B. COM. PART-I (SEMESTER-I)

B.C. 104
BUSINESS LAW-I

UNIT NO. 1

Centre for Distance and Online Education, Punjabi University, Patiala

Lesson No. :

NOTE : Students can download the syllabus from department's website www.pbidde.org

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B.COM. PART-I (Ist Semester)
BC 104: BUSINESS LAWS - 1

Time allowed : 3 hours | Max Marks: 100
Pass Marks : 35% | Internal Assessment: 30
Periods per week : 6 | External Assessment: 70

Instructions for Paper-Setters/Examiners

The question paper covering the entire course shall be divided into three sections as follows:

SECTION-A

It will consist of essay type questions. Four questions shall be set by the examiner from UnitI of the syllabus and the candidate shall be required to attempt two. Each question shall carry 10 marks; total weight of the section shall be 20 marks. .

SECTION-B

It will consist of essay type questions. Four questions shall be set by the examiner from UnitII of the syllabus and the candidate shall be required to attempt two. Each question shall carry 10 marks; total weight of the section shall be 20 marks. .

SECTION-C

It will consist of 12 very short answer questions from entire syllabus. Students are required to attempt 10 questions up to five lines in length. Each question shall carry 3 marks; total weight of the section shall be 30 marks

UNIT - I

LAW OF CONTRACT (1872): Nature of contract, Classification; Offer and acceptance; Capacity of parties to contract; Free consent; Consideration; legality of object; Agreements declared void; Performance of Contract; Discharge of contract, Remedies for breach of contract. Special Contracts: Indemnity; Guarantee; Bailment and Pledge; Agency

UNIT - II

SALES OF GOODS ACT (1930): Formation of contracts of sale; Goods and their classification, price; conditions, and warranties; Transfer of Property in Goods; Performance of the Contract of Sales; Unpaid Seller and his Rights, Sale by Auction; Hire Purchase Agreement. Partnership Act (1932): Nature and characteristics, Registration of Partnership firms, Types, Rights, Duties and Implied Authority. Mode of Dissolution. The Limited Liability Partnership Act (2008): Salient features, LLP Agreement, Incorporation by Registration.

BOOKS RECOMMENDED

1. Singh, Avtar : The Principles of Mercantile Law
2. Kuchhal M.C. : Business Law
3. Kapoor, N.D. : Business Laws
4. Chandra, P.R. : Business Law, Galgotia, New Delhi
5. Sharma, V.K. : Business Law

LESSON NO. 1.1 AUTHOR : ANJU SINGLA

NATURE OF CONTRACT

Structure :

1.1.1 Objective:

After going through this chapter, following concepts will be clear:

I. Meaning of contract
II. Essential of Contract
III. Different types of Contract

1.1.2 Introduction:

It is the most important part of the mercantile law. It affects every person in one way or the other, as all of us enter into some kind of contract every day. Some of these are made consciously, for example purchase or sale of share of a company or a plot of land. Sometimes, we do not even realize that we are making a contract e.g. hiring a taxi, buying a book, takes a credit card from bank, takes a seat in a bus and goes to Cinema to see movie etc. In any case, contract which so ever made, confer legal rights on one party and subjects the other party to some legal obligations. In case of people engaged in business, they carry on business by entering into contract. Thus, the business executives, corporate counsels, entrepreneurs and professionals in different fields deal frequently with contracts. Therefore, it is necessary for them to know what constitutes a contract.

In India, the law relating to contracts is contained in the INDIAN CONTRACT ACT, 1872. The act came into force on the first day of September, 1872 and it applies to the whole of India except the state of Jammu and Kashmir. This law relates to general principle of contract.

1.1.3 Definition of Contract:

The term contract is defined in section 2(h) of the Indian Contract Act,1872 which reads as under:

"An agreement enforceable by law".

The analysis of this definition shows that a contract must have the following two elements.

(1) An agreement

(2) An agreement must be enforceable by law.

In other words :

Contract = An Agreement + Enforceability (by law)

Agreement: Section 2(e) defines an agreement as "every promise and every set of promises forming consideration for each other".

Promise: Proposal when accepted, becomes a promise.

An agreement involves proposal or offer by one party and acceptance of same by the other party. Thus, an agreement is the outcome of two consenting minds i.e. Consensus ad idem.

Agreement = Offer + Acceptance

Every agreement is not a contract, until an agreement creates some legal obligations and is enforceable by law, it is regarded as a contract

Example : D Airlines sells a ticket on 1 January to X for the journey from Mumbai to Bangalore on 10 January. The Airlines is under an obligation to take X from Mumbai to Bangalore on 10 January. In case the Airlines fails to fulfill its promise, X has remedy against it. Thus, X has a right against the Airlines to be taken from Mumbai to Bangalore on 10 January. A corresponding duty is imposed on the Airlines. As there is a breach of promise by the promisor (the Airlines, the other party to the contract (i.e. X) has a legal remedy.

There are several agreements which do not give rise to legal obligations and hence are not contracts. On the other hand, there are certain obligations, which do not come out from an agreement, but are enforceable at Law. e.g., Torts or civil crimes, Quasi Contracts, Decrees by courts. Law of contract creates rights in personam and right-in-rem. e.g. Mr. X is the owner of a house and Mr Y is immediate neighbour. Mr X can enjoy this possession not only against Mr Y but against the whole world. This is right-in-rem. Another example in Mr X is to received some money from Mr Y. This right only Mr X can exercise and that too only against Mr Y. This is right in Personam.

1.1.4 Essential Elements of Contract:

1.1.4.1 Agreement :

In an agreement there must be at least two parties, one of them making the offer and other accepting it. In other words, there must be an offer by one party and its acceptance by other. The offer when accepted becomes agreement.

1.1.3.2. Intention to create legal relationship: In case, there is no such intention on the part of the parties, there is no contract. Agreement of social or domestic nature do not contemplate legal intention.

Example : An agreement to have lunch at a friend's house is not an agreement intending to create legal relations. Agreements between husband and wife, generally lack the intention to create legal relations.

Case : Balfour V. Balfour (1919)

Mr. Balfour was employed in Ceylon. Mrs. Balfour owing to ill health, had to stay in England and could not accompany him to Ceylon. Mr. Balfour promised to send her $ 30 per month, while he was abroad. But Mr. Balfour failed to pay that amount. So Mrs. Balfour filed a suit against her husband for recovering the said amount. The court held that it was a mere domestic agreement and that the promise made by the husband in this case was not intended to be a legal obligation.

In this case, the intention not to create a legal obligation was clear from the conduct of the parties.

1.1.3.3. Free Consent : The contract must have been made with free consent of the parties. It may be noted that the consent is not free, when it is obtained by coercion, undue influence, fraud, misrepresentation of facts etc. If the consent of the parties is not free, then no valid contract comes into existence.

Example : A threatened to shoot B's son unless B signs a promissory note for Rs. 20,000 in favour of A. B signed the promissory note under the threat. In this case, B's consent is not free as it is obtained under pressure, therefore the promissory note is not valid.

1.1.3.4. Parties competent to Contract : The parties to an agreement must be competent to contract. If either of the parties does not have the capacity to contract, the contract is not valid. Accordingly, to Section 11, "every person is competent to contract, who is of the age of majority accordingly 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. Accordingly the following persons are incompetent to

contract. (a) minors (b) persons of unsound mind, and (C) persons disqualified by law.

1.1.3.5. Lawful consideration : Consideration is an essential element in a contract. It has been defind as the prize for which the promise of another is made. The law enforces only those promises which are made for consideration. An agreement without consideration subject to certain exceptions is void. Consideration may be past, present or future but it must be real and lawful.

Example : A promised to obtain an employment for B in a government department, and B promised to pay Rs. 10,000/- to A. In this case, the agreement is not valid as the consideration for it is unlawful.

1.1.3.6. Lawful object : The object of the agreement must be lawful. It must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful, then no valid contract comes into existence.

Example : When a landlord knowingly lets a house to a prostitute to carry on prostitution, he cannot recover the rent through a court of law.

1.1.3.7. It must be writing : According to the Indian Contract Act, a contract may be oral or in writing but in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered.

1.1.3.8. Agreement not be declared void or illegal : The agreements must not have been expressly declared to be void by any law in force in the country. If certain agreements are expressly declared to be void by the law of the country, then such agreements if entered into, shall not be enforceable by Courts of Law.

Example : An agreement in restraint of marriage, an agreement in restraint of trade, and an agreement by way of wager have been expressly declared void under section 26,27 and 30 respectively.

1.1.3.9. Certainty of meaning : Section 29 of the Contract Act provides that meaning of the agreement must be certain. In other words , an agreement whose meaning is not certain is not valid.

Example : A agreed to sell to B "hundred tonnes of oil". Here it is not clear what kind of oil is intended to be sold. (Quality and Purity not mentioned) In this case, the agreement is not valid as it is not certain.

1.1.3.10 Possibility of performance : Another essential feature of valid contract is that it must be capable of performance. Section 56 lays down that an agreement to do an impossible act itself is void.

1.1.5 Classification of Contracts:

Contracts may be classified on the basis of their :-

1.1.5.1 Validity/Enforceability
1.1.5.2 Formation
1.1.5.3 Performance

1.1.4.1 Classification of Contracts According to their Enforceability or Legal Validity

The contracts may be classified into five categories on the basis of their enforceability or legal validity :

(a) Valid Contract: An agreement enforceable at law is a valid contract. In other words, a valid contract is that which satisfies all the conditions of enforceability as per section10 of the Indian Contract Act.
Example: A offers to sell his house for Rs.10,000 to B. B agrees to buy it for this price. It is a valid contract.

(b) Void Contact: An agreement which was legally enforceable when entered into but which has become void due to supervening imposibility of performance.
Example: A contract to take indigo for B to a foreign port. A's government afterwards declares war against the country in which the port is situated. The contract become void when war is declared.

(c) Voidable Contract: An agreement which is enforceable by law at the option of one or more of the parties thereon, but not at the option of the other or others, is a voidable contract.
Example: A agreed to sell his horse to B for Rs. 20,000/-. The consent of A was obtained by use of force. The contract is voidable at the option of A. And he (A) may put an end to this contract if he so decides.

(d) Unenforceable Contract: It is neither void nor voidable, but it cannot be enforced in the court because it lacks some items of evidence such as writing, registration or stamping or because of some technical defects etc. Such contract will not be enforceable by the court until or unless the defects is rectified. e.g. If alongwith an application, bank draft is demanded and cash is sent instead of it.

(e) Illegal Contract : A contract which is either prohibited by law or otherwise against the policy of law is an illegal contract. It is void ab initio. Thus, a contract to commit dacoity is an illegal contract and cannot be enforced at law. An illegal contract should be distinguished from a void contract. Every illegal contract is a void contract but every void contract may not be illegal contract e.g. a wagering agreement is void but not illegal or an agreement with a minor is void but not illegal.

1.1.4.2 Classification of Contracts According to their Formation or Mode of Creation

The contracts may be classified into the following types according to their formation or mode of creation :

(a) Express Contacts: An express contract is one when the proposal and acceptance is made in words. These may be either spoken or written.
Example: A wrote a letter to B, "I am prepare to sell my car for Rs. 50,000. B also accepted the offer by a letter. This is an express contract.

(b) Implied Contracts: An implied contract is that which is not made in words. Such contracts come into existence on account of act or conduct of the parties. In a continuing course of dealing, the acts or conduct of the parties may give rise to implied contracts.
Example: A went to a restaurant, and took a cup of tea. In this case, there is an implied contract that he will pay for the cup of tea.

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

1.1.4.3 Classification of Contracts According to their Performance :

The contracts may be classified into the following types according to their performance.

(a) Unilateral Contracts : A unilateral contract is a one sided contract in which only one party has to perform his obligation. In such contracts, promise on one side is exchanged for an act on the other side. It may be noted that after the formation of a unilateral contact, only one party remains liable to perform his obligation because the other party has already performed his obligation by doing some act. The unilateral contracts are also known as contracts with executed consideration.
Example : A makes payment for bus fare for his journey from Mumbai to Pune. He has performed his promise. It is now for the transport company to perform its promise.

(b) Bilateral Contracts : A bilateral contracts is two sided contract in which both the parties have to perform their respective obligations, i.e. at the time of formation of a contract, the obligations of both the parties are

outstanding. In such contracts, promise on one side is exchanged for a promise on the other

Example : A promised to paint a picture for B, and B promised to pay Rs.100 to A. It is a bilateral contract as there is exchange of promises, and obligations of both the parties are outstanding at the time of formation of the contract.

(c) Executed Contracts : When a contract has been completely performed, it is termed as executed contract, i.e. it is a contract where, under the terms of a contract, nothing remains to be done by either party. A contract may be executed at once i.e. at the time when it made.

Example : A buys a bicycle from a dealer. A pays cash. The dealer delivers the bicycle.

(d) Executory Contracts: An executory contract is one which remains wholly unperformed, or in which there remains something further to be done.

Example : On June, 1, A enters into a contract with a dealer to buy a bicycle. The contract is to be performed on June, 15.

1.1.6 Summary

The law of contract deals with the law relating to the general principle of contract. It is the most important part of Mercantile Law. It affects every person in one way or the other, as all of us enter into some kind of contract every day. For business community, the law of contract is a great significance as all the business transactions are based on the contracts. The law of contract determine the circumstances under which a promise or an agreement shall be legally binding on the person making it. It also provides the remedies which are available in a court of law against the person who fails to fulfill his contracts and other conditions, under which remedies are available. The term contract can be defined as an agreement between two or more persons which can be enforced in a court of law. Essentials of a valid contract are minimum two parties, free and mutual consent of the parties, legal obligations, competency of the parties, lawful consideration, and lawful objects etc. The contracts may be classified on the basis of their enforceability ,formation and performance.

1.1.7 Self Check Exercise

1. Explain the term illegal contract
2. What is free consent.

1.1.8 Key words:

Agreement
Enforceability
Offer and Acceptance
Free consent

Coercion
Undue influence
Fraud
Misrepresentation
Valid Contracts
Void Contracts
Voidable Contracts
Illegal Contracts
Express Contracts
Implied Contracts
Quasi Contracts
Unilateral Contracts
Bilateral Contracts
Executed Contracts
Executory Contract

1.1.9 Self Assessment Questions/Exercise:

1. Define the term contract. What are the essentials of a valid contract?.
2. "An agreement enforceable by law is a contract". Explain this statement.
3. "All contracts are agreements but all agreements are not contracts".Comment.
4. Explain the test to be applied in determining whether an agreement is enforceable at law.
   (a) According to their enforceability
   (b) According to their formation i.e. mode of creation.
   (c) According to their performance.
5. Define and distinguish the following classes of contracts with suitable examples.
   (a) Void and voidable contracts
   (b) Express and implied contracts
   (c) Unilateral and bilateral contracts
   (d) Executed and executory contracts
6. Write notes on the following :
   (a) Valid contracts
   (b) Unenforceable contracts
   (c) Quasi-contracts
   (d) Illegal agreements.

Objective Type Questions :

1. The Indian Contract Act, 1872 applies to the
   (a) Whole of India including Jammu & Kashmir
   (b) Whole of India excluding Jammu & Kashmir
   (c) States notified by the government every year
   (d) Northern and Eastern Indian states.
2. A jus in personam means a right against
   (a) A specific person
   (b) The public at large
   (c) A specific thing
   (d) None of these
3. Which of the following statements is true
   (a) An agreement enforceable by law is a contract.
   (b) An agreement is an accepted proposal.
   (c) Both (a) and (b)
   (d) None of these
4. A void contract is one which is
   (a) Enforceable at the option of one party
   (b) Enforceable at the option of both the parties
   (c) Enforceable at the direction of court
   (d) Not enforceable in a court of law.
5. A voidable contract is one which
   (a) Can be enforced at the option of aggrieved party
   (b) Can be enforced at the option of both the parties
   (c) Cannot be enforced in a court of law.
   (d) Courts prohibit.
6. Implied contract, even if not in writing or express words, is perfectly valid if other conditions are satisfied.
   (a) True, as an implied contract has the same effect as an express contract.
   (b) False, as a the Contract Act recognizes only express contract

Answers

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

Practical Problems

(1) X invited Y and his family to dinner on a certain night. Y accepted X's invitation. On the date fixed Y drove with his family from Sector 14 to Industrial Area and found his house locked. They waited upto 9.30 p.m. but the hosts did not turn up. They left the place and had their meals in

Piccadilly in Sector 17. The cost of meal came to Rs.100. Can Y recover the amount.

(2) A enters into a contract with B for supplying 800 tonnes of iron ore within 4 months. A fails to make the delivery in time owing to difficulty in transport. But he admitted the availability of iron ore in the market at a higher price. Can A take the plea of impossibility of performance? Give reason (Hint. A cannot take the plea of impossibility of performance. S 56).

1.1.10 Further Readings :

Singh Avtar, "Principles of Mercantile Law", Eastern Book company
Gulshan, S.S.," Mercantile Law", Excel Books.
Gogna, P.P.S., "A Business Law", Sultan Chand & Company Ltd.
Kuchhal M.C, "Mercantile Law", Vikas Publishing House Pvt. Ltd.
Chawla, R.C., Garg,K.C. & Sareen, V.K., " Commercial & Labour Law",
Kapoor N.D. " Element of Mercantile Law", Sultan Chand & Sons
Kumar Arun, " Mercantile Law", Atlantic Publisher & Distribution.

LESSON NO. 1.2 AUTHOR : DR. RITU LEHAL

OFFER AND ACCEPTANCE

1.2.0 Objectives of the lesson

According to Indian Contract Act, 1872, all agreements are contracts if they fulfil the essentials of a valid contract. The following lesson includes the very first essential of a valid contract, i.e., offer and acceptance. The aim of this lesson is to make it clear that what are the essentials of a valid offer and acceptance and when an offer can be revoked before acceptance.

1.2.1 Introduction

A contract is an agreement between two parties. One party will make an offer and other will accept it. This is the first essential of a valid contract that there is a proposal from one party and acceptance from the other party. First, we will discuss the meaning of an offer and then some provisions related to offer.

1.2.2 Offer

One party makes a proposal for entering in a legally bound agreement, to another party. Section 2(a) of contract act defines "an offer as when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence."

Example

A offers to sell his house to B for Rs. 5,00,000. B agrees to pay A Rs. 5,00,000

for his house. Here A is an offeror/promisor and B is the offeree/promisee. It means a person who makes an offer is willing to enter in a contract, on the terms stated in that contract, provided the other party also gives its assent for the same. An offer may be expressed or implied. Expressed offer is made by spoken or written words, e.g., A offers to sell his cycle to B for Rs. 300. It is an expressed offer.

Implied offer is one, where conduct may also convey as clearly as words. e.g., if a person goes to a doctor for treatment, his conduct implies that if treatment is given, as offeror he will pay the normal charges of the doctor.

Offer may be specific or general. When it is made to a specific person or body of persons it is known as specific offer. When an offer is addressed to the whole world, it is called a general offer, e.g. A promises B, his servant, that if he brings back his lost suitcase, A will give him Rs. 500, this is a specific offer. If A announces that whosoever will bring back the lost suitcase, will be paid Rs. 500, it is a general offer.

1.2.2.1 Essentials of a valid offer

(1) An offer must create legal relations

There should be a legal relationship between the parties. If A invites B for lunch to his house and because of some reasons B could not join A, A cannot sue B. Because here parties had never intended for having a legal relationship.

In 'Balfour V. Balfour', when a husband serving in some other country, could not send promised money to his wife, wife was not able to get anything through court, because it was just a domestic arrangement and parties had no intention of creating legal obligation.

(2) Offer must be certain, definite and not vague

An offer should not be vague and uncertain. It should be definite, so that rights of the parties can be determined exactly.

In "Taylor V Portington", A was ready to take B's house on rent only if it is thoroughly repaired and drawing rooms are decorated according to modern style. The terms are very unclear and uncertain. The modern style can not be defined exactly. So contract can not be enforced.

(3) Offer must be communicated to the offeree

Proper communication of an offer to the offeree makes it a valid offer, e.g. A writes a letter to B that he is interested in selling his car to B for Rs. 1,00,000. But he forgot to post the letter. It is not an offer because it is not communicated to B, who in turn is not in a position to accept it.

(4) An offer may be conditional

An offer may be subject to a condition. A conditional offer lapses when the condition is not accepted.

In 'Thomson V/s.L.M. & S. Railway', T could not read the conditions, which were written on the back of an excursion ticket issued by the railway. One of the conditions was that, the railway company would not be liable for personal

injuries to passangers. In case of an accident, T could not recover any damage from the railway company as the offer was a conditional offer.

(5) Offer should not contain a term, the non-compliance of which would amount to acceptance

For example : A writes to B that "I offer to sell my horse for Rs. 10,000. If I do not receive any reply from you by next Sunday, I shall assume that you have accepted the offer. If B does not reply, there will be no contract.

Self-Check Exercise No.1

A offers to sell his horse to B for Rs. 20,000. He also writes a letter that if B does not reply till next Monday, it will be assumed as his acceptance to the offer. Is it a valid offer?

(6) The aim of the offer should be to obtain the assent of the other party

(7) Lapse of an Offer

An offer lapses:

(i) If either offeror or offeree dies before acceptance.

(ii) If it is not accepted within (a) specified time or (b) a reasonable time. The term reasonable time depends upon the circumstances of a particular case.

(iii) If acceptance made is not valid, e.g., if acceptance is conditional.

(iv) An offer can also lapse by revocation, before its acceptance.

(8) An invitation to an offer is not an offer

The aim of an invitation to an offer is to circulate the information only. Such invitations are not offers in the eyes of law. e.g. A prospectus issued by a company is just an invitation to offer but not an offer.

1.2.2.2 Standing or open offer

e.g. An offer for the continuous supply of a certain article, at a certain rate over a definite period is called a standing offer. The offeror can withdrw his offer at any time before an order is placed with him.

1.2.2.3 Counter offer

A counter offer is rejection of original offer and making a new offer. This new offer is a counter offer.

Self-Check Exercise No.2

Solve the following case:

A father promises to give Rs. 100 to his son as pocket money daily. One day, there was some problem between the father and the son and the father did not give him pocket money for 2-3 days. The son filed a case on father. Can he sue his father?'

1.2.3 Acceptance

Without the acceptance of a proposal, no agreement can come into existence. To understand these terms clearly, take an example. A prospectus issued by a company is an invitation to offer. An application for the shares of a company is an offer. The allotment of shares by the company is an acceptance.

Like an offer, acceptance may also be expresed or implied. Acceptance made by words, spoked or written, is an expressed acceptance. Acceptance given by the conduct of parties is an implied acceptance, e.g., if a person goes to hotel and eats some food, it is implied that he accepts to pay for it.

An offer can be accepted only by the person to whom it is made, e.g. if A offers to sell his scooter to B for Rs. 10,000 and C accepts it, it is not a valid contract.

Self-Check Exercise No.3

If A goes to a shop after watching the things through window display. The shopkeeper tells him the price of the articles and A accepts to pay for it. Specify clearly when one party is making an offer and when another party is accepting it.?

1.2.3.1 Essentials of a valid acceptace

(1) Acceptance must be absolute and unconditional

An offer may be conditional but an acceptance should always be unconditional. Any variation in the terms and conditions of the offer, while accepting the offer will make it invalid.

e.g. If A offered to sell a car to B for Rs. 1,00,000. B in reply, made an offer of Rs. 90,000. This is not a valid acceptance.

(2) Acceptance must be communicated to the offeror

If an offeree does not say anything or show any response to the offer, no contract is framed. Offeree must convey his intention for acceptance. Mental acceptance or uncommunicated assent does not result in a contract.

e.g. if A agrees with the offer made by B, but fails to post the letter of acceptance, it is not a valid acceptance.

(3) Acceptance must be made within a reasonable time

Acceptance should be given within the time mentioned in the offer or if no time is specified, it should be made within reasonable time. The meaning of reasonable time will vary from case to case.

In 'Ramstage Victoria Hotel Co. V. Montefine', when a person applied for shares in a company in June, he can not be bound by an allotment made late in November.

(4) Acceptance must be given according to the mode prescribed or usual/reasonable mode

Acceptance should be given in the same manner, as it is demanded in the offer. In 'Surender Nath V. Kedar Nath', it was a condition that acceptance should be given in writing at some given address. Instead of writing it, the offeree sent his agent on the same address. This acceptance was held invalid.

(5) The acceptor must be aware of the proposal at the time of the offer

If the acceptor is not aware of the offer and conveys his acceptance, no contract comes into being. In 'Lalman Shukla V. Gauri Datt', D sent P (D's servant) in

search of his missing nephew. After that D announced a reward in this context. P brought the nephew back and asked for the reward. But it was held that there can be no acceptance unless offeree has the knowledge of the offer.

(6) Acceptance cannot be implied from silence of offeree

If offeree remains silent, no contract is entered in. Silence does not mean acceptance given for a contract. It should be rather clearly expressed.

1.2.3.2 Effect of silence on acceptance

Proposal made to other cannot be valid merely because the offeree makes no reply even though the proposal states that silence will be taken as acceptance. But in following cases even silence may be indicative of acceptance.

A. Where offeree has the opportunity to reject the offered goods or services but even then he takes the benefit of them, it will amount to an acceptance.

B. Where because of previous dealings the offeree has given the proposer reason to understand that the silence was intended by the offeree as a manifestation of asset and the offeror does so understand.

1.2.4 Revocation of an offer

An offer can be revoked any time before it's acceptance. Revocation must be communicated to the other party.

In 'London and Northern Bank V. Jones', A applied for shares in a company. After sometime he withdrew the offer. In the meantime the company allotted him the shares, but the company received his letter of revocation before posting the allotment letter. It was held that revocation was good enough and applicable.

Modes of revocation

1. Revocation by notice

The offer may be revoked by giving a notice to the other party. The notice is effective if it is communicated to the offeree. The offer may be withdrawn at any time before it is accepted.

2. After lapse of time

If the time for acceptance is prescribed in the offer, an offer is revoked by lapse of the time given. If no time is prescribed, then reasonable time will be considered for this.

3. By non-fulfilment of condition precedent

e.g. If A offers to sell certain goods to B on the condition that if Y makes the payment before a certain date. The proposal is revoked if Y fails to pay before given time, because the condition has not been fulfilled.

4. By death or insanity

If the fact of death or insanity comes to the knowledge of the acceptor before acceptance, a proposal is revoked by death/insanity of the proposer.

5. By counter offer

If offeree makes a counter offer, an offer is revoked.

e.g. A offers to sell his house to B for Rs. 1,00,000. B replies offering Rs. 95,000. A refuses and then B writes accepting the original offer. There is

no contract as the original offer has lapsed.

6. By non-acceptance of the offer according to prescribed mode. Even in such a case the offer will stand revoked.

1.2.5 Revocation of an acceptance

An acceptance may be revoked any time before the communication of acceptance is complete as against the acceptor but not afterwards.

e.g. X offers by a letter sent by post to sell his house to Y. Y accepts the offer by a letter sent by post. The letter of acceptance is on the course of transmission to X. Y may revoke his acceptance at any time before the letter communicating the acceptance reaches X but not afterwards.

If the letter of acceptance is delayed, the benefit thereof goes to the acceptor.

1.2.6 Offer and acceptance through telephone or telex

When a contract is made by post, it is clear that acceptance is complete, as soon as the letter of acceptance is put into the post box. But in case of telephone or telex, the contract is complete when the acceptance is received by the offeror and the contract is made at the place where the acceptance is received.

1.2.7 Summary

This lesson included the following topics :

1. Offer

Offer is proposal made by one party for entering in a legally bound agreement, to another party.

An offer may be expressed or implied.

An offer may be specific or implied.

Essentials of a valid offer :

(i) An offer must create a legal relationship.
(ii) Offer must be certain, definite and not vague.
(iii) Offer must be communicated to the offeree.
(iv) An offer may be conditional
(v) Lapse of an offer.

An invitation to an offer is not an offer.

Standing offer.

Counter offer.

2. Acceptance

Without acceptance of a proposal, agreement can not come into existence. Acceptance may be expressed or implied.

Essentials of a valid acceptance:

(i) Acceptance must be absolute and unconditional.
(ii) Acceptance must be communicated to the offeror.
(iii) Acceptance must be given within reasonable time.
(iv) Acceptance must be given according to the mode expressed.
(v) Acceptance can not be implied from silence.

Effects of silence on acceptance

Revocation of an offer and modes of revocation.
Revocation of acceptance, offer and acceptance through telephone or telex.

1.2.8 Answers to self-check exercises

1. A can make such an offer. There will be no contract if B does not reply actually.
2. The son cannot sue his father because this was a domestic arrangement between the parties and parties were never interested in creating a legal obligation when the agreement was entered in.
3. The goods which were displayed in window was an invitation to an offer. The rate given by shopkeeper was an offer and If A is ready to pay it is an acceptance to the offer.

1.2.9 Key words

Words	Meanings
Abstinence	To stop from something that you enjoy
Assent	Acceptance
Non-compliance	Not to act according to the terms
Lapse of time	When a particular duration of time is over
Variation	Change
Manifestation	It is sign that something exists
Revocation	Cancellation of an order

Questions

Q.1. What are the essentials of a valid offer?
Q.2. Explain the following terms:
(i) Standing Offer
(ii) Counter Offer
(iii) Effect of Silence or Acceptance
Q.3. How an offer can be revoked?

1.1.1 Further Readings :

Singh Avtar, “Principles of Mercantile Law”, Eastern Book company
Gulshan, S.S.,” Mercantile Law”, Excel Books.
Gogna, P.P.S., “A Business Law”, Sultan Chand & Company Ltd.
Kuchhal M.C, “Mercantile Law”, Vikas Publishing House Pvt. Ltd.
Chawla, R.C., Garg,K.C. & Sareen, V.K., “ Commercial & Labour Law”,
Kapoor N.D. “ Element of Mercantile Law”, Sultan Chand & Sons
Kumar Arun, “ Mercantile Law”, Atlantic Publisher & Distribution.

LESSON NO. 1.3 AUTHOR : ANJU SINGLA

CONSIDERATION

Structure :

1.3.0 objective: this chapter discuss the important element of contract i.e,. consideration that makes the contact valid. An enforceable agreement must be supported by consideration also. The objective of this chapter is to explain all the terms related to consideration.

1.3.1 Introduction :

The consideration is one of the essential element of a valid contract. A mere promise is not enforceable. As a matter of fact, an enforceable agreement must be supported by consideration also.

Section 25 of the Indian Contract Act specifically states that, "an agreement made without consideration is void". Therefore, general rule is that an agreement is void if there is no consideration to it. However certain exceptions are also provided in this section.

1.3.2 Definition :

Section 2 (d) of the Indian Contract Act defines consideration as"when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains form doing, or promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise" .

In simple term, consideration is a price of promise. The term consideration is used in the sense of quid pro que, i.e. "something in return". This something or consideration need not be in terms of money. This "something" may even be some benefit, right, interest or profit accruing to one party, or some forbearance, deteriment, loss or responsibility given, suffered or undertaken by the other party. Also a promise by one

party may be consideration for the promise of other party. Thus, a person who makes a promise to do something usually does so as a return of equivalent of some loss, damage or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received, or the loss, damage or inconvenience so caused is regarded, in law, as the consideration for the promise.

Example :A agrees to sell his motorcycle to B for Rs. 20,000. Here B's promise to pay the sum of Rs. 20,000 is the consideration for A's promise to deliver the motorcycle, and A's promise to sell the motorcycle is the consideration for B's promise to pay Rs. 20,000.

Example :A owed Rs.10,000 to B. A failed to pay the amount on due date, and B filed a suit against him for the recovery of this amount. Afterwards, As friend C requested B to withdraw the suit. He also promised that if B withdrew the suit then he will pay the amount due to B from A. In consideration of this promise, B. withdrew the suit. This is a valid agreement and B can recover the amount from C.

1.3.3 Types of Consideration :

Consideration can be classifed into three types, which are as follows :

1. Present Consideration : The consideration which moves simultaneously with the promise is called present consideration or Executed Condideration.
   Example : A buys a book from a shop and pays the price immediately.The conisderation moving from.A is present consideration.
2. Past Consideration : When the consideration of one party was given before the date of promise, it is called past consideration.
   Example : Suppose X dose some work for Y in the month of April and in May Y promises to pay him some money.The consideration of X is past Consideration.
   In English law past consideration is no consideration and a contract based on past consideration is good consideration.
3. Future Consideration : When the consideration is to move at a future date, it is called future consideration or executory consideration.In contract, the consideration may be executed on both sides. A promise may support a promise.

Example : X's promise to Y, to pay money at a future date for goods to be delivered at a future date is a valid contract.

1.3.4 Essentials of a Valid Consideration :

1.3.4.1 The consideration must move at the desire of the promisor

The first essential characteristic of consideration is that the act or abstinence must have been done at the desire of the promisor. It follows that any act performed at the desire of a third party cannot be a consideration. The desire of the promisor may be expressed or implied. The leading case on this point is:

Durga Parsad V. Baldeo

D promised to pay P a commission on articles sold by him in a bazaar in which he occupied a shop in consideration of P having expended money in the construction of such bazaar. The money had not been spent by P at the request of D but was spent by him at the desire of the Collector of the District. In a suit by P, it was held that there was no consideration for the promise made by D and hence no contract.

1.3.4.2 The consideration may move either from the promisee or any other person.

Consideration may move either form the promisee or any other person. It is not necessary that the consideration must move from the promisee. It may move from any other person. In such a situation, the promisee can maintain a suit even if he is a stranger to the consideration. But he must not be a stranger to the contract.

Example : An old lady, by a deed of gift, transferred certain landed property to B, her daughter. By the terms of the gift deed, B was required to pay certain sum of money to C (sister of A), annually. On the same day, B executed an agreement in favor of C promising to pay the stipulated amount. Later on, B refused to pay the amount to C on the plea that no consideration had moved from C to B. C sued B to recover the amount. It was held hat C is entitled to recover the amount as the consideration was validly furnished by A, the old lady.

1.3.4.3 The consideration need not be adequate.

According to this rule, an inadequate consideration does not render a contract void because consideration is something in return. Therefore it is not at all necessary that this something in return should be equal in value with something given.

Example : A agreed to sell house worth Rs.5 lacs for Rs. 1 lac. A's consent to the agreement was freely given. The consideration , though inadequate, will not effect the validity of the contract. There is also a decided case of Patna High Court in which the transfer of good will and the whole of the assets of a business for a bare Rs. 100o has been held valid.

1.3.4.4 The consideration must not be performance of legal obligation.

A person may be bound to do something by law. The consideration must be something more than that what the promisee is already bound to do by law. The performance of legal duty is not a consideration for the promise.

Example : A had received summons to appear before a Court of L.aw to give evidence. B, who was a party to the case, gave him a promissory note promising

to pay some money for his trouble, loss of time and other inconveniences. The promissory note was held to be void for want of valid consideration because A was under legal duty to appear before the Court of Law and give evidence.

1.3.4.5. The consideration may be present, past and future.

A consideration which moves simultaneously with the promise is called present (for executed) consideration. 'Cash Sales' provides an excellent example of the present consideration. Where the consideration is to move at a future date it is called future or executory consideration. It takes the form of a promise to be performed in the future. When the consideration for a present promise was given before the date of the promise, It is said to be past consideration

1.3.4.6 The consideration must be real and not illusory.

It is one of the essential element of consideration that it must be real and not illusory. It will be interesting to know that though there is no provision in the Indian Contract Act, but it is an established principle that the consideration must be real.

Example : A promised to pay Rs. 1000 to B if he (B) bring a star from the sky to earth. Here, consideration for A's promise to pay Rs. 1000 is "to bring a star from the sky". The contract is void as the consideration is illusory. This promise is also physically impossible to perform.

1.3.4.7 The consideration must be lawful.

The consideration for an agreement must be lawful. If it is not lawful, then agreement will be void. The consideration of a agreement is lawful unless

(i) It is forbidden by law; or

(ii) Is of such a nature that if permitted it would defeat the provisions of any law; or

(iii) Is fraudulent; or

(iv) Involves or simple injury to the person or property of another; or

(v) The court regards it as immoral or opposed to public policy.

Example : A promise to obtain for B an employment in public services and B promise to pay Rs.5000 to A. The agreement is void as the consideration for it is unlawful.

1.3.5 Exceptions:

According to Section 25 of the Indian Contract Act, an agreement without consideration is void. However, there are certain exceptions to this rule which are as follows :-

1.3.5.1 Natural Love and Affection- Section25(1): According to this exception, an agreement in writing which is registered and is based on natural love and affection between near relatives is valid and enforceable even if there is

no consideration. The following conditions must be satisfied for the application of this exception :

(a) The agreement must be in writing and registered.
(b) The agreement must be based on natural love and affection.
(c) The agreement must be between the parties who are in near relation to each other.

Example : A, for natural love and affection, promised to give Rs.1000 to his son B. A put his promise to B in writing and registered it. This is a valid contract.

1.3.5.2 Past voluntary services - Section 25(2) : According to this exception, a promise to pay for past voluntary services is binding even though it is without consideration. The following conditions must be satisfied for the application of this exception :

(a) The service should have been rendered voluntarily.
(b) The service should have been done by the promisor.

Example : A found B' cycle and give it to him. B promised to give A Rs. 100/- as reward. This is a valid contract.

1.3.5.3 Promise to pay time-barred debt -Section 25(3): According to this exception, a promise to pay a time-barred debt is enforceable if such promise

is in writing and duly signed. The following conditions must be satisfied for the application for this exception :

(a) The promise to pay must be definite and express.
(b) The promise must be in writing.
(c) The promise must be signed by the promisor or his authorized agent.
(d) The debt must be time-barred i.e. the limitation period for recovery the of the debt, must has expired.

1.3.5.4 Gift actually made : According to this exception, the gift actually made is valid even though it is made without consideration. Thus, the absence of consideration shall not affect the validity of any gift actually made.

1.3.5.5 Contract of agency : According to this exception, no consideration is necessary to create an agency. Thus, when a person is appointed as an agent, his appointment is valid even if there is no consideration.

1.3.6 Privity of Consideration :

The term 'privity of consideration' means stranger to the consideration or consideration given by any other person other than the promisee. The validity of privity of consideration is covered in Section 2(d) of the Indian Contract Act which states that the act which is to be constitute consideration may be done by the "Promisee or any other person". Thus, it is not necessary that the consideration should be furnished by the promisee only. A promise is

enforceable so long as there is some consideration for it, and it is immaterial whether it is furnished by the promisee or other person even a stranger.

1.3.7 Privity of contract:

The term 'privity of contract' means stranger to a contract. As per doctrine of privity of contract, a person, who is not a party to the contract, cannot sue for carrying out the promise made by the party to the contract. In other words, a contract cannot be enforced by a person who is not a party to the contract. However, there are certain exceptions to this privity of contract.

1.3.8 Exceptions To The Rules Of Privity Of Contract:

1.3.8.1 Trust or charge : A case of trust, the beneficiary may enforce the contract even though he is stranger to the contract creating the trust. A stranger can sue when he is beneficiary under an obligation amounting to trust arising out of the contract.

Example : A was appointed by his father as his successor. A was put in possession of the entire estate of his father. It was agreed between A and his father that he (A) would give certain some of money and a village to B (an illegitimate son of A's father), on his attaining majority. It was held that a trust was created in favour of B for the specific amount and a village, therefore he is entitled to recover it from A.

1.3.8.2 Marriage settlement, partition or other family arrangements: Sometimes, an agreement is made in connection with marriage, partition or other family arrangements,, and a provision is made for the benefit of some person. In such cases, a person, for whose benefit the provision is made in such family arrangements, can enforce the agreement even if he is not a party to it. He may, however, be noted that provision must be made for the benefit of the person who wants to enforce such marriage arrangements.

Example : On partition of joint properties, two brother agreed to pay certain some of money in equal shares for the maintenance of their mother. The brothers subsequently refused to pay the amount. On a suit, It was held that she was entitled to require her sons to make the payment for her maintenance although she was not a party to the partition of the property.

1.3.8.3. Acknowledgement of payment : Sometimes, one of the parties to the contract acknowledges the payment to the third party or otherwise constitutes himself as an agent of the third party. In such cases, the party incurs a binding obligation towards the third party who can enforce it, e.g. where, by the terms of a contract, a party is required to make a payment to a third person. And that party acknowledges the payment to the third person or

constitutes himself as an agent of that third person, then the third person can recover the amount from such a party.

1.3.8.4 Agreements relating to the land: In certain cases, the owner of the land is entitled to certain rights and obligation created by an agreement affecting the land. When any person purchases such land with a notice of rights and obligation of the owners, then he shall be bound to those rights an obligation although he was not a party to the agreement.

1.3.8.5 Contract through an agent : A principal can enforce the contracts which are entered into by his agent though he was not a party to the contract. He may, however, be noted that the agent must act within the scope of his authority, an also in the name of his principal.

1.3.9 Self check exercise

1. What are the exceptions to valid consideration
2. What is privity of contract.

1.3.9. Summary : Consideration is one of the essential element of a valid contract. The term consideration may be defined as the price of the promise. An agreement without consideration is null and void (Subject to certain exceptions). Under the Indian Law, the consideration may move either from the promisee or any other person. In such a situation , the promisee can maintain a suit even if he is a stranger to the consideration but he must not be stranger to the contract. However, there are certain exceptions to the stranger to the contract. The consideration can be present, past and future.

1.3.10. Keywords :

Consideration
Promise
Promisee
Promisor
Present consideration
Past consideration.
Future consideration.
Agency
Guarantee

1.3.11. Self Assessment Questions/Exercise :

Q1. Define 'Consideration'. Why it is treated as an essential part of contract? State the legal rules regarding consideration.

Q2. "A contract without consideration is void". Comment. Are there any exceptions to this rule? If so, explain.

Q3. "Insufficiency of consideration is immaterial; but an agreement without consideration is void". Explain

Q4. " A stranger to consideration can sue, but a stranger to contract cannot sue". Comment

Q5. "Consideration need not be adequate but it must have some value in the eyes of law. Explain.

Q6. "No consideration no contract" – Critically examined.

Q7. "Consideration may be past, present and future. Explain with examples.

Q8. What are the exceptional situations in which a contract is valid without consideration?

OBJECTIVE TYPE QUESTIONS :

1. As a general rule, an agreement made without consideration is
   (a) Void (b) Voidable (c) Valid (d) Unlawful.
2. All agreements made without consideration are void
   (a) True, as there is no exception to this rule
   (b) False, as there are certain exceptions also.
3. A agrees to sell his car worth Rs.100.000 to B for Rs.20,000 only, and A's consent was obtained by coercion. Here, the agreement is
   (a) Void (b) Valid (c) Voidable (d) Unlawful.
4. An agreement made with free consent to which the consideration is lawful but inadequate, is
   (a) void (b) valid (c) voidable (d) unlawful
5. If the consideration to an agreement is furnished by a stranger and not by the promisee himself, the agreement will be void.
   (a) True, as the consideration must be furnished by the promisee.
   (b) False, as the law requires that there must be some consideration, who furnished it is immaterial
6. A person who is not a party to the contract can enforce the contract on the same principle that consideration furnished by a stranger is valid.
   (a) True, as the rule is that a stranger is valid.
   (b) False, as the rule is that a stranger to a contract cannot sue.
7. For the enforcement of a promise to pay a time-barred debt without consideration, which of the following condition is not required?
   (a) it must be in writing.
   (b) It must be definite and express
   (c) It must be signed by the promisor
   (d) It must be registered in court of law.

ANSWER

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

1.3.12 Further Readings :

Singh Avtar, "Principles of Mercantile Law", Eastern Book Company
Gulshan, S.S., Mercantile Law"', Excel Books.

Gogna, P.P.S., "A Business Law", Sultan Chand & Company Ltd.
Kuchhal M.C, "Mercantile Law", Vikas Publishing House Pvt. Ltd.
Chawla, R.C., Garg,K.C. & Sareen, V.K., " Commercial & Labour Law",
Kapoor N.D. " Element of Mercantile Law", Sultan Chand & Sons
Kumar Arun, " Mercantile Law", Atlantic Publisher & Distribution.

LESSON NO. 1.4 CONVERTED BY: DHIRAJ SHARMA

CAPACITY OF PARTIES

Learning objectives:

The major objectives of this lesson are to discuss:

- Minor
- Effects of Minor's Agreements
- Persons Of Unsound Mind
- Contracts With A Person Of Unsound Mind
- Other Persons Disqualified By Law

Structure :

1.4.1 Introduction

An agreement will be a contract if it has been entered into by the parties who are competent to contract. An essential ingredient of a valid contract is competency of the parties. Every person is presumed to have capacity to contract but there

are certain persons whose age, condition or status renders them incapable of binding, themselves by a contract. Incapacity must be proved by the party claiming the benefit of it and until proved the ordinary presumption remains. According to Section 11 of Contract Act the following persons are incompetent to contract:

(a) Minor
(b) Person of unsound mind, and
(c) Persons disqualified by law to which they are subject

1.4.2 Minor

According to Section 3 of the Indian Majority Act, 1875, a minor is a person who has not completed eighteen years of age. In the following two cases, he attains majority after twenty years of age:

(i) Where a guardian of a minor person or property has been appointed under the Guardian and Wards Act, 1890, or
(ii) Where the superintendence of a minor's property is assumed by a court of words.

The rules Governing minor's agreements are based on his fundamental rules. The first rule is that the law protects minor against their own inexperience and against the possible improper designs of those who are more experienced in years.

1.4.2.1 Effects of Minor's Agreements

1. An agreement with or by a Minor is valid Contract :-

A minor may make a contract, but he is not bound by the contract; however the minor can make the other party bound by the contract. Thus, a minor is not bound on a mortgage or a promissory note, but he can be a mortgagee, a payee, or an endorsee. He can derive benefit under the contract.

2. No Ratification :-

An agreement with a minor cannot be ratified by him on his attaining majority so as to make himself bound by the same. Further, if he has received any benefit under the contract, the minor cannot be asked to refund the same.

3. Minor can be a promisee or a beneficiary

If a contract is beneficial to a minor, it can be enforced by him. There is no restriction on a minor from being a beneficiary, for example, being a payee or a promisee in a contract, thus a minor is capable of purchasing immovable property, and he may sue to recover the possession of the property upon tender of the purchase money.

4. No estoppel against a Minor

When a minor by misrepresenting his age has induced the other party to enter into a contract with him, he can not be made liable on the contract. There can

be no estoppel against a minor. In other words a minor is not estopped from pleading his infancy in order to avoid a contract.

5. No Specific Performance

A minor's contract being absolutely void, there can be no question of the specific performance of such a contract. A guardian of a minor can not bind the minor by an agreement for the purchase of immovable property. So the minor can not ask for the specific performance of the contract which the guardian had no power to enter into.

6. Liability for Torts

A minor is, however, liable in tort, where a minor borrowed a horse for riding only, he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend. But a minor can not be made liable for a breach of contract by framing the action on tort, you can not convert a contract into a tort to enable you to sue an infant.

7. No Insolvency

A minor can not be declared insolvent even though there are dues payable from the properties of the minor.

8. Partnership

A minor being incompetent to contract can not be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the benefit of partnership.

9. Minor can be an agent

A minor can act as an agent, but he will not be liable to his principal for his act. A minor can draw, deliver and endorse negotiable instruments without himself being liable.

10. Minor can not bind Parent or Guardian

In the absence of authority expressed or implied, an infant is not capable of binding his parents or guardian, even for necessaries.

11. Liability for Necessaries

The case of necessaries supplied to a minor or to any other person whom such minor is legally bound to support is governed by Section 68 of the Indian Contract Act. A claim for necessaries supplied to a minor is enforceable at law. But a minor is not liable for a price that he may promise and never for more than the value of the necessaries. There is no personal liability of the minor but only his property is liable. A minor is also liable for the value of necessaires supplied to his wife. Necessaries mean those things that are essentially needed by a minor. These can not include luxuries or costly or unnecesary articles. Necessaries extended to all such things as reasonable persons would supply to

an infant in that class of society to which the infant belongs. Certain services rendered to a minor have been held to be necessaries. These include education, medical advice, a house given to a minor or rent for the purpose of living and continuing his studies, etc. Goods necessary when ordered might have ceased to be necessary by the time they are delivered, e.g., where a minor orders a suit from a tailor but buys other suits before, that order is actually delivered. Here the minor could not be made to pay the tailor. The following have been held to be necessaries:

(i) Liability for an Officer's servant.
(ii) Horse when doctor advised riding as exercise.
(iii) Goods supplied to a minor's wife for her support.
(iv) Rings purchased as gifts to the minor's fiance.
(v) A Racing bicycle.

On the other had, following have not been held to be necesaries:

(i) Goods supplied for the purspose of trading.
(ii) A silver gilt goblet.
(iii) Cigars and tobacoo.
(iv) Refreshment to an undergraduate for entertaining.

1.4.3 PERSONS OF UNSOUND MIND

Section 11 disqualifies a person who is not of sound mind from entering into a contract. Contract made by persons of unsound mind is void like a minor's contract. The reason is that a contract requires assent of two minds but a person of unsound mind has nothing which the law recognises him as a mind. Section 12 deals with the question as to what is a sound mind for the purpose of entering into a contract. It lays down that a person is said to be of sound mind for the purpose of making a contract, if at the time, when he makes it he is capable of understanding it and of forming a rational judgment as to its effort upon his interest. A person who is usually of sound mind but occasionally of unsound mind may not take a contract when he is of unsound mind.

Example

(a) A patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals. Soundness of mind of a person depends on two facts:

(i) his capacity to understand the contents of the business concerned and
(ii) his ability to form a rational judgement as to its effect upon his interest.

If a person is incapable of both, he sufferes from unsoundess of mind. Whether a party to a contract is of sound mind or not is question of fact to be decided by the court. There is a presumption in favour of sanity. If a person relies on the unsoundness of mind, he must prove it sufficiently to satisfy the court.

1.4.4 CONTRACTS WITH A PERSON OF UNSOUND MIND

Lunatics

A lunatic is a person who is mentally deranged due to some mental strain or mental illness or other personal experience. He suffers from intermittent intervals of sanity and insanity. He can enter into contracts during the period when he is of a sound mind.

Idiots

An idiot is a person who has completely lost his mental powers. He does not exhibit understanding of even ordinary matters. Idiocy is permanent whereas lunacy devotes periodical insanity with lucid intervals. An agreement of an idiot, like that of minor, is void.

Drunken or Intoxicated Persons

A drunken person sufferes from temporary incapacity to contract, i.e., at the time when he is so drunk that he is not capable of forming a rational judgement. The position of a drunken person is similar to that of a lunatic.

Agreements Entered into by Persons of Unsound Mind are Void

There are, however, liabilities for necessaries supplied to them or their minor dependents. But even in such cases, no personal liability attaches to them. It is only their estate which is liable (Section 68).

1.4.5 OTHER PERSONS DISQUALIFIED BY LAW

1.4.5.1 Alien Enemies

An alien (a citizen of a foreign country) is a person who is not a subject of the Republic of India. He may be (i) an alien friend, (ii) an alien enemy. Contracts with an alien friend (an alien whose state is at peace with the Republic of India) subject to certain restrictions, are valid. But an alien friend cannot acquire property in an Indian ship. Similarly, he can not be employed as Master of any other chief officer of such ship. Contracts with an alien enemy (an alien whose state is at war with the Republic of India) may be studied under two heads, namely:

(a) Contracts during the war and

(b) Contracts made before the war.

During the continuance of war, an alien enemy can not enter in a contract which neither with an Indian subject nor he can be sued in an Indian court. He can do so only after he receives a licence from the Central Government. Contracts made before the war may either be suspended or dissolved. They will be dissolved if they are against the public policy or if their performance would benefit the enemy. For this purpose, even an Indian who resides voluntarily in a

hostile country or who is carrying on business he would be treated as an alien enemy.

1.4.5.2 Foreign Sovereigns, their Diplomatic Stage and Accredited Representatives of Foreign States

They have some special privileges and generally can not be sued unless they on their own submit to the jurisdiction of our law courts. They can enter into contracts and enforce those contracts in our courts. But an Indian citizen has to obtain a prior sanction of the Central Government in order to sue them in our law courts.

1.4.5.3 Corporation

A corporation is an artificial person created by law having a legal existence apart from its members. it may come into existence by a special Act of the Legislature or by registration under the Companies Act, 1956. As regards a statutory corporation, i.e., a corporation formed by a special Act of the Legislature, its contractual capacity is limited by the statute governing it.

1.4.5.4 Insolvents

When a debtor is adjudged insolvent, his property vests in the official Receiver or official Assignee. As such, the insolvent is deprived of his power to deal in that property. It is only the official Receiver or official Assignee who can enter into contracts relating to his property and sue and be sued on his behalf. The insolvent also sufferes from certain disqualifications which are removed when the court passes an order of discharge.

1.4.5.5 Convicts

A convict when undergoing imprisonment is incapable of entering into a contract. He can, however, enter into, or sue on a contract if he is lawfully at large under a licence called "ticket of leave". This incapacity to contract, or to sue on a contract, comes to an end when the period of sentence expires or when he is pardoned. The convict, however, does not suffer from rigorous of the law limitation. Limitation is held in abeyance during the period of his sentence.

1.4.6 self check exercise

1. who is minor?
2. What is alien enemies?
3. Write example of person with unsound mind?

1.4.7 Summary

1.4.8 Key Words

Minor

According to Section 3 of the Indian Majority Act, 1875, a minor is a person who has not completed eighteen years of age.

Alien

An alien (a citizen of a foreign country) is a person who is not a subject of the Republic of India. He may be (i) an alien friend, (ii) an alien enemy.

Corporation

A corporation is an artificial person created by law having a legal existence apart from its members. It may come into existence by a special Act of the Legislature or by registration under the Companies Act, 1956.

1.4.9 Self Assessment Questions/Exercise

1. Discuss the provisions of law relating to contracts by minors.
2. Name the various persons who are incompetent to contract.

Short questions:

1. Write effects of minor's agreement?
2. Who is person with unsound mind.

1.4.10 Further Readings

1.	Business Regulatory Framework	:	Garg K.C.,Chawla R.C.
2.	Mercantile Law	:	Kappor G.K.
3.	Mercantile Law	:	Kappor N.D.
4.	Principles of Mercantile Law	:	Singh Avtar
5.	Business Laws	:	V.K. Sharma

B.COM. PART-I

B.C. 104
BUSINESS REGULATORY FRAMEWORK

LESSON NO. 1.5

AUTHOR : SAWINDER KAUR

FREE CONSENT

1.5.1 objectives

1.5.0 objective: The following are the objectives :

I. Meaning of Consent
II. Write the flaws in consent.

1.5.2 Introduction

A contract which is valid in all other respects may still fail because there is no real consent to it by one or both of the parties. It is essential to the creation that parties to it should agree to the same thing in the same sense. The parties to a contract should have the identity of mind. This is called in English law as consensus ad idem. The parties must understand the subject matter of the contract in the same sense.

Consent:

Two or more perosns are said to consent when they agree upon the same thing in the same sense (Sec 13). It means that there is no contract if the parties have not agreed upon the same thing and in the same sense. If the parties enter into an agreement concerning particular persons or things but each has different persons or things in his mind, there is no agreement and no contract comes into existence between them. No effective contract can come into existence unless the parties and ad idem on all the essential terms of the transaction. Absence of consent may arise from number of causes, namely,

(1) by reason of an error as to the nature of the contract itself,

2) by reason of an error as to identity of the party with whom the contract is entered into,

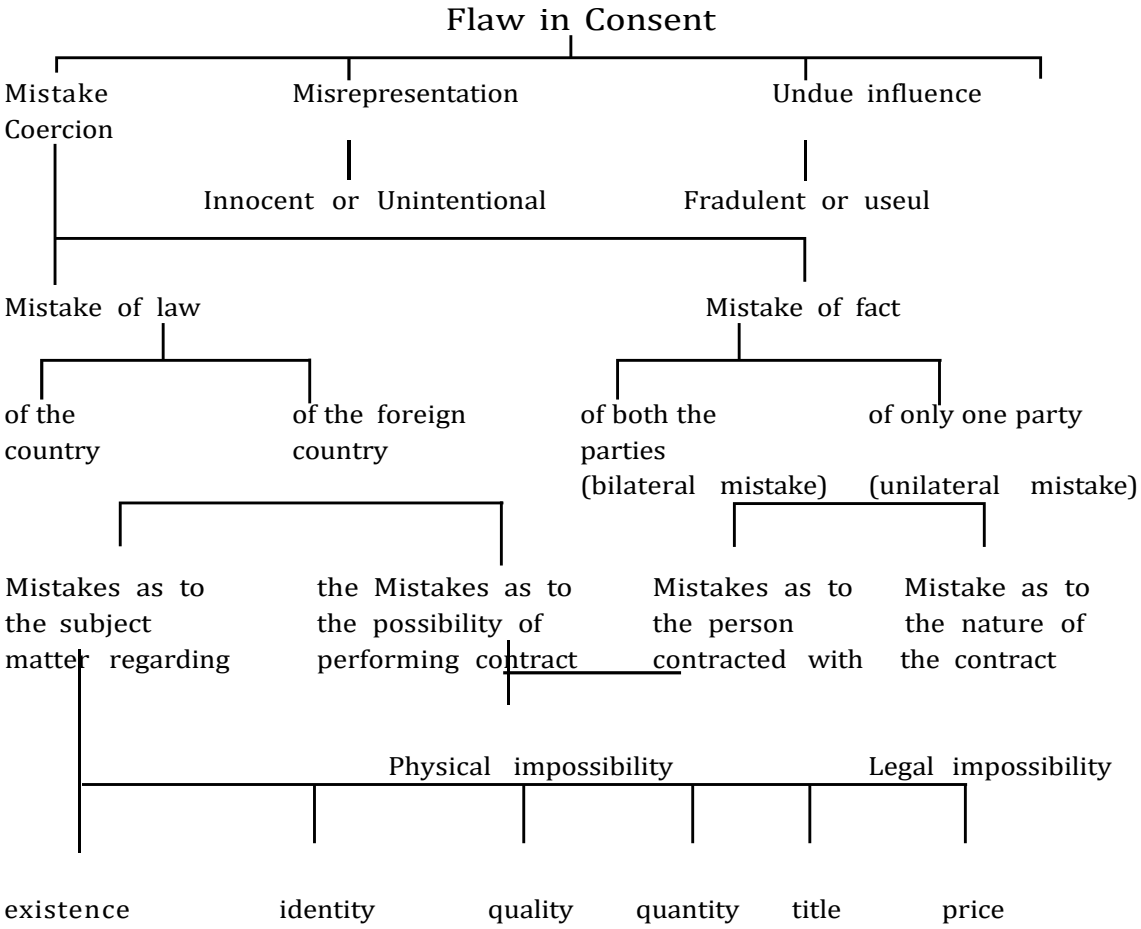
3) by reason of an error as the subject matter of the agreement. In all the cases, there is no contract at all because the law of contract requires consensus ad idem as a condition essential to the formation of contract.

Free Consent

Not only the parties to a contract should have identity of mind but the consent of the parties must also be real and free. Free consent is an essential requisite of a valid contract. Free consent is the consent which has been obtained by the free will of the parties out of their own accord. According to section 14, consent is said to be free when it is not caused by:

1. Coercion
2. Undue influence
3. Fraud
4. Mis-representation or
5. Mistake

For various flaws in consent refer to the following chart:



These flaws are explained in detail.

Coercion

Section 15 of the Indian Contract act defines coercion as committing or threatening to commit any act forbidden by the Indian penal code or any unalwful detaining or threatening to detain, any property to the prejudice of any person with the intention of causing any person to enter into an agreement. It is immaterial whether the Indian penal code is or is not in force at a place where the coercion is employed.

Example:

A, on board on 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 sued B for breach of contract at Calcutta. A has employed coercion although his act is not an offence by the law of England, and although Section 506 of the Indian Penal Code was not in force at the time when or where the act was done.

Threats of imprisonment are included under the head 'coercion' e.g. where A was induced to part with valuable documents by threats of continued confinement, Consent obtained at the gun point with valuable documents by threats of continued confinement. Consent obtained at the gun point or intimidation is also an act of coerciion. Similarly a threat to commit suicide with the intention of causing a person to enter into an agreement is an act of coercion. It is not necessary that coercion must proceed from a party; to the contract nor it is necessary that the subject of the coercion must be the other contracting party it may be directed against any third person what ever.

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

An act will amount to coercion if the following essentials are fulfilled:

1. There must be clear utterance of threat.
2. The threat should be to commit an act forbidden by the Indian Penal Code.
3. It must be uttered with the intention of causing plaintiff to enter in an agreement.

1. Consent is said caused by coercion when it is obtained by committing or threatening to commit any act forbidden by the Indin Penal Code.

Example:

A girl of 13 lost her husband and her husband's relatives refused to have the husband's corpse removed unlesss she adopted one of their choices. It was held that the adoption was not binding on her as the consent was obtained under coercion within the meaning of section 15. Any person who obstructed a dead body from being removed would be guilty of an offence under section 297 of the Indian Penal Code.

2. The unlawful detaining or threatening to detain any property.

Example:

An agent refused to hand over the account books of the business at the end of his term of office to a new agent sent in his place, unless the principal gave him a release from all liabilities and such a release had to be given before the new agent could get the books. It was held that the release deed was viodable at the instance of the principal who was made to execute the released to deed under coercion.

Effect of Coercion

According to section 19 when consent to an agreement is caused by coercion, the agreement is a contract voidable at the option of the party whose consent was so caused. But according to section 72, a person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it.

Example:

A railway company refused to deliver up certain goods to the consignee,

except upon the payment of an illegal charge of carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

The onus of proving that the consent of party to a contract was caused by coerction and that he would not have entered into it, has the coerction not been employed, lies on the party who want to relieve himself of the consequences of coercion.

Undue Influence

Sometimes a party is compelled to enter into an agreement against his will as a result of unfair persuasion by the other party. This happens when a special kind of relationship exists between the parties such that the party is in a position to exercise undue influence over the other . Section 16 defines undue influence as follows:-

A contract is said to be induced by "undue influence" where the relations subsisting betweeen the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other (Section 16).

A person is deemed to be in a position to dominate the will of other:-

(a) Where he holds a real or apparent authority over the other, e.g. the relationship bewteen master and servant.

(b) Where he stands in a fiduciary position (relation of trust and confidence) to the other. It is supposed to exist, for example, between father and son, solicitor and client.

(c) Where he makes a contract with a person whose mental capcity is temporarily or permanently affected by reason of age, illness or mental or bodily distress. Such a relation exists, for example, between a medical attendant and his patient.

Example:

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

(b) A, a man enfeebled by disease or age, is inducted, by B's influence over his medical attendant, to agree to pay B an unresonable sum for his professional services, B uses undue influence.

Undue influence is also sometimes called moral coercion. Halsbury defined undue influence as " the unconscientious use by a person of power possessed by him over another in order to induce the other party to enter into a contract.

Effect of Undue Influence

When consent to an agreement obtained by undue influnece, the agreement is a contract voidable at the point to the party whose consent was so obtained. Any such contract may be set aside absolutely or if the party who is entitled to avoid has received any benefit their upon, such terms and conditions as to

the court may seem just and equitable (Section 19-A)

Example:

(a) A's son has forged B's name to promissory note. B under threat of prosecuting A's son, obtains a bond from A for the amount of the forged note. If B sues on this bond, the court may set the bond aside as it's not a valid contract.

Burden of Proof

If an action to avoid a contract on the ground of undue influence, the plaintiff has to establish that;

(i) The other party was in a position to dominate his will. Mere proof of nearness of relationship is not sufficient for the court to assume that one relation was in a position to dominate the will of the other.

(ii) The other party actually used his influence to obtain the plaintiff's consent to the contract; and

(iii) The transaction is unconscionable where a person, who is in a position to dominate the wish of another, enters into contract with him; and the transaction appears, on the face of it or on the evidence abducted, to the inconsiderable , lies upon the person in the position to dominate the will of the other section [16(3)].

Example:

A being in debt to B, a money lender of his village, contracts a fresh loan on terms which appear to bad unconscionable.

It lies on B to prove that the contract was not induced by undue influence.

Influence is suspected in the following cases:

(i) Inadequancy of consideration.

(ii) Inequality between the parties as regard to age, intelligence, social status etc.

(iii) Fiduciary relationship between the parties.

(iv) Paradnashin women.

(v) Unconscionable bargains.

Fraud

Fraud is the wilful representation made by a party to a contract with the intention to deceive the other party to induce such party to enter into a contract. It means a false statement made knowingly without belief in its truth or recklessly without caring whether it is true or false . Fraud denotes an absence or honest belief and a wicked mind. Whenever one person obtains any material advantages from another by unfair and wrongful means, it is said that he has committed fraud. According to Section 17, fraud includes any of the follwoing acts done with intention to deceive or to induce a person to enter into contract:

(i) A false suggestion as to a fact known to be false or not believed to be ture; or

(ii) The active concealment of a fact with knowledge or belief of the fact: or

(iii) A promise made without any intention of performing it; or

(iv) Doing any other act fitted to deceive: or

(v) Doing any such act or making any such omission as the law specifically delcared to be fraudulent

Elements of Fraud:

(i) The fraud must have been committed by a party to the contract or with his connivance or by his agent. Fraud by a stranger to contract does not affect its validty.

Exmaple:

The director of a company issued a prospectus containing false representation, on the faith of which Z agreed to buy some shares from the company. Z may avoid the contract because the directos are deemed to be the agents of the company.

(ii) There must be any of the followinhg ingredients in the act of fraud:

- (a) A suggestion as to a fact which is not ture by one who does not believe it to be ture.
- (b) An active concealment of a fact by one having knowledge or belief of the fact.
- (c) A promise made without any intention of performing it.
- (d) Any other act committed to deceive.
- (e) Any such act or omission as the law specially declared to be fraudulent.

(iii) The act of fraud must have been committed with intention to deceive and must actually deceive. A fraud which does not deceive is not a fraud. No cause of action rises where there is fraud without damage or damage without fraud.

(iv) The representation must have been aimed at the other party to the contract.

Mere Silence is not Fraud:

Mere silence of a party as to certain facts does not generally amount to fraud. A party to the contract is under no obligation to disclose the whole truth to the other party.

Exceptions:

However, there are two exceptions to the rule which are given in the explantion to section 17, These are:

(i) Where circumstances create a duty on the party of the person keeping silence to speak; and

(ii) Where silence in itself is equivalent to speech.

Duty to Speak:

Where there is a duty or obligation to speak and a man in breach of that duty or obligation holds his tongue and does not say the thing he was bound to say, there is fraud.

Effect of Fraud:

When consent to an agreement is caused by fraud, the agreement is a contract voidable at the option of the party whose consent was so obtained. A party whose

consent to an agreement was caused by fraud has two remedies, namely:

(a) He may rescind the contract, or

(b) He may insist that the contract shall be performed and that he shall be put in the position in which he would have been, if the representation made had been ture.

Example:

A fraudulently informs B that A's estate is free from encumbrance. B thereupon buys the estate. The estate is subject to a mortgage. B may avoid the contract or may insist on its being carried out and the mortgage debt repaid by A.

Apart from the above, the person defrauded may obtain recession, restitution or damages.

Misrepresentation

A statement of fact which one party makes in the course of the negotiations with a view to induce the other party to enter into a contract is known as misreprsentation. It must relate to some fact which is material to the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties.

A representation, when wrongly made, either innocently or intentionally is a misrepresentation. Misrepresentation may be:

(i) An innocent or unintentionl misrepresentation, or

(ii) An Intentional, deliberate or wilful misrepresentation with an intent to deceive or defraud the other party.

The former is called 'representation' and the later 'fraud'. Misrepresentation is a false statement which the persons making it honestly believed to be true or which he does not know to be false. It also includes no disclosure of a material fact or facts without any intent to deceive the other party.

Example:

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

Section 18 defines " misrepresentation"

According to it, there is misrepresentation:

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

(ii) When there is any breach of duty by a person which brings an advantage to the person committing by misleading another to his prejudice.

(iii) When a party causes, however innocently, the other party to the agreement to make a mistake as to the substance of the thing which is subject of the agreement.

Requirements of Misrepresentation:

A misrepresentation is relevant if it satisfies the following requirements:

(1) It must be representation of a material fact.

(2) it must be made before the conclusion of the contract with a view to inducing the other party to enter into contract.

(3) It must be made with the intention that it should be acted upon by the person to whom it is addressed.

(4) It must actually have been acted upon and must have induced the contract.

(5) It must be wrong but the person who made it honestly believed it to be ture.

Consequences of Misrepresentation:

The aggrieved party, in case of mis representation by the other party, can:

(i) Avoid or rescind the contract.

(ii) Accept the contract but insist that he shall be placed in the position in which he would have been if the representation made had been ture.

Mistake

Mistake is a misconception or error. A mistake means that parties intending to do one thing have by unintentional error done something else. It is a slip made not by designs but by mischance. Mistake in the formation of a contract may be of three kinds, unilateral mistake, mutual mistake and common mistake.

Unilateral Mistake

Where only one of the contracting parties is mistaken and the other knows of his mistake. There is, thus no valid proposal and acceptance.

Mutual Mistake

Where the parties misunderstood each other and are at cross purpose. Hence there is no real correspondence of offer and acceptance. In fact in such cases there is no agreement at all.

Common Mistake

When both parties make the same mistake. Each party is mistaken about some fundamental fact. The minds of the contracting parties are ad idem and there comes into being an agreement but it lacks effectiveness.

Mistake may also be classifed as

(i) Mistake of fact,

(ii) Mistake of Law

Mistake of Fact

Mistake of fact may be either : mistake of both the parties i.e. Mutual or Bilateral mistake or mistake of only one party i.e. unilateral mistake.

Bilateral Mistake

A mistake of fact in the minds of both parties is like a negatives consent and the contract becomes void. Four Conditions must be fulfilled before a contract can be avoided on the ground of mistake.

(a) There must be a mistake as to the formation of contract.

(b) The mistake must be of both the parties i.e. bilateral and unilateral.

(c) It must be mistake of fact and not of law.

(d) It must be about a fact essential to the agreement.

The cases falling under bilateral mistakes are discussed below:

Mistake as to the Subject Matter:

Mistake as to subject matter falls into six heads namely :

(a) Existence (b) Identity (c) Title (d) Price (e) Quantity (f) Quality

(a) Mistake as to the Existence of the Subject Matter :

The parties may be mistaken as to the existence of the subject matter of the contract at the date of contract. The contract is void if without the knowledge of the parties, the subject matter does not exist at the date of the contract.

(b) Mistake as to the Identity of the Subject Matter:

A mistake of both parties in relation to the identity of the subject matter (as where one party had one subject in mind and the other party had another) prevents consensus ad idem and invalidates the agreement.

The result would be same even if the mistake is caused by the negligence of a third party.

(c) Mistake as to the Title of the Subejct Matter:

Where unknown to the parties the buyer is already the owner of that thing which the seller wants to sell him, the contract is void.

(d) Mistake as to the Price of the Subject Matter:

The Agreement is viod if there is a mutual mistake as to the price of the subject matter. Where a seller of certain plots mentioned in his letter the price as Rs. 1250 when he really intended to write Rs. 2250 the agreement is void.

(e) Mistake as to Quantity of the Subject Matter:

There is no contract between the parties if there is a difference between the quanity sold and purchased. Thus where a broker gave two invoices under a contract to a seller and buyer, and if the two invoices differed as to quantity sold and purchased there was no enforceable contract.

(f) Mistake as to Quality of the Subject Matter:

Mistake as to the quality of the thing does not effect consent unless it is the mistake of both parties and it is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be.

(II) Mistake as to the possibility of Performing the Contract:

(a) Physical impossibility (b) Legal impossibility

Unilateral Mistake:

Section 22 provided that if one party alone is under a mistake of fact, the contract is not rendered voidable.

In the following cases even though the mistake is unilateral the agreement would be void.

(a) Mistake as to the Nature of the Contract:

A blind man signing a document read over to him wrongly will not bind him. This is because of the fact that the mind of the signatory does not accompany the signature. But this rule will not apply to a person who can read.

(b) Mistake as to the Indentity of the person contracted with:

Mistake as to the indentity of a person may also avoid a contract. This is nowhere the indentity of the person contracted which is of fundamental

importance i.e. the mistaken party would not have entered into the contract if he had known the true indentity to the other.

(c) Mistake as to the attribute of the other party:

Mistake as to the attribute of a person can not make the consent negative. Thus, where one person enters into a contract with another person, falsely representing himself to be a rich man, the contract does not become void but at the most it will make the contract voidable.

Mistake of Law

Mistake of law may be of two kinds:

(a) Mistake of Law of the Land; (b) Mistake of Foreign Law.

The effect of mistake of law on a contract is expressed by the principal 'Ignorance of law is no excuse'. Mistake of law is no ground for avoiding a contract. But this rule is applicable only to law of the country and not to foreign law.

1.5.4 summary :

Consent is very important for a valid contract. A contract which fails to have real consent will be deemed to be void. The parties sould have identity of mind. Two persons are said to consent when they agree upon the same thing in the same sense. The consent should be free when it is not caused by coercion, undue influence, fraud , mis-represntation and mistake.

1.5.5 Glossary

1. Coercion: Committing or threatening to commit any act forbidden by the Indian penal Code or any unlawful detaining or threatening to detain with intention of causing any person to enter into an agreement.

2. Undue Influence: When special type of relationship exists between parties then one party is compelled to enter into argument against his will as a result of unfair persuasion by other party.

1.5.6 Self check Exercise

1. write examples for fraud in consent.
2. what is free consent.

Suggested questions

1. Under what conditions a consent is not said to be free. What is the effect of such consent on the formation of the Contract?
2. Discuss the law relating to the effect of the mistake on Contracts.
3. Write short note:
   1. What are flaws in free consent
   2. Difference between mistake and mispresentation
   3. What is mistake as to quantity of subject matter.

Suggested Readings

Mercantile Law : Avtar Singh
Mercantile Law : N.D.Kapoor

LESSON NO. 1.6

LEGALITY OF OBJECT AND VOID AGREEMENTS

Learning objectives:

The major objectives of this lesson are to discuss:

- Agreements Opposed To Public Policy
- Trading with Enemy
- Stifling prosecutions
- Maintenance and Champerty
- Traffic relating to Public Offices
- Agreement tending to create interest of posted to Duty

Structure :

1.6.1 Introduction

As per Section 23 of the Indian Contract Act, an agreement, of which the object or consideration is unlawful, is void; Object means purpose or design of the contract. It implies the manifestation of intention. Thus, if a person, while in insolvent circumstances transfers to another for consideration some property with the object of defrauding his creditors. The consideration of the contract is lawful but the object is unlawful. Both the object and the consideration of agreement must be lawful; otherwise the agreement would be void. The word lawful means "permitted by law". Section 23 of the contract act speaks of three things:

(i) Consideration for the agreement;
(ii) Object for the agreement; and
(iii) Agreement

The consideration or the object of an agreement is unlawful in the following cases:

(i) If it is forbidden by law:

If the consideration or object for a promise such as, is forbidden by law, the agreement is void. The agreement is forbidden by law, if the legislature penalises it or prohibits it. It is illegal and can not become valid even if the parties act according to such agreement. For example, where the lawful wife was alive, any agreement by the husband to marry another woman is unenforceable as being forbidden by law.

Examples

A promises to obtain an employment for B in the public service and B promises to pay Rs. 1000 to A. The agreement is void as the consideration for it is unlawful.

(ii) If it is of such a nature that if permitted it defeats the provisions of any law

A contract which seeks to exclude the applications of a statutory provision equal to the parties is not valid.

(iii) If it is fraudulