on the instrument from the parties liable on it.
(iii) If necessary, he can sue the parties in order to recover the money due on the instrument.
(iv) He can validly discharge the instrument on payment of the instrument.
(v) He may indorse the instrument to any other person.
(vi) He is entitled to convert 'indorsement in blank' in to full indorsement.

## 14.3 Holder in Due Course

Section 9 of the Act defines 'holder in due course' as any person who

**(i)** for valuable consideration,

**(ii)** becomes the possessor of a negotiable instrument payable to bearer or the indorsee or payee thereof,

**(iii)** before the amount mentioned in the document becomes payable, and

**(iv)** without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. (English law does not regard payee as a holder in due course).

Thus the essential qualification of a holder in due course may, therefore, be summed up as follows:

1. He must be a holder for valuable consideration. Consideration must not be void or illegal, e.g. a debt due on a wagering agreement. It may, however, be inadequate. A donee, who acquired title to the instrument by way of gift, is not a holder in due course, since there is no consideration to the contract. He cannot maintain any action against the debtor on the instrument. Similarly, money due on a promissory note executed in consideration of the balance of the security deposit for the lease of a house taken for immoral purposes cannot be recovered by a suit.

2. He must have become a holder (possessor) before the date of maturity of the negotiable instrument. Therefore, a person who takes a bill or promissory note on the day on which it becomes payable cannot claim rights of a holder in due course because he takes it after it becomes payable, as the bill or note can be discharged at any time on that day.

3. He must have become holder of the negotiable instrument in good faith. Good faith implies that he should not have accepted the negotiable instrument after knowing about any defect in the title to the instrument. But, notice of defect in the title received subsequent to the acquisition of the title will not affect the rights of a holder in due course.

   Besides good faith, the Indian Law also requires reasonable care on the part of the holder before he acquires title of the negotiable instrument.

   He should take the instrument without any negligence on his part. Reasonable care and due caution will be the proper test of his bona fides. It will not be enough to show that the holder acquired the instrument honestly, if in fact, he was negligent or careless. Under conditions of sufficient indications showing the existence of a defect in the title of the transferor, the holder will not become a holder in due course even though he might have taken the instrument without any suspicion or knowledge.

   **Example:**

   **(i)** A bill made out by pasting together pieces of a tom bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill. A bill should not be taken without enquiry if suspicion has been aroused.

   **(ii)** A post-dated cheque is not irregular. It will not preclude a bona fide purchase instrument from claiming the rights of a holder in due course. It is to be noted that it is the notice of the defect in the title of his immediate transferor which deprives a person from claiming the right of a holder in due course. Notice of defect in the title of any prior party does not affect the title of the holder.

4. A holder in due course must take the negotiable instrument complete and regular on the face of it.

### 14.3.1 Holders not Holders in Due Course

Following persons/holders cannot be said to be the holders in due course:

1. The holder who has obtained the instrument by way of gift.
2. The holder who has obtained the instrument after its maturity.
3. The holder who has obtained the instrument for an unlawful consideration.
4. The holder who has obtained the instrument by illegal methods i.e. by stealing or defrauding.
5. The holder who has found the lost instrument, i.e. finder of the lost instrument.
6. The holder who has obtained the instrument without good faith or bona fide. In other words, who obtains an instrument having notice of any defect in the title of the person from whom he delivered his titled.
7. The holder who is not entitled in his own name to the possession of the instrument.
8. The holder who is not either the payee or the indorser if the instrument is payable to order.
9. The holder who has incomplete or irregular instrument.
10. The holder who is having forged instrument

### 14.3.2. Privileges of a Holder in Due Course

1. **Instrument Purged of All Defects:** A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties although, as a matter of fact, no consideration was paid by some of the previous parties to instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like a current coin. Who-so-ever takes it can recover the amount from all parties previous to such holder (Sec. 53).

   It is to be noted that a holder in due course can purify a defective title but cannot create any title unless the instrument happens to be a bearer one.

   **Examples:**

   (i) A obtains Bs acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will also get a good title to it except when he is also a party to the fraud played by A.

   (ii) A bill is payable to "A or order". It is stolen from A and the thief forges A's signatures and indorses it to B who takes it as a holder in due course. B cannot recover the money. It is not a case of defective title but a case where title is absolutely absent. The thief does not get any title therefore, cannot transfer any title to it.

   (iii) A bill of exchange payable to bearer is stolen. The thief delivers it to B, a holder in due course. B can recover the money of the bill.

2. **Rights Not Affected in Case of an Inchoate Instrument:** Right of a holder in due course to recover money is not at all affected even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. (Sec. 20)

3. **All Prior Parties Liable:** All prior parties to the instrument (the maker or drawer, acceptor and intervening indorers) continue to remain liable to the holder in due course until the instrument is duty satisfied. The holder in due course can file a suit against the parties liable to pay, in his own name (Sec. 36)

4. **Can Enforce Payment of a Fictitious Bill:** Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first indorser are in the same hand, for the bill being payable to the drawer's order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

5. **No Effect of Conditional Delivery:** Where negotiable instrument is delivered conditionally or for a special purpose and is negotiated to a holder in due course, a valid delivery of it is conclusively presumed and he acquired good title to it. (Sec. 46).

   **Example:** A, the holder of a bill indorses it "B or order" for the express purpose that B may get it discounted. B does not do so and negotiates it to C, a holder in due course. D acquires a good title to the bill and can sue all the parties on it.

6. **No Effect of Absence of Consideration or Presence of An Unlawful Consideration:** The plea of absence of or unlawful consideration is not available against the holder in due course. The party responsible will have to make payment (Sec. 58).

7. **Estoppel Against Denying Original Validity of Instrument:** The plea of original invalidity of the instrument cannot be put forth, against the holder in due course by the drawer of a bill of exchange or cheque or by an acceptor for the honour of the drawer. But where the instrument is void on the face of it e.g. promissory note made payable to "bearer", even the holder in due course cannot recover the money.

   Similarly, a minor cannot be prevented from taking the defence of minority. Also, there is no liability if the signatures are forged. (Sec. 120).

8. **Estoppel Against Denying Capacity of the Payee to Indorsee:** No maker of promissory note and no acceptor of a bill of exchange payable to order shall, in a suit therein by a holder in due course, be permitted to resist the claim of the holder in due course on the plea that the payee had not the capacity to indorse the instrument on the date of the note as he was a minor or insane or that he had no legal existence (Sec 121)

9. **Estoppel Against Indorser to Deny Capacity of Parties:** An indorser of the bill by his indorsement guarantees that all previous indorsements are genuine and that all prior parties had capacity to enter into valid contracts. Therefore, he on a suit thereon by the subsequent holder, cannot deny the signature or capacity to contract of any prior party to the instrument.

### 14.3.3 Distinction Between Holder and Holder in Due course

Though the holder in due course is a special type of holder, who occupies a privileged position. But he can be distinguished from a mere holder of an instrument in the following ways:

***Table – 1***

***Difference between holder and holder in due course***

| Base | Holder | Holder in Due Course |
|---|---|---|
| **Meaning** | A holder is a person who is entitled to possess an instrument in his own name and recover the payment from the party liable to pay | Holder in due course is a holder who gets an instrument before maturity, in good faith and for valuable consideration |
| **Consideration** | For a holder it is not necessary that he must have given consideration for the instrument. | Holder in due course consideration must have been given by him for acquiring an instrument |
| **Maturity** | A holder may acquire an instrument even after the date of maturity | Holder in due course must get an instrument before the date of maturity |
| **Title** | A holder of an instrument will get same title as the transferor had | The holder in due course gets title better than that of transferor |
| **Liability of parties to pay** | For a holder it is only a drawer, drawee and transferor who are liable to pay | But for holders in due course all parties prior to him are liable to pay until the instrument is duty discharged |
| **Privileged position** | A holder does not enjoy special position or right | While as, the position of a holder in due course is privileged and he gets special rights |
| **Fictitious** | A holder cannot recover the amount on a fictitious instrument | A holder in due course can recover the amount on a fictitious instrument provided he proves that the signature of the drawer and the first indorsee are in the same handwriting |
| **Unlawful means or consideration** | A holder cannot enforce his rights against the instrument obtaining by unlawful means or for unlawful consideration | A holder in due course can enforce his rights against the person who obtained the instrument by unlawful means or for unlawful consideration |
| **Original validity of the instrument** | A holder cannot enforce his rights on the instrument if original validity of the instrument is denied | A holder in due course can claim on an instrument even if original validity of the instrument in denied |
| **Payee's capacity to indorse** | A holder cannot claim on an instrument if payee's capacity to indorse is denied | A holder in due course can claim rights against the instrument even if payee's capacity to indorse is denied |
| **Signature or capacity of prior parties** | A holder cannot enforce his right of the signature or capacity to contract of any prior to the instrument is denied | A holder in due course can enforce his rights even if the signature or capacity of contract of any prior party to the instrument is denied |

## 14.4 Crossing of a Cheque

A cheque may be an open cheque or a crossed cheque. An open cheque is one that can be paid by the paying banker across the counter while crossed cheque cannot be paid across the counter.

Crossing of cheques is a universally adopted practice. It is a direction to the paying banker that the payment shall not be made across the counter. The payment on a crossed cheque can be collected only through a banker.

Cheques are usually crossed as a measure of safety. Crossing is made by drawing two parallel traverse lines across the face of the cheque with or without the addition of certain words. The usage of crossing distinguishes cheques from other bills of exchange.

In this regard section 123 of the Negotiable Instruments Act states:

*"Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two traverse lines, or of two parallel traverse lines simply, either with or without the words 'not negotiatble' that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally".*

### 14.4.1 Who May Cross the Cheque?

Crossing of a cheque is an instance of an alteration which is authorized by the Act. Thus, the following parties may cross a cheque :

1. **Drawer:** The drawer of the cheque may cross the cheque generally or specially.
2. **Holder:** Where the drawer does not cross the cheque, the holder may cross it generally or specially. Even if the cheque is already crossed the holder may add the words 'not negotiable'.
3. **Banker:** Where a cheque crossed specially the collecting banker may again cross it especially to another banker as its agent for collection. This is the only case where the Act allows a second special crossing by a banker and for the purpose of collection

## 14.5 Types of Crossing

Crossing may be either (1) general or (2) special.

1. General crossing, and
2. Special crossing.

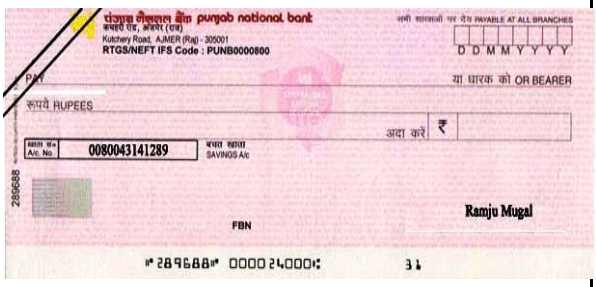
These basic kinds of crossing may take several forms. Some of them are:

3. Account payee crossing or Restrictive crossing.
4. Not negotiable crossing.

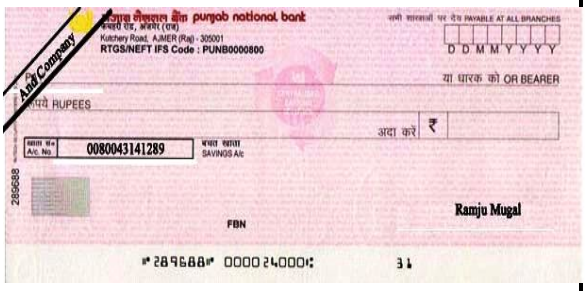
1. **General Crossing:** Section 123 of the Act refers to general crossing. Where a cheque bears across its face two traverse lines with or without the words "and Company" or any abbreviation thereof or the words 'not negotiable, the cheque is said to have been crossed generally.

   "*Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to the banker" (Section 126).* The payee may get the cheque collected through a bank of his choice.

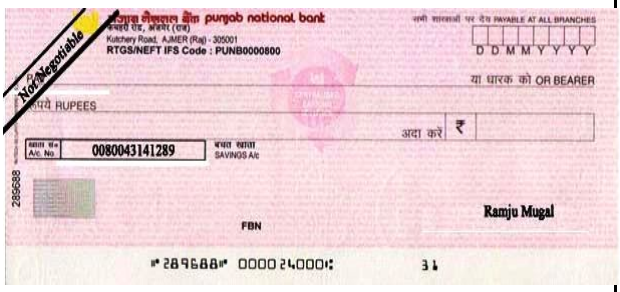
**Crossing by parallel transverse lines**




**Crossing by adding the words 'and company'**




**Crossing by adding the words 'Not Negotiable'**




**Crossing by any combination of the above**

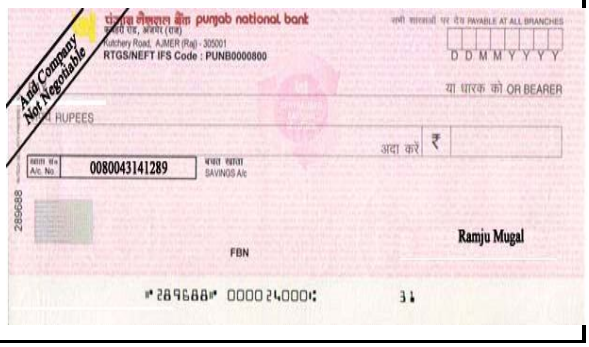



**Figure 14.1 Specimens of General Crossing**

**Effect of General Crossing**

i. The cheque is not payable to the counter of the bank

ii. The drawee bank shall pay the amount of the cheque only to a banker. Therefore, the holder will have t deposit the cheque in an account with any banker. [Sec. 126, para 1]

2. **Special crossing:** Special crossing implies the specifications of the name of the banker on the face of the cheque. The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned.

   In the case of special crossing the addition of two parallel transverse lines is not essential though generally the name of the bank to which the cheque is crossed specially is written between the two parallel transverse lines (Section 124).

Section 126 of the Act provides that –

*"Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection."*

Section 127 of the Act provides that –

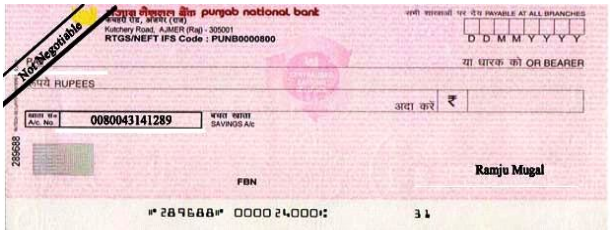
*"Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof."*

**Specimens of Special Crossing**

**Special crossing with parallel transverse lines**


**Special crossing with words 'not negotiable'**


**Special crossing with words 'and company'**




**Special crossing with words 'and company and not negotiable'**

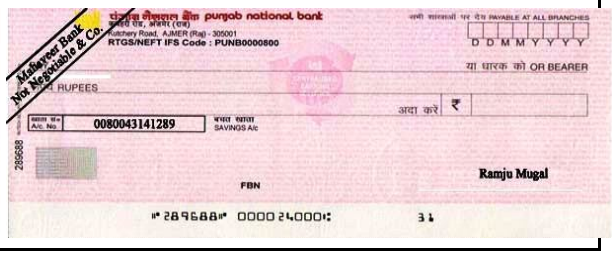



**Figure 14.2 Specimens of Special Crossing**

**Effects of Special Crossing -** In the case of a cheque especially crossed, the payment can be obtain only through the particular banker whose name appears across the face of the cheque or his agent for collection.

### 3. "Account Payee" Crossing or Restrictive Crossing

This type of crossing acts as a warning to the collecting bankers that the proceeds are to be credited into the account of the payee.

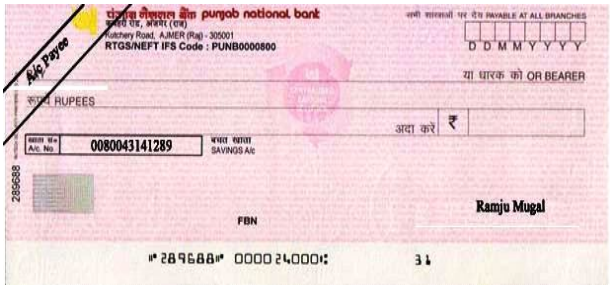
These words are a mere direction to the receiving or collecting banker. These do not affect the paying banker who is under no duty to ascertain that the cheque in fact has been collected for the account of the person names as the payee.

It has been held that crossing cheque with the words "Account Payee" and mentioning a bank is not a restrictive indorsement so as to invalidate further negotiation of the cheque by the indorsee.

It has been decided by the courts that an "account payee" crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt. The banker can disregard the direction only at his own risk and responsibility.

**Specimens of Restrictive Crossing**

**Restrictive crossing of a cheque crossed generally**




**Restrictive crossing of a cheque crossed specially**

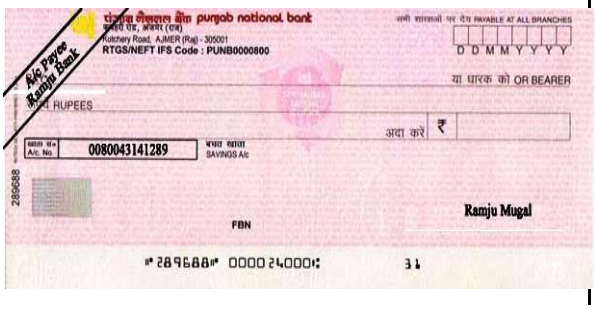



**Fig. 14.3 Specimens of Restrictive Crossing**

**4. Cheque Marked "Not Negotiable"**

The general rule about the negotiability is that the holder in due course of a bill or promissory note or cheque takes the instrument free from any defect which might be existing in the title of the transferor. If the holder takes the instrument in good faith, before maturity and for valuable consideration, his claim is not defeated or affected by the defective title of the transferor. In case of any dispute, it is the transferor with the defective title who is liable.

Addition of the words "not negotiable" to the crossing of a cheque, makes the position different. The principle of 'nemo date quod non habet – (nobody can pass on a title better than what he himself has) will be applicable to a cheque with a "not negotiable" crossing.

Section 130 of the Negotiable Instruments Act provides that –

*"A person taking a cheque crossed generally or specially bearing in either case the words 'not negotiable' shall not have or shall not be able to give a better title to the cheque than the title of person from whom he took had."*

The effect of such a crossing is that the title of the transferee would be vitiated by the defect in the title of the transferor. The transferee of such a crossed cheque cannot get a better title than the transferor himself. The transferee cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith for value.

**14.5.1 Bankers Liability on Payment of Crossed Cheque in Due Course**

In respect of a crossed cheque it is presumed that the banker, on whom it is drawn, has made payment to the true owner of the cheque, though in fact, the amount of the cheque may not reach the true owner. In other words, the banker making payment in due course is protected, whether the money is or is not, in fact, received by the true owner of the cheque (Section 128).

**14.5.2 Bankers Liability on Wrong Payment of a Crossed Cheque**

Section 126 of the Act states that:

**a)** in the case of generally crossed cheque the banker shall not pay it otherwise than to a banker, and

**b)** in the case of a specially crossed cheque it shall not be paid by the banker otherwise than to the banker to whom it is crossed or to his agent for collection.

Where the drawee banker pays a crossed cheque otherwise than in accordance with the provisions of Section 126 it shall be liable to the true owner of the cheque for any loss he may have sustained (section 129)

**14.5.3 Protection of Banker in Respect of Uncrossed Cheques**

Section 85(2) reads:

*When a banker makes payment on an uncrossed cheque in due course he is authorized to debit the account of his customer with the amount so paid irrespective of the genuineness of the Indorsement thereon.*

For example, a cheque is drawn payable to N or order and it is stolen. Thereafter, the thief or someone else forges N's indorsement and presents the cheque to the bank for encashment. On paying the cheque, the banker would be able to debit the drawer's account with the amount of the cheque.

The original character of the cheque issued as bearer, is not altered by subsequent indorsements , so far as the paying bank is concerned, provided that the payment is made in due course. Hence the proposition that "*once a bearer instrument always a bearer instrument"*.

**Protection in Respect of Crossed Cheques:** When a banker pays a cheque drawn by his customer in accordance with section 126 of the Act he can debit the drawer's account with the amount paid, even though the amount of the cheque does not reach the true owner.

### 14.5.4 Prerequisites for Caiming Protection

The protection in both the cases referred above can be availed of only if the payment has been made in due course i.e.

a) According to the apparent tenor of the instrument,

b) In good faith and without negligence.

c) To any person in possession thereof,

d) In circumstances that do not incite any suspicion that he is not entitled to receive payment of the cheque.

### Liability of Drawee of Cheque

Section 31 of the Act states that:

The drawee bank is under a duty to pay the cheque, provided he has in his hands sufficient funds of the drawer and the funds are properly applicable to such payment. If the banker refuses payment without sufficient cause being shown, he must compensate the drawer, not the holder, for any loss caused by such improper refusal (Section 31).

The banker must pay the cheque only when he is duly required to do so e.g. if there is an agreement between the drawer and the banker that the former shall not draw more than one cheque every week, the banker is not bound to pay the second cheque.

The amount of compensation that the drawee would have to pay to the drawer is to be measured by the loss or damage say loss of credit, suffered by the drawer. The principle is : "*The lesser the value of the cheque dishonoured, the greater the damage to the credit of the drawer*".

### 14.5.5 When Banker Shall Refuse the Payment?

**a)** A banker will be justified or bound to dishonour a cheque in the following cases, viz;

**b)** The cheque is undated.

**c)** The cheque is *stale* i.e. it has not been presented within the validity period of the cheque.

**d)** The instrument is inchoate (unclear or unformed or tentative) or not free from reasonable doubt.

**e)** The cheque is post-dated and presented for payment before its ostensible date.

**f)** The customer's funds in the banker's hands are not 'properly applicable' to the payment of cheque drawn by the former.

**g)** The customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn.

**h)** A garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker.

**i)** Authority of the banker to honour a cheque of his customer is determined by the notice of the drawer's death, lunacy and insolvency. However, any payment made prior to the receipt of the notice of death is valid.

**j)** Notice in respect of closure of the account is served by either party on the other.

**k)** The cheque contains material alterations, irregular signature of irregular indorsement.

**l)** The customer has countermanded payment.

**m)** Any ambiguity in the material part of the cheque including the defects resulting from the crossing of the cheque.

**n)** Any difference between the amount of cheque in words and in figures.

**o)** Any irregular indorsements.

**p)** The cheque is mutilated.

**q)** Signature of the drawer has been forged.

### 14.5.6 Liability of Payee's Banker

Section 131 of the Act provides that –

"*A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.*"

Section 131 of the Act confers a special protection on the collecting banker which is available to him subject to fulfillment of certain conditions. If the following conditions do not co-exist, this protection would be denied to the collecting banker :

***a) The Collecting Banker Should Have Acted in Good Faith and Without Negligence:*** In Lloyds Savouy Co. (1933) A.C. 201, the court held that if the banker receives payment of a cheque to which the customer has no title, the onus is on him to disprove negligence. What amounts to negligence is, however a question of fact in each case. "Negligence" means want of "reasonable care" with reference to the interest of the true owner. The test of "negligence" is whether the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so flagrantly out of the ordinary course that it ought to have aroused suspicion in the mind of the banker and caused him to make enquiry (Bopulal Prem Chand v. The Nath Bank Ltd. 48 Bom. L.R.393).

***b) That the Collecting Banker Acts Only to Receive Payment of the Crossed Cheque for a Customer :*** To make a person a customer of a bank it is essential that there must be some sort of account, either a deposit or a current account or some similar relationship. Protection under section 131 is available only when the banker is acting as an agent for collection but not to a case where the banker is himself the holder.

***c) That Crossing Had Been Made Before the Cheque Fell Into the Hands of the Collecting Banker :*** Section 131 does not provide an absolute immunity to the collecting banker and unless the banker brings himself within the conditions stipulated under this section, he is left to his common

law for conversion. The onus of proving that he had taken all reasonable steps to ensure compliance with the requirements of this section lies on the banker.

It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the *prima facie* genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.

## 14.6 Dishonor of a Cheque

### 14.6.2 Meaning of Dishonor

Section 92 of the Act reads as under –

*"A promissory note, bill of exchange or cheque is said to be dishonored by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same."*

If on presentation the banker does not pay then dishonor takes place and the holder acquired at once the right of recourse against the drawer and the other parties on the cheque.

**Effects of Dishonor**

The important point to be noted in connection with the dishonor of a cheque is that its negotiability is lost.

### 14.6.2 Types of Dishonor

Dishonor of cheque can be divided into two categories i.e.

a) **Rightful Dishonor:** Dishonor of cheque by the drawee banker for any of the reasons specified above or for any other rightful reason. In this case there is no remedy available against the banker but the holder in due course has remedy both civil and criminal against the drawer.

b) **Wrongful Dishonor:** Dishonor of cheque by the banker due to negligence or carelessness by its employees. The drawer may bring an action against the bank for losses suffered by him. The payee has no action against the banker in this case.

**Dishonor of Cheque is an Offence**

Section 138 of the Negotiable Instruments Act states that the return of a cheque by a banker because the money standing to the credit of the accountholder is insufficient to honor the cheque or that it exceeds the amount arranged to be paid from the account by an agreement made with the bank, is a criminal offence. The drawer shall be deemed to have committed an offence and such offence will be punishable with imprisonment for a term up to two years imprisonment or with a fine twice the amount of the cheque or both.

Provisions of section 138 of the Act are applicable only if –

a) The cheque in question has been issued in discharge of a liability only. Unless contrary is proved, as per the provisions of section 139, a cheque is presumed to have been received by the holder in discharge of a debt or liability. A cheque given as gift will not fall in this category.

b) The cheque is presented to the bank for payment within six months or its specific validity period, whichever is earlier.

**c)** The payee or holder in due course has given notice demanding payment within thirty days of the receiving information of dishonor which should be for a reason other than insufficiency of funds.

**d)** The drawer does not make payment within 15 days of the receipt of the notice. The complaint can be made only by the payee/holder in due course, within one month.

**Offences by Companies**

If the person committing an offence under section 138 is a company, every person who was in charge of the affairs of the company and was responsible for the business of the company at the time offence was committed shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. (Section 139) However, a person shall not be punishable under section 139 if it is proved that the offence has been committed without his knowledge or consent and that he had taken all due care to prevent commission of the offence.

### 14.6.3 Action to Be Taken

If a cheque is dishonored for lack of funds, the drawer can be punished with imprisonment upto one year and/ or within a fine up to double the amount of the cheque if:

- The cheque has been presented to the bank within a year from the date on which it was drawn or within its validity.
- The payee or holder makes a demand for payment by giving notice in writing to the drawer within thirty days of the receipt of the information.
- The drawer of the cheque fails to make payment within fifteen days of receipt of the notice.

## 14.7 Summary

The holder' of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. While Agent, Servant, Beneficial or Real Owner, Thief, Finder, Forged Indorsee, and Indorsee for Collection cannot be holder. On the other side 'holder in due course' as any person who becomes the possessor of a negotiable instrument payable to bearer or the indorsee or payee thereof, before the amount mentioned in the document becomes payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. A cheque may be an open cheque or a crossed cheque. An open cheque is one that can be paid by the paying banker across the counter while crossed cheque cannot be paid across the counter. Crossing of cheques is a universally adopted practice. It is a direction to the paying banker that the payment shall not be made across the counter. Crossing may be general, special, account payee crossing or restrictive crossing, and not negotiable crossing. A promissory note, bill of exchange or cheque is said to be dishonored by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same.

## 14.8 Self Assessment Question

**1.** Define the term 'holder' and 'holder in due course'. Distinguish between 'holder' and 'holder in due course'.

**2.** "Once a negotiable instrument passes through the hands of a holder in due course it is purged or cleansed of all its defects." Comment and enumerate the privileges of a 'holder in due course'.

**3.** Write a short note on crossed cheque.

**4.** Explain clearly the meaning of 'general' and 'special' crossing of a cheque with suitable examples.

**5.** Explain the effect of (i) Not negotiable crossing (ii) Account payee only crossing.

**6.** Who can cross a cheque after issue?

**7.** What do you mean by dishonor of a cheque?

**8.** State the circumstances in which a bank would be justifies in dishonoring of a cheque.

## 14.9 Reference Books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# Unit - 15 : Introduction to the Companies Act

**Structure of Unit:**



## 15.0 Objectives

After completing this unit, you would be able to:

- Able to understand the history of Companies Act till Independence;
- Point out the various Amendments of Companies Act;
- Know about the extent and Application of Company law;
- Understand the meaning and nature of Company;
- Able to know all the situations under which the corporate veil of a Company may be lifted;
- Understand the meaning of promotion;
- Know about promoters and their duties, liabilities and functions of promoters.

## 15.1 Introduction

As a result of growth of business and industrilization, proprietorship and partnership firms are Gradually developing as company which is today's requirement proprietorship firms of organization could not always fulfil the ever increasing requirement of the business. This firm of business organization is being created for globalisation of business, mass production and delivering vast opportunities of employment, standerd and quality of life to the people world-over. Company law is the law relating to the various affairs of companies that is registration and winding-up of the companies. It elobrately discloses how The Companies Act, 1956 has been amended several times to protect Investors, to protect the legal rights of shareholders, to ensure honesty in company management etc. The companies are created, functioning companies, rights and duties of shareholders and directors, companies meetings and their proceddings, punishment for offences, remedies against oppression and mis- management of the companies etc.

## 15.2 Brief History Till Independence

The first company legislation was passed in India in 1850 on the models of British Company Act of 1844. At that time most of the laws in India were passed on the models of British law and the decisions were taken as precedents by the Indian courts. This Act of 1850 did not confer the privilege of limited liability of members. Which last was introduced by the Act of 1857. This benefit, however was not entered to banking and insurance companies. In 1860 the privilege of limited liability was extended to banking companies although subject to certain conditions. Thus after this Act all the companies were allowed to be registered with the provisions of limited liability. Then after, the companies Act 1866 was passed. It incorporated and regulated all the previous companies Act. It was based on the British Companies Act 1862. There after it was replaced by the act of 1882. The Act remained in force till 1913. During the period of 1882-1913 the following amendments were paased in India:

- Companies (Amendment) Act, 1887
- Companies (Memorandum of Association) Act, 1895
- Companies (Branch Register) Act, 1900
- Companies (Amendment) Act, 1910

The Companies Act, 1913 based on the English companies (Consolidation) Act, 1908 with certain additional provisions to satisfy, the peculiar business conditions in this country. The Indian companies act 1913 remained in force till 43 years i.e. from 1913 to 1956. However the act of 1913 was found to be deficient on many courts. Therefore some amendments were made in 1914, 1915, 1920, 1926, 1930 and 1932.

In order to remove the deficiencies and to control the evils of the managing agency system, the Indian Companies Act was passed in 1936 and it became operative from 15 January, 1937. The amendments made in 1936 were extensive and contained the provisions for regulating managing agency system in Indian companies.

## 15.3 The Companies Act, 1956

The Companies Act, 1956 come into force with effect from 1st April, 1956. It is based on the recommendations of the Bhabha committee which submitted its report in 1952 recommending wholesaler amendments in the Indian Companies Act, 1913. The Company Act, 1956 consist of 658 sections and 15 schedules.The Companies Act, 1956 has been amended several times since its enactment. The Companies Act, 1956 also helps the growth of companies on health business principles.

**Objectives of The Companies Act, 1956**

The main objectives of Companies Act are as follows:

- To protect the legal rights of shareholders and creditors.
- To recognize the effectiveness of Company Act.
- To publish full and fair disclosure of companies affairs in their annual reports.
- To establish minimum standerds of good behaviour and business honesty in company formation.
- To recognize the rights of shareholders to get correct information.
- To empower the manager and workers to discharge their duties and fulfil their liabilities.
- To empower the government to interfare and regulate the work of the company.

### 15.3.1 Amendments to the Companies Act, 1956

1. **The First Amendment Has Been Made In 1960 -** This amendment impose some restrictions on management of companies, managerial remunerations of private companies.
2. **The Second Amendment Has Been Made in 1962 -** This amendment relates to the contribution by the second of directors to national defence fund or any other fund approval by the central government.
3. **The Third Amendment Has Been Made In 1963 -** Through this amendment a companies tribunal was established. The amendment was carried out for the purpose of more practical and effective control by way of tracking the cases of found.
4. **The Fourth Amendment Has Been Made In 1964 -** This act introduce protection to employees during the period of investigation by an inspector.
5. **The Fifth Amendment Has Been Made In 1965 -** This amendment provided strength to the provisions regarding to investigate the affairs of companies.
6. **The Sixth Amendment Has Been Made In 1966 -** The purpose of this amendment was to introduce in respect of production of documents under section 240 and loans to companies under some management under section 370.
7. **The Seventh Amendment Has Been Made in 1967 -** Through this amendment the companies tribunal was abolished. The powers of companies tribunal were transferred back to the central government.
8. **The Next Amendment Made in 1969 -** This amendment restricted to donate any money to political parties.
9. **Thereafter Amendments Made in 1971, 1972, 1977 and 1988 -** The amendment of 1988 was based on the recommendations of sachar committee.
10. **The Companies (Amendment) Act, 2000 -** Every private company existing on the commencement of the companies (Amendment) Act, 2000, with a paid-up capital of less than one lakh rupees, shall with in a period of two years from such commencement, enchance its paid up capital to one lakh rupees. Every public company existing on the commencement of the companies (Amendment) Act, 2000, with a paid up capital of less, than five lakh rupees, shall with in a period of two years from such commencement, enchance its paid up capital to five lakh rupees.

**Activity A:**

1. Write the objectives of companies Act, 1956.

### 15.3.2 Extent of the Act

The Companies Act 1956 extends the whole of India from 1 April, 1956 [sec. 1(3)]. But certain exceptions are as follows:

1. In the case of companies in Nagaland, this Act shall be applicable with those amendments as may be notified by the Central Government in official Gazette from time to time [sec. 1(36)].
2. In the case of companies in centrally ruled Goa, Daman and Due, the Central Government may issue directions through official notification that certain provisions of this Act shall not be applicable

to those companies for a period notified or applicable with those amendments or changes or modifications notified in the Official Gazette [sec 620(B)].

3. In the case of companies in the State of Jammu and Kashmir, the Central Government may issue directions through official notification that provisions of this Act shall not be applicable to those companies situated in the State for a period notified or applicable with those amendments, modifications or changes, as the case may be, notified in the Official Gazette.
4. In the case of companies in Sikkim, the Registration of Companies (Sikkim) Act, 1961 is applicable.

### 15.3.4 Application of the Act

This Act applies to the whole of India. In Jammu & Kashmir it applies only to the extent to which its provisions relate to incorporation, regulation and winding up of the insurance, banking and financial corporations.

The Act applies to the following companies -

1. Companies formed or registered under the Act;
2. Every existing company (section 561);
3. Every company registered but not formed under any previous companies law to the extent and in the manner declared in Part IX of the Act (section 562);
4. Unlimited companies registered as limited companies in pursuance of any previous companies law;
5. Unregistered companies for the purpose of winding up under Part X of the Act;
6. Foreign companies which comply with the provisions of section 592 of the Act;
7. Insurance companies, except in so far as the provisions of the Act are inconsistent with the provisions of the Insurance Act, 1938 (IV of 1938);
8. Banking companies except in so far as the provisions of the Act are inconsistent with those of the Banking Companies Act, 1949 (X of 1949);
9. Companies engaged in the generation of supply of electricity, except in so far as the provisions of the Act are inconsistent with those of the Indian Electricity Act, 1910, or the Electricity Supply Act, 1948 (LIV of 1948);
10. Any other company governed by any special Act for the time being in force, except in so far as the provisions of the Act are inconsistent with those contained in such special Act;
11. Such body corporate incorporated by any Act for the time being in force, as the Central Government may, by notification in the Official Gazette, specify in this behalf subject to such exceptions, modifications or adaptations as may be specified therein.
12. Government companies in which not less then 51percent of the paid-up share capital is held by the Central Government or by any State Government and party by one or more State Government and subsidiaries of such companies (section 617), subject to such exceptions, modifications and adaptations of the provisions of the Act (other then ss. 618, 619 and 619A) as may be specified by the Central Government in a notification published in the Official Gazette [section 620 (1) (b)]; and

13. Nidhis or Mutual Benefit Societies declared as such by the Central Government by notification in the Official Gazette, subject to such exceptions, modifications and adaptations as may be specified in the notification [section 620A (2) (b)].

## 15.4 Meaning and Nature of Company

Company means an organization of certain number of persons formed for any common purpose like business, charity etc. Any association recognize as company only it is registered under the Companies Act. In other works we can say that company is an artificial person and it is created by law.

**Defination of Company -** The definition of a "Company" may be classified into three groups-

a. **Definitions as Given in the Companies Act According to The Companies Act 1956 section 3(1)(i) -** "Company means a company formed and registered under this act or an existing company formed under any previous Indian company laws."

b. **Judicial Definitions According to Chief Justice Marshall -** "A corporation is an artificial being invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

**According to Lord Justice Lindley -** "A company is an association of many persons who contributed money or money's worth to a common stock and employed in some trade or business and who share the profits and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is after more or less restricted."

**According to Justice James -** "A company is an association of persons united for common object."

c. **Author's definitions According to Prof. Haney -** " A company is an artificial person created by law, having a separate entity with perpetual succession and a common seal."

**According to Dr. William R. Spriegal -** "The corporation is a creature of the state and possesses an entity separate and distinct from the persons owing its stock or securities."

**Conclusion –** A Company, thus, may be defined as an incorporated association, which is an artificial person, having an independent legal entity, with a perpetual succession, a common seal, a common capital comprised of transferable shares and carrying limited liability.

**Nature and Characteristics of the Company**

The characteristics of company are as follows-

1. **Incorporated Association -** The company is a voluntary association of persons (two or more persons in case of private company, seven or more persons in case of public company) registered under the companies act. The registration is compulsory and cannot be optional. If an association is not registered then it is deemed to be an illegal association and the liability of the members of such an association is unlimited.

2. **Artificial Legal P erson -** A company is an artificial person and created by law. On the other hand, we can say it is not a natural person. It does not exist like a living person but it exist in the eye of law.

The company may acquire, and dispose of property. A company can make a contract through its agents. Because of all these points a company is called an artificial person. But is not a natural person because it cannot be sent to jail, can't marry or divorce.

3. **Limited Liability -** The liability of the members of a registered company is limited but if the company is not registered the liability of the members is unlimited. It is the most important advantage of a company that the liability of its members is limited.

   **a. In Case of Company Limited by Shares -** In this type of company the liability of a member is limited to the nominal value of shares held by him.

   **Illustration -** Ram a shareholder of a company limited by shares. Ram buys 50 shares of Rs. 10 each. The pays Rs. 7 on each share. (Rs. 350 paid by Ram). Now the remaining amount is Rs. 150. He can be made to pay remaining Rs. 150. But he cannot be made to pay more than Rs. 500 in all. It is because the liability of Ram is limited to the nominal value of shares held by him.

   **b. In Case of a Company Limited by Guarantee -** In this type of company the liability of a member is limited to the extent of the amount guaranteed by him.

   **Illustration -** Sheela is a member of a company limited by guarantee. She has guaranteed to contribute Rs. 2000. The company, in the event of its being wound up deemed contribution from Sheela manimum to the extent of the amount guaranteed by her (Rs. 2000).

4. **Separate Legal Entity -** It means the company has a separate legal entity distinct from and independents of the individual persons who are for the time, being its members. The company is not liable for the individual debt of its members. The principle of separate legal entity was recognized in the famous case of Salomon VS Salomon Company Limited. In this case Mr. Salomon carried a business as a leather merchant for many years. Later on in the year 1892. He decided to convert his business into a limited company. He formed his company by incorporating his wife, one daughter and four sons with a share of 1 each to fulfil statutory requirement i.e. 7 members. A board of director was constituted with himself and his two sons. The purchase consideration was paid by the company by the allotment of 20000 shares of 1 each and 10000 debentures which gave Salomon change over all the assets of the company and the balance was paid in cash to the Salomon. The company almost immediately ran into difficulty and a year later the holder of debentures was appointed as receiver and the procedure of liquidation is started. The position or liquidation was as follows-

   Debentures issued to Salomon 10000, unsecured creditors 7000 and assets 6000. It was observed that after paying the debenture holders nothing left for unsecured creditors. The unsecured creditors contended that Salomon and Salomon is company are one and the same Salomon could not our money to himself but it was held that once the company was incorporated under the act it had separate legal entity , independent of its members. In this case where Salomon was a secured creditor he was entitled to be repaid in priority over the unsecured creditors.

5. **Common Seal -** Every company have a common seal. A company is an artificial person it cannot sign document for itself. That's why common seal is required for every company. The common seal is used as a substitute for its signature. When the seal of the company is assined on any document, below to director's signature then only the signature of director are valid.

6. **Perpetual Succession** - A company never dies, law creates it and law alone can dissolve it. Company has a perpetual succession. The existence of company is not affected by the death,

insolvency or exit of any shareholder. " During the war all the members of one private company , while in general meeting, were killed by a bomb. But the company survived not even a hydrozen bomb could have destroyed it." This perpetual succession mean that the company is not affected with the death, insolvery of its members. Members may come, members may go but the company never affected. It go forever.

7. **Transferable Shares -** It is an important characterstic of public limited company. The shares of a public limited company is freely transferable. According to Indian companies act, " the shares or other interest of any member in a company shall be movable property transferable in the manner provided by the articles of the company." (section 82). A public limited company transfer its shares but in case of a private company some restrictions are held on the right to transfer its share by its articles.

8. **Separate Property -** A company has the right to acquire and transfer property in its own Name. The members of the company cannot use the company's property for their personal aim. The members can use property only for company's business. A member does not have insurable interest in the property of company.

9. **Capacity to Sue and Being Sued -** A company is capable to make contract. It is an artificial person so it may sue on other parties in its own name. Just like it other parties may also sue the company is its own name.

10. **Share Capital and Shareholders -** The company have its own share capital and its capital is divided into small parts called shares. The person who buy shares are known as shareholders. According to section 3(1), "The minimum paid-up capital of a public company is Rs. 5 lakh and of a private company is Rs. 1 lakh.

11. **Limited Capacity to Make Contract -** A company can make contract under the scope of memorandum of association. If any work is done beyond the rules prescribed there of shall have no enforcement.

12. **Borrowing Loans -** A company can borrow loan from financial institutions and commercial banks.

13. **Number of Members -** According to the provisions of Indian companies act, 1956 a private company must have minimum of two members and maximum have fifty members. In public company must have seven members. There is no limit maximum members.

14. **Social form of a Company -** Company is an artificial person and created by law. It is exists in the society work for the society and operated by the persons of society. Company has some social responsibility towards society. Products manufactured by company should be in accordance of society. It should not concentrate only on profits, it should also be proactive towards interest of social rights.

15. **Democratic Management -** It is also known as representative management. Company is an artificial person. Its work is manage by the agents and selected people. They make contract on behalf of the company, for the company and enforce the same.

16. **Company is Not Citizen -** Company is a artificial body. Its cannot claim fundamental rights under constitution law or any law. It is cannot be called an Indian citizen but if any rights granted to the company are violated or encroached then company may take shelter of the court.

17. **Termination of Existence -** Being an artificial personality, a company cannot die a natural death. It is created by law and carries on its affairs according to law normally. The existence of a company is terminated by means of winding up of a company. However to avoid winding up, companies change form by means of recoganisation and reconstitution.

**Activity B:**

1. "A company is an artificial person created by law, having a separate entity with a perpetual succession and a common seal." Discuss it and explain the characterstics of company.

## 15.5 Lifting or Piercing of Corporate Veil

A company is a legal person different from its members. There is a curtain between company and its members. But if work done by the company or its managers are against the public interest then the court has power not to accept the principle of separate legal entity. The court may held the directors of the company as personally liable and punish them according by. This process is known as lifting or piercing the corporate veil.

The grounds in which the lifting of corporate veil is done are divided into two categories -

1. Under statutory provisions -
2. Under judicial provisions -

**1. Under Statutory Provisions -**

**a. Reduction of Membership (Section 45) -** The minimum number of members in a private company is two and in a public company is 7. If the members of a company is reduced below the statutory minimum (below 7 or below 2 respectively) And the company carries on business for more than six months after the reduction, and if it is in the knowledge of the member then the member of such company are personally liable for any debt due to the company during that period.

**b. Mis-Statement in Prospectus (Section 62) -** If there is mis-statement in companies prospectus, and any person who buy the shares on the basis of that statement, then every person (who authorized the issue of the prospectus) is liable to pay compensation.

**c. Failure to Refund Application Money (Section 69(5)) -** It the company is unable to allotted the shares , to someone, then the company is bound to return the application money within 130 days of issuing the prospectus.

**d. Misdescription of Name of the Company (Section 147) -** The name of company must be properly written on all documents issued by company. However, if the name of the company is not mentioned then the persons who make contract on behalf of company liable for it.

**e. Non-payment of Income Tax (Section 179) -** The company is responsible to pay tax on its income. But if any amount of tax is found to be outstanding or company is not paying the tax then its separate entity will not recognized. The company shall be responsible for the payment of outstanding tax.

**f. Holding and Subsidiary Companies (Section 212) -** When one company controls the constitution of the board of directors of another company or holds more than 50% of the share capital then it is called the holding company. If one company is holding and other is subsidiary then the principle of separate legal entity will not be accepted.

**g. To Simplify the Investigation of Affairs of the Company (Section 239) -** If an inspector is appointed to investigate the affairs of the company, he shall also have power to investigate the affairs of any other corporate of the some group.

**h. Investigation of Ownership of a Company (Section 247) -** When the central government wants to determine the true persons (a) who have been financially interested in success or failure of the company (b) who have been able to control or materially influence the power of the company. Then the central government appoint an investigator for lifting the corporate status of a company.

**i. Fraudulent Trading (Section 542) -** Sometimes in the course of winding up of a company , it came to know that any business operated by the company with an intent to defrurd creditors or any other person or any other fraudulent purpose. In this situation, the court may declare that all the knowingly parties are personally liable for any of debt of the company. The liability of such persons are unlimited.

**2. Under Judicial Provisions -**

**a. For Protection of Revenue -** When the company is formed for the aim of evading taxes then the court have the power to disregard the corporate entity.

**Illustration** - 'Ram' an assessee was a rich man. He is enjoying huge dividends and interest incomes. To reducing his tax liability Ram established four companies and divided his income in four parts. The court held that "the company was formed by the assessee purely and simply as a means of avoiding tax and the company was nothing more then the assessee himself. Hence, the court decided to disregard the corporate entity and lift the corporate veil.

**b. To Prevent Fraud** - If any company is established with some frandulent object, then the court will not accept to uphold the separate existence of the company or the court can lift the veil of or the existence of companies.

**Illustration** - H was appointed as a managing director of a company on the condition that he would not entice away the customers of the company. When H left the job, he established a company to carry on his own business. His company solicited the customers of G company. It was held by the court, the company was a mere clock or sham for the purpose of enabling H to commit a breach of his covenant against solicitation. Therefore the court issued an injunction against H.

**c. For Determining the Character of the Company** - The company is an artificial person. It make contract through its selected members. The company cannot act like a natural person that's why it can be neither a friend or enemy. But if the persons in control of its affairs are residents of an every country or working under the instructions of an every country then the company may assume as an every character and in this situation the court may lift or pierce the corporate veil and examine the characters of the persons constituting it.

**Illustration** - In Daimler Company limited vs continental tyre & rubber company. A company was incorporated in England for the purpose of selling tyres manufactured by a German company. The German company held the bulk of share in the English company. All the directors and shareholders (except one) were Germans. Thus the English company was controlled by Germans. During the first world was the English company filed a suit to recover a trade debt it was held that the company had become an every company as the affair of the company was controlled by residence in an every country and the suit was dismissed. It will be against the public policy to allow the enemies to function as a company.

**d. In Case the Company is Acting as an Agent or Trustee of the Shareholders** - if the company is acting as an agent on behalf of its members or shareholders then the members held responsible for the acts or the liabilities of the company .

**Illustration** - an American company financed the production of a film named 'Monsoon' in India in the name of a English company. 90% of shares of English company were held by American director. The board of trade of great Britain refused to register the film as a British film because this is the English company acted as an agent for the American company.

**e. Ignorance of Labour Welfare and Social Security Law** - If the employer of any company ignored the provision of the labour welfare and social security law made be government then the court empowered to left the veil of corporate entity.

**f. In Case of Company is Formed for Illegal Purpose** - If any company is formed for illegal purpose or used for illegal purpose then the court may lift the corporate veil.

**g. For the Protection of Public Policy** - For the protection of public policy the court empowered to lift the corporate veil.

**Activity C:**

1. Discuss the situations under which the corporate veil of a company may be lifter. Explain it with illustration.

## 15.6 Meaning Of Promotion

A company is an artificial person created by law for any purpose of business, charity, sports etc. The main purpose of the formation a company is start a new business or to acquire any existing business. The process of company formation is divided into following stages -

1. Promotion Stage
2. Registration Stage
3. Capital Subscription Stage
4. Commencement of Business Stage

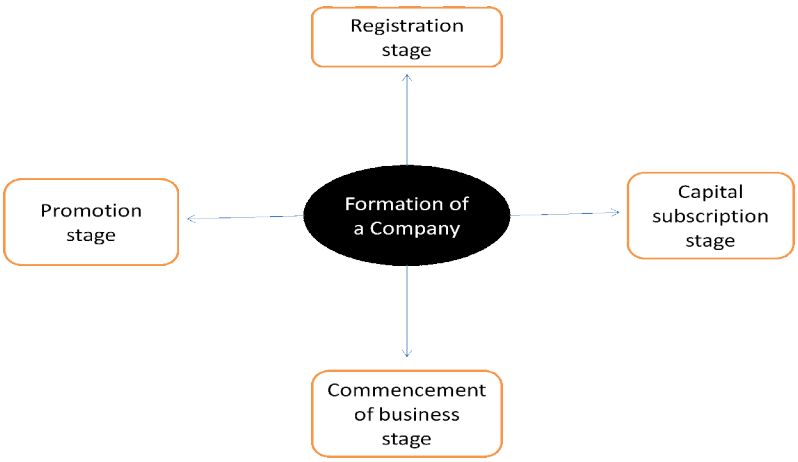


**Figure – 15.1**

**Definition of Promotion**

The term 'promotion ' has not been define in the companies act. Promotion is the first stage in the formation of accompany . in simple words, promotion mean all those activities with starts of the idea of establishing any business and bring into the position of the starting the business in to realistic way.

**According to Gerstenberg** - " Promotion is the discover the business opportunities and the subsequent organization of fund. Property and managerial ability into a business concern for the purpose of making profits there from".

**According to E.S. Mead** - "Promotion involves four elements:- Discovery, investigation, assembling and financing ".

**According to Dr. Henry E. Hogland** - "Promotion is the process of creating a specific business enterprises the aggregate of activities contributed by all those the participated in the building of the business constitutes promotion."

**Conclusion** – Thus, promotion involves discovery of business opportunities and subsequent arrangement of funds, men, materials, etc. to form a business enterprises.

## 15.7 Who Are Promoters

Before a company can be formed, there must be some persons who have an intention to form a company and who take the necessary steps to carry that intention into operation, such person are called "Promoters". The term 'promoter' does not defined in the companies act. The term 'promotion' is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence. A promoter is a convenient way of designating those who set in motion the machinery by which the act enables them to create an incorporated company.

**According to L.J. Browen** - "It is not a term of law but of business, usefully summing up in a single commercial word, a number of business operations, familiar to the commercial world, by which a company is brought into existence."

**In the words of Justice C. Cockburn** - "A promotion is one who undertakes to form a company with reference to a given project and to get it going and who takes the necessary steps to accomplish that purpose."

**According to Sir Francies Palmer** - "Promoter is a person who originates a scheme for the formation of a company, has the memorandum and the articles prepared, executed and registered, and finds the first directors, settles the terms of preliminary contracts and prospectus, if any and makes arrangements for advertising and circulating the prospectus and placing the capital."

**Conclusion** - So we can say that promoter is a person who take all pain and decision to develop and bring into its existence. He is the only person who put all his efforts heart and sole out to develop a company. That is why he is called promoter.

### 15.7.1 Functions of Promoters

1. **Conveicing the Idea of Forming a Company** - First of all, an idea of formation of a company conceived in a person or group of persons. Then they analyse the idea. After that they decide how the company is to be created. Then they/he determines the objects, nature, objects and scope of the proposed company.

2. **Work Related to Investigation and Analysis -**

- To study the primary report received from consultants.
- To evaluate the plans of business.
- To collect related data.
- Determination of size of the enterprise.
- Promoters can take help of experts.
- To investigate the competitors, their products and the level o competition.

3. **Work Related to Preliminary Contracts -** After the investigation the promoter have to make preliminary contracts for purchase of land, building or any other machinery. The promoter have to pay preliminary expenses. Usually a preliminary contract contain the detailed description of the property and assets, its purchase price, made of payment remedies for branch of contract.

4. **Appointment of Officers and Related to Accumulate of Resources -**

- After the appointment of legal advisors the promoter may give them orders to prepare necessary documents.
- Then the promoter appointed managers, secretaries and other workers.
- After the appointments it is for necessary promoter to accumulate funds to fulfit the basic needs for purchase land, building, machinery etc.

5. **Work Related to Legal Formalities -**

- To decide the name of the company.
- To decide the place of the registered office of company.
- To decide the objectives of the company.
- To determine the capital of the company.
- To receive industrial License from government.
- To prepare memorandum of association.
- To make suitable arrangements for printing of memorandum of association.

6. **Work Related to Incorporation of Company -** After the legal formalities the promoter files application to the register for registration of company and receive the certificate of incorporation.

7. **Work Related to Subscription of Capital -** After incorporation the promoter make plan for capital subscription. Promoter make suitable arrangements for preparation of prospectus. Then he determine the remuneration of Auditors, Bankers, Underwriters etc. he also make suitable arrangements for allotment of shares and issue of share certificate to shareholders.

8. **Receiving "Certificate of Commencement of Business" -** This is the last but most important function of promoter to getting a certificate of commencement of business from the registar. For this purpose, it is necessary for promoter to submit a certificate to the registrar that minimum subscription has been subscribed.

### 15.7.2 Right of Promoters

1. **Right to Receive Preliminary Expenses** - It is the right of promoter to receive all the preliminary expenses incurred by him in the process of formation of company. But the right to claim the preliminary expenses is not contracted right of promoter. It depends on the discretion of directors.

   **1. Right to Receive Proportional Amount from Company Promoters** - If more than one promoter act as the promoters of company, then one promoter can claim another promoter to receive proportional amount of damages.

2. **Right to Receive Remuneration** - It is the right of promoter to receive remuneration from company for his services. He has the right to sue the company for recovery of remuneration only when, if company make any agreement with promoter to that effect.

### 15.7.3 Liabilities of Promoters

A promoter of a company is subject to certain liabilities under the Indian Companies Act, 1956. They are -

1. Matters to be set out in the prospectus are mentioned in Section 56 of the Act. The promoter may be held liable for non compliance of the provision of this section.

2. The Promoter is liable for any untrue statement in the prospectus to any person who is subscribed shares or debentures of the company and liable to pay damage. Any false statement in the prospectus may lead the following consequences -

   - The Allotment of shares or debentures may be set aside.
   - The promoter may sue for damages and also for compensation.
   - Criminal proceedings may instituted against the promoter and may incur criminal liability.
   - If it appears that the promoter has been guilty of any offence punishable under Section 542 (whether he has been convicted or not), the court may restrain the promoter from taking part in the management of the company for a period of 5 years.

3. Section 63 of Indian Companies Act, 1956 makes a promoter criminally liable for the issue of prospectus containing false or deceptive statements. The punishment may be for a term which may extend to two years or with fine which may extend to Rs. 5000/- or with both.

4. The promoter may however escape liability if he proves that he had reasonable ground to believe that the statement was true or the statement was immaterial from the point of view of attracting the investors.

5. If the company is being wound up by the order of the court and the liquidators report alleges any fraud in the promotion and formation of the company, the promoters shall be liable to public examination like any other officer or director of the company.

6. If the promoter retained any property of the company, he can be sued by the company for branch of duty or deceit, as the case may be.

7. In the event of death of promoters, the company may recover damages or compensation from the property of the deceased.

8. The liability of Promoter commences only after they have started functioning as promoter and not for earlier acts. The promoters are liable for only those acts which are purported have been done for the company which they intend to float.

### 15.7.4 Duties of the Promoters

The main duties of the promoters are as follows -

1. To conceive the idea of floating the company.
2. To find out suitable persons who may sign the memorandum of association and are also willing to act as the first detectors of the company.
3. To select suitable names of the company and settle the amount and form of its capital, the kinds of shares to be issued the rights of various shareholders, etc.
4. To select the bank where the account of the company is to be kept and also the auditors, legal advisers and brokers for the company.
5. To prepare a draft of the memorandum of association and prospect of the company and get it printed.
6. To submit to the registrar of joint stock companies all the documents required for the incorporation of the company.
7. To arrange for advertisement of prospect of the company in the newspaper.
8. To meet all the preliminary expenses for the forming or Fioating of the company.
9. To disclose fully all the material facts relating to the information of the company.
10. To arrange for the completion of the contracts with vendors managing agents and underwrites.
11. To receive remuneration from the vendors in the form of a commission on the sold property or get founder's shares fully paid up for the services rendered by them to the company.

## 15.8 Summary

In summarized form we can say that company is an artificial person created by law. It does not exist like a living person because it can't be sent to jail, can't marry or divorce. It exist in the eye of law. The following are the characterstics of company -

1. Incorporated association
2. Artificial legal person
3. Limited liability
4. Separate legal entity
5. Common seal
6. Perpetual succession
7. Transferable shares
8. Separate property
9. Capacity to sue and being sued
10. Statutory obligations
11. Share capital and share holders
12. Limited capacity to make contract
13. Borrowing loans

14. Number of members
15. Social form of company
16. Democratic management
17. Company is not a citizen

**Lifting the Corporate Veil -** The principle of separate legal entity has considered as a fundamental principle of company law. The principle of separate legal entity means the company has separate legal entity distinct from its members. Thus a kind of veil is drown between company are its members. But when the affairs of company has done against the public interest then the court has discretion to lift the limited liability of members. This is known as lifting or piercing the corporate veil.

**Promotion and Promoters -** Promotion is the first stage of formation of a company where as promoters are the persons who creates a company. Promoter may be on individual, a firm, an association of persons or even a company. Whether a person is or is not a promoter of a company merely depends upon the facts in each particular case. It is no doubt to say that any person who has a desire be formed and is fully prepared to take some steps to implement it is a promoter.

**The Functions of Promoters are as follows –**

1. Conveicing the idea of forming a company
2. Work related to investigation and analysis
3. Work related to "preliminary contracts"
4. Appointment of officers
5. Legal formalities
6. Incorporation of capital
7. Subscription of capital
8. Receiving certificate of commencement of business

**Rights of Promoters are Follows –**

1. Right to receive preliminary expenses
2. Right to receive proportional amount
3. Right to receive remuneration

**Liabilities of Promoters are Follows –**

1. Liability towards misstatement in prospectus
2. Liability towards profits
3. Liability towards breach of trust

## 15.9 Practical Problems

1. An Association of persons may form a company and get itself registered as such under the companies Act. What are the considerations which may actuate it to do so?

2. A and B are friends, who were the only two members of 'Private Limited Company' are dead on road accident. Whether the company also die with them?

3. If the members composing the company die or dissociate themselves, the company also gets extinct. Is it correct statement? Give the reason.

4. All the four persons A, B, C and D, who are the only members of a private company. Go on trip by a boat. The boat expsizers in to the open sea and they are drowned and all of them die. Whether the private company remains in existence.

5. The promoters of a company before its incorporation enter into an agreement with a to buy a oil-mill on behalf of the company. After incorporation, the company refuses to buy the said oil-mill. Has any remedy either against the promoters or against the company?

6. A promoter sell his own property to a company formed by him. A shareholder approaches you and your advice as to the steps he can take against the promoters. Give him advice fully.

7. The promoter of a company incorporated on 1 october,2012 had entered into a contract with A 1 August, 2012 for supply of goods when the company came into existence. The company, however, does not want to proceed with the contract. Discuss the correctness or otherwise of the company's action.

8. A debt was contracted by the promoter for on behalf of a public company before the date which the company was entitled to commence its business. The promoters applied for shares in the company and debt was set off against payment in cash for allotted stares. Discuss the validity of the set-off.

## 15.10 Self Assessment Questions

1. What do you mean by company? Explain the characterstics of a company?

2. Describe the history of Companies Act, 1956.

3. "A company is a legal person just as much as an individual but with no physical existence." Explain it.

4. "A company is an artificial person created by law, having a separate entity with a perpetual succession and a common seal." Discuss this statement and explain the characteristics of a company.

5. "A company has a separate legal existence other than of its members." Discuss the statement and state the circumstances under which the Court may ignore this principle.

6. "Limited liability" and "Separate legal existence" are basic features of company but under their cover directors cannot do whatever they like" Analyse this statement and explain it.

7. "What do you understand by "lifting the corporate veil"? under what circumstances is it necessary to lift the corporate veil?

8. Who are promoters? Write all the functions of promoters?

9. Write the duties and liabilities of promoters?

## 15.11 Reference Books


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# Unit - 16 : Consumer Protection Act

**Structure of Unit:**



## 16.0 Objectives

After completing this unit, you would be able to:

- Introduction
- Consumer Protection Act.
- Salient Features of the Act.
- Important definitions related to Act
- District Forum of the Act.
- State Commission of the Act.
- National Commission of the Act.
- Conclusion

## 16.1 Introduction

The moment a person comes into this would, he starts consum-ing. He needs clothes, milk, oil, soap, water, and many more things and these needs keep taking one form or the other all along his life. Thus we all are consumers in the literal sense of the term. When we approach the market as a consumer, we expect value for money, *i.e.,* right quality, right quantity, right prices, information about the mode of use, etc. But there may be instances where a consumer is harassed or cheated.

The Government of India understood the need to protect consumers from unscrupulous suppliers, and several laws have been made for this purpose. We have the Indian Contract Act, the Sale of Goods Act, the Indian Standards Institution (Certification Marks) Act, the Prevention of Food Adulteration Act, etc. which to some extent protect consumer interests. However, these laws require the con-sumer to initiate action by way of a civil suit involving lengthy legal process which is very expensive and time consuming.

The Consumer Protection Act, 1986 was enacted to provide a sim-pler and quicker access to redressal of consumer grievances. The Act for the first time introduced the concept of 'Consumer' and conferred express additional rights on him. It is interesting to note that the Act doesn't seek to protect every consumer within the literal meaning of the term. The protection is meant for the person who fits in the definition of 'Consumer' given by the Act.

## 16.2 Consumer Protection Act, 1986

The Consumer Protection Act, 1986 is a milestone in the history of socio-economic legislation in India. It is the most progressive and comprehensive regulations formulated to safeguard the interest of consumers in the country. It was enacted after an in-depth study of Consumer Protection Laws in several countries and in consultation with representatives of consumer bodies, trade and industry and extensive discussions within the government. The Act Attempts to give consumers complete protection from malpractices of manufacturers, producers, suppliers, wholesalers and retailers. The Act is designed to make available, inexpensive and speedy justice to the consumer.

It is an Act to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consum-ers' disputes and for matters connected therewith.

The Consumer Protection Act was passed in December 1986 and came into force in April 1987. The Act is in force to whole of India except the state of Jammu and Kashmir. It was amended in 1991, 1993 and 2002 (effective from March 15, 2003) to make it more functional and purposeful. Remedy for consumers under this Act is through an effective three-tier quasi-judicial mechanism comprising of the District Forum at the grass root, State Commission at the State Level and National Commission at the apex.

At present, there are 35 State Commissions and One District Forum in each district of the country. The State governments are accountable for setting up the district forums and the State Commissions. The Government of India has declared '24December' as the 'National Consumer Day' as it was on that date then President of India had given his consent to the enactment of this historic Act. Besides this, '15 March' is observed as 'World Consumer Rights Day'.

## 16.3 Salient Features of the Act

The salient features of the Act are as follows:

1. The Act applies to all goods and services unless specifically exempted by the Central Government.
2. It covers all the sectors i.e. Public, Private and Co-operative
3. The provisions of the Act are chiefly compensatory in nature.
4. It seeks to confer upon the consumers the following six rights:
    a. **Right to Safety:** It is the right of the consumer to be protected against the marketing of goods and services by unscrupulous sellers, which are potentially hazardous to life and property. The goods purchased and services availed of should not only meet their immediate needs, but also fulfill long term interests.
    b. **Right to be Informed:** This refers to the entitlement of the consumer to be informed about the quality, quantity, potency, purity, standard and prices of goods so as to protect the buyer against unfair trade practices. A consumer should insist on getting all the information about the product or service before making a choice or a decision. This will enable him/ her to act wisely and responsibly and also enable him to desist from falling prey to high pressure and misleading selling techniques.
    c. **Right to Choose:** It is the right of the consumer to be assured, as far as possible, of access to a variety of goods and services at competitive price. In case of monopolies, it implies the

right to be assured of satisfactory quality and service at a fair and reasonable price.

d. **Right to be Heard:** This implies that consumer's interest will receive due consideration at appropriate forum. it also includes the consumer's liberty to be represented in various forum constituted for consumer welfare.

e. **Right to Seek Redressal:** This refers to the privilege of the consumer to seek compensation against unfair trade practices or unscrupulous exploitation. Is also includes the right to fair settlement of genuine grievances of the consumer. Consumer can also take the help of consumer organizations in seeking redressal of their grievances.

f. **Right to Consumer Education**: This refers to the entitlement of the consumer to acquire the knowledge and skill to be an informed buyer throughout his/ her life. Ignorance of consumers, particularly of rural folk, is the main cause of their exploitation. They should know their rights and must exercise them.

5. The Act also envisages establishment of Consumer Protection Councils at the Central, State and District Levels, whose main objectives will be to promote and protect the rights of consumers

6. To provide a simple, speedy and inexpensive redressal of consumer grievances, the Act envisages three-tier quasi-judicial machinery at the National, State and District levels. There are National Consumer Disputes Redressal Commission known as National Commission, State Consumer Disputes Redressal Commission known as State Commissions and District Consumer Disputes Redressal Forums known as District Forums.

7. Engagement of an advocate is not mandatory to file a complaint under the Consumer Protection Act.

It is worth mentioning that the provisions of Consumer Protection Act, 1986 are in addition to, and not in derogation of the provisions of any other law for the time being in force. The Act has not overridden or repealed any of the legislation in force prior to this Act.

## 16.4 Important Definitions Related to Act

### 16.4.1 Appropriate Laboratory

"Appropriate Laboratory" means a laboratory or organization that is:

i. recognised by the Central Government;

ii. recognised by a State Government, subject to such guide-lines as may be prescribed by the Central Government in this behalf; or

iii. any such laboratory or organisation established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect [Section 2(1) (A)]

### 16.4.2 Branch Office

"Branch Office" means:

(i) any establishment described as a branch by the opposite party; or

(ii) any establishment carrying on either the same or substan-tially the same activity as that carried on by the head office of the establishment;

### 16.4.3 Complainant

"Complainant" means—

(i) a consumer; or

(ii) any voluntary consumer association registered under the Companies Act, 1956 (1of1956)or under any other law for the time being in force; or

(iii) the Central Government or any State Government,

(iv) one or more consumers, where there are numerous consum-ers having the same interest;

(v) in case of death of a consumer, his legal heir or representative; who or which makes a complaint;

### 16.4.4 Complaint

"Complaint" means any allegation in writing made by a complain-ant that:

(i) an unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;

(ii) the goods bought by him or agreed to be bought by him; suffer from one or more defects;

(iii) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

(iv) a trader or service provider, as the case may be, has charged for the goods or for the service mentioned in the com-plaint a price in excess of the price –
   (a) fixed by or under any law for the time being in force
   (b) displayed on the goods or any package containing such goods ;
   (c) displayed on the price list exhibited by him by or under any law for the time being in force;
   (d) agreed between the parties;

(v) goods which will be hazardous to life and safety when used or being offered for sale to the public:
   (A) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;
   (B) if the trader could have known with due diligence that the goods so offered are unsafe to the public;

(vi) services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety;"

### 16.4.5 Consumer

"Consumer" means any person who—

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person,

but does not include a person who obtains such goods for resale or for any commercial purpose; or

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly prom-ised, or under any system of deferred payment and includes any beneficiary of such services other than the person who 'hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person ***but does not include a person who avails of such services for any commercial purposes***;

Explanation: For the purposes of this clause, "commercial purpose" does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment.

The definition of 'Consumer' given in the Act makes it clear that it includes not only the person who buys and goods or hires a service for consideration, but also any user of such goods or services, when such use is made with the approval of the buyer or hirer.

### 16.4.6 Consumer Dispute

"Consumer Dispute" means a dispute where the person against whom a complaint has been made, denies or disputes the allega-tions contained in the complaint.

### 16.4.7 Defect

"Defect" means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods.

### 16.4.8 Deficiency

"Deficiency" means any fault, imperfection, shortcoming or inade-quacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

### 16.4.9 District Forum

"District Forum" means a Consumer Disputes Redressal Forum established under clause (a) of section 9.

### 16.4.10 Goods

"Goods" means goods as defined in the Sale of Goods Act, 1930 (3 of 1930);

### 16.4.11 Manufacturer

"Manufacturer" means a person who—

(i) makes or manufactures any goods or part thereof; or
(ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others; or
(iii) puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer;

Explanation: Where a manufacturer dispatches any goods or part thereof to any branch office maintained by him, such branch office shall not be deemed to be the manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office;

### 16.4.12 Member

"Member" includes the President and a member of the National Commission or a State Commission or a District Forum, as the case may be.

### 16.4.13 National Commission

"National Commission" means the National Consumer Disputes Redressal Commission established under clause (c) of section 9;

### 16.4.14. Notification

"Notification" means a notification published in the Official Gazette.

### 16.4.15 Person

"Person" includes,—

(i) a firm whether registered or not;
(ii) a Hindu undivided family;
(iii) a co-operative society;
(iv) every other association of persons whether registered under the Societies Registration Act, 1860 (21 of 1860) or not.

### 16.4.16 Prescribed

"Prescribed" means prescribed by rules made by the State Gov-ernment, or as the case may be, by the Central Government under this Act.

### 16.4.17 Service

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

### 16.4.18 State Commission

"State Commission" means a Consumer Disputes Redressal Commission established in a State under clause (b) of section 9.

### 16.4.19 Trader

"Trader" in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof.

### 16.4.20 Unfair Trade Practice

"Unfair Trade Practice" means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely;

1. The practice of making any statement, whether orally or in writing or by visible representation which
    i. falsely represents that the goods are of a particular standard, quality, quantity, grade,

composition, style or model;

ii. falsely represents that the services are of a particular standard, quality or grade;

iii. falsely represents any re-built, second-hand, reno-vated, reconditioned or old goods as new goods;

iv. represents that the goods or services have sponsor-ship, approval, performance, characteristics, accesso-ries, uses or benefits which such goods or services do not have;

v. represents that the seller or the supplier has a spon-sorship or approval or affiliation which such seller or supplier does not have;

vi. makes a false or misleading representation concern-ing the need for, or the usefulness of, any goods or services;

vii. gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof;
Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence.

viii. makes to the public a representation in a form that purports to be—

(i) a warranty or guarantee of a product or of any goods or services; or

(ii) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result, if such purported warranty or guarantee or prom-ise is materially misleading or if there is no reasonable prospect that such warranty, guaran-tee or promise will be carried out;

(ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;

(x) gives false or misleading facts disparaging the goods, services or trade of another person.

For the purposes of clause (1), a statement that is

(a) expressed on an article offered or displayed for sale, or on its wrapper or container; or

(b) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or

(c) contained in or on anything that is sold, sent, delivered, transmit-ted or in any other manner whatsoever made available to a member of the public, shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed, made or contained;

(d) permits the publication of any advertisement whether in any news-paper or otherwise, for the sale or supply at a bargain price, of goods or services that are not intended to be

offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

2. For the purpose of clause (2), "bargaining price" means

   (a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise, or

   (b) a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold;

3. An unfair trade practice is one which permits

   i. the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;

   ii. the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest;

   (3A) withholding from the participants of any scheme offering gifts, prizes or other items free of charge, on its closure the information about final results of the scheme.

   Explanation: For the purposes of this sub-clause, the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time, published, prominently in the same newspapers in which the scheme was originally advertised.

4. Permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions, fin-ishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods;

5. Permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services.

6. Manufacture of spurious goods or offering such goods for sale or adopts deceptive practices in the provision of services (Inserted by the Consumer Protection (Amendment) Act, 2002)

## 16.5 Three Tier Grievance Redressal Machinery

In order to provide simple and speedy redressal of consumer grievances, Section 9 of the Consumer Protection Act envisages three-tier quasi-judicial machinery at the national, state and district levels. Collective popular as consumer courts, the redressal machinery comprises the following:

1. National Consumer Disputes Redressal Commissions or the "National Commission" at the apex. It is based in Delhi.

2. Consumer Disputes Redressal Commissions or "State Commissions". These are based in every state capital.

3. Consumer Disputes Redressal Forum or "District Forums" which are established at the district level.

At present, there are 35 state commissions, one in each State or Union Territory and 571 District forums.

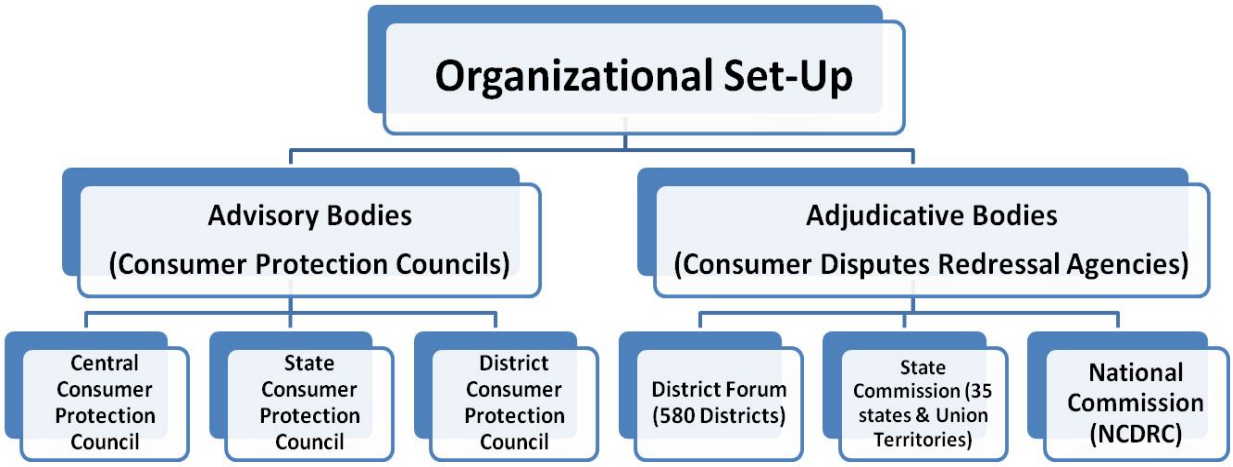


**Figure 1: Organizational Set up under Consumer Protection Act, 1986**

## 16.6 District Forum

Section 9 (a) of the Act lays down that there shall be established for the purpose of this Act, a Consumer Disputes Redressal Forum to be known as the 'District Forum' established by the state government by notification. The state government may, if it deems fit, establish more than one District Forum in a district.

**Composition of the District Forum**

Section 10 of the Act states that each District Forum shall consist of:

a. a person who is, or has been, or is qualified to be a District Judge, who shall be its President;

b. two other members, one of whom shall be a woman, who shall have the following qualifications, namely:

(i) be not less than thirty-five years of age,
(ii) possess a bachelor's degree from a recognized university,
(iii) be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that a person shall be disqualified for appointment as a member if he/ she

a. has been convicted and sentenced to imprisonment for an offence which, in the opinion of the state Government involves moral turpitude; or
b. is an undischarged insolvent; or
c. is of unsound mind and stands so declared by a competent court; or
d. has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or
e. has, in the opinion of the state Government, such financial or other interest as is likely to

affect prejudicially the discharge by him of his functions as a member; or

f. has such other disqualifications as may be prescribed by the State Government;

Every appointment under sub-section (I) shall be made by the State Government on the recommendation of a selection committee consisting of the following, namely

| | | |
|---|---|---|
| i. | President of the State Commission | Chairman |
| ii. | Secretary, Law Department of the State | Member |
| iii. | Secretary In-Charge of the Department dealing with Consumer affairs in the State | Member |

Every member of the District Forum shall hold office for a term of five years or up to the age of sixty-five (65) years, whichever is earlier, and shall not be eligible for re-appointment.

The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the District Forum shall be such as may be prescribed by the State Government. However, the appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work load of the District Forum.

The District Forum subject to the other provisions of this Act, shall have jurisdiction to entertain complaints where the value of the goods or services and the compensation, if any, claimed ‘’does not exceed Rupees Twenty lakhs (Rs 20 Lakh).

A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction:

a. the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain, or

b. any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided that in such case either the permission of the District Forum is given, or the opposite parties who do not reside, or carry on business or have a branch office, or personally work for gain, as the case may be, acquiesce in such institution; or

c. the cause of action, wholly or in part, arises (Section 11).

## 16.7 State Commission

State Commission forms the middle tier of the redressal mechanism. One in each state capital the State Commission settle issues between Rupees 20 Lakhs (Rs 20 Lakh) and Rupees One Crore (Rs 1 Cr). These commissions also serve as appellate courts for verdicts of the District forums. Each State Commission is headed by a President or Chairman, who is the rank of a serving High Court Judge and Two to Four members (one of whom is woman).

Section 9(b) of the Act lays down that “there shall be established for the purposes of this Act a Consumer Disputes Redressal Commission to be known as the “State Commission”, established by state government by notification.

Each State Com-mission shall consist of:

a. a person who is or has been a Judge of a High Court, appointed by the State Government, who shall be its President, provided that no appointment under this clause shall be made except after

consultation with the Chief Justice of the High Court.

b. not less than two, and not more than such number of members, as may be prescribed, and one of whom shall be a woman, who shall have the following qualifications, namely

(i) be not less than thirty-five years of age;

(ii) possess a bachelor's degree from a recognised university; and

(iii) be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Nevertheless, not more than fifty per cent of the members shall be from amongst persons having a judicial background.

The expression "persons having judicial background" shall mean persons having knowledge and experience for at least a period of ten years as a presiding officer at the district level court or any tribunal at equivalent level:

Further that a person shall be disqualified for appointment as a member if he—

a. has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude; or

b. is an undischarged insolvent; or

c. is of unsound mind and stands so declared by a competent court; or

d. has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or

e. has, in the opinion of the State Government, such financial or other interest, as is likely to affect prejudicially the discharge by him of his functions as a member; or

f. has such other disqualifications as may be prescribed by the State Government.

Every appointment under sub-section (1) shall be made by the State Government on the recommendation of a Selection Committee consisting of the following members, namely:

| | | |
|---|---|---|
| i. | President of the State Commission | Chairman |
| ii. | Secretary, Law Department of the State | Member |
| iii. | Secretary In-Charge of the Department dealing with Consumer affairs in the State[Section 16 as Amended by the Consumer Protection (Amendment) Act, 1986] | Member |

Under Section 16 (2), the salary or honorarium and other allowances payable to, and the other terms and conditions of service of, the members of the State Commission shall be such as may be prescribed by the State Government. The appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work load of the State Commission.

Every member of the State Commission shall hold office for a term of five years or up to the age of sixty-seven years, whichever is earlier and shall not be eligible for re-appointment.

Subject to the other provisions of this Act, the State Commission shall have jurisdiction:

a. to entertain

i. complaints where the value of the goods or services and compensation, if any, claimed exceeds Rupees twenty lakhs but does not exceed Rupees one crore;

ii. appeals against the orders of any District Forum within the State; and

b. to call for the records and pass appropriate orders in any con-sumer dispute which is pending before or has been decided by any District Forum within the State, where it appears to the State Commission that such District Forum has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity. (Section 17)

A complaint shall be instituted in a State Commission within the limits of whose jurisdiction:

a. the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain; or

b. any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain, provided that in such case either the permission of the State Commission is given or the opposite parties who do not reside or carry on business or have a branch office or personally work for gain, as the case may be, acquiesce in such institution; or

c. the cause of action, wholly or in part, arises.

On the application of the complainant or of its own motion, the State Commission may, at any stage of the proceeding, transfer any complaint pending before the District Forum to another District Forum within the State if the interest of justice so requires.

## 16.8 National Commission

At the apex of the redressal mechanism, stands the five-member National Commission headed by a person no less than the rank of serving or retired Supreme Court Judge. Out of the other four members, two are supposed to have a judicial background and one of them has to be a woman.

The National Commission shall consist of:

a. a person who is or has been a Judge of the Supreme Court, to be appointed by the Central Government, who shall be its President. However, no appointment under this clause shall be made except after consultation with the Chief Justice of India;

b. not less than four, and not more than such number of members, as may be prescribed, and one of whom shall be a woman, who shall have the following qualifications, namely:
   i. be not less than thirty-five years of age;
   ii. possess a bachelor's degree from a recognised university; and
   iii. be persons of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

However, not more than fifty per cent of the members shall be from amongst the persons having a judicial background. The expression "persons having judicial background" shall mean persons having knowledge and experience for at least a period of ten years as a presiding officer at the district level court or any tribunal at equivalent level:

Further a person shall be disqualified for appointment if he/ she

a. has been convicted and sentenced to imprisonment for an offence which, in the opinion of the Central Government, involves moral turpitude; or
b. is an undischarged insolvent; or
c. is of unsound mind and stands so declared by a competent court; or
d. has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or
e. has in the opinion of the Central Government such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or
f. has such other disqualifications as may be prescribed by the Central Government :

Every appointment under this clause shall be made by the Central Government on the recommendation of a selection committee consisting of the following, namely:

i. A person who is a judge of the Supreme Court, to be nominated by the Chief Justice of India Chairman

ii. Secretary in the Department of Legal Affairs in the Government of India Member

iii. Secretary of the Department dealing with Consumer affairs in the Government of India Member

The salary or honorarium and other allowances payable to and the other terms and conditions of service of the members of the National Commission shall be such as may be prescribed by the Central Government.

Every member of the National Commission shall hold office for a term of five years or up to the age of seventy years, whichever is earlier and shall not be eligible for re-appointment.

Subject to the other provisions of this Act, the National Commission shall have jurisdiction—

a. to entertain:

i. complaints where the value of the goods or services and compensation, if any, claimed exceeds Rupees One Crore; and

ii. appeals against the orders of any State Commission; and

b. to call for the records and pass appropriate orders in any con-sumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested, or has acted in the exercise of its jurisdiction illegally or with material irregularity [Under Section 21].

The National Commission may, with the previous approval of the Central Government, by notification, make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

In particular and without prejudice to the generality of the foregoing power, such regulations may make provisions for the cost of adjournment of any proceeding before the District Forum, the State Commission or the National Commission, as the case may be, which a party may be ordered to pay.

No suit, prosecution or other legal proceedings shall lie against the members of the District Forum, the State Commission or the National Commission or any officer or person acting under the direction of the District Forum, the State Commission or the National Commission for executing any order made by it or in respect of anything which is in good faith done or intended to be done by such member, officer or person under this

Act or under any rule or order made thereunder.

## 16.9 Summary

The Consumer Protection Act, 1986 deals with all the issues relating to the redressal of Consumer grievances. In the modern market the seller is organized and has professional skills, whereas the buyer is generally considered unorganized and amateur. Most of the modern goods are technological gadgets about which the consumer knows little or even nothing. The principle of *caveat emptor* (let the buyers beware), thus has ceased to be appropriate as a general rule. The common consumer deserves to get what he pays for in real quantity and real quality.

In every society, consumer remains the pivot of all business and industrial activity and does need protection by law when goods fail to live upto the promises. The Consumer Protection Act, 1986 is a landmark regulation. The Act is designed to make available cheap and quick remedy to an individual and unorganized consumer. It applies to all goods and services unless specifically exempted by the Central Government and covers all the sectors. The provisions of the Act are rather compensatory than preventive or punitive. It seeks to promote and protect the rights of the consumers. For simple, fast and inexpensive settlement of consumers' disputes and for the matters connected therewith, the Act envisages three-tier quasi-judicial machinery. The Act also makes provision for the establishment of Consumer Councils and other authorities. The Act, however, does not attempt to derogate the provisions of any other law.

## 16.10 Self Assessment Questions

1. State whether the following statements are True or False.
   a. A person who buys goods for commercial purpose is not a consumer.
   b. Utility of a product is the sole reason to buy it.
   c. Engagement of advocate is mandatory for the complainant under the Consumer Protection Act.
   d. The provisions of the Consumer Protection Act, 1986 are in addition to and not in derogation of the provisions of any other law, for the long time in force, to protect the interest of consumers.
   e. The 'National Commission' has the jurisdiction to entertain (a) complaints where the value of the goods or services and compensation, if any, claimed exceeds One Crore rupees, and (b) appeals against the orders of any state commission.

   (a) True (b) False (c) False (d) True (e) True

2. Describe the salient features of the Consumer Protection Act, 1986?
3. Discuss the aim and objectives of the Consumer Protection Act, 1986?
4. Who is a Consumer as per Consumer Protection Act, 1986?
5. What is the statutory definition of 'Defect' as per Consumer Protection Act, 1986?
6. What is the statutory definition of 'Deficiency' as per Consumer Protection Act, 1986?
7. What is the statutory definition of 'Goods' as per Consumer Protection Act, 1986?
8. What is the statutory definition of 'Manufacturer' as per Consumer Protection Act, 1986?
9. What is the statutory definition of 'Complainant' as per Consumer Protection Act, 1986?
10. What is the statutory definition of 'Complaint' as per Consumer Protection Act, 1986?

11. What is the statutory definition of 'Person' as per Consumer Protection Act, 1986?

12. What is the statutory definition of 'Trader' as per Consumer Protection Act, 1986?

13. What is the statutory definition of 'Unfair Trade Practice' as per Consumer Protection Act, 1986?

## 16.11 Reference Books


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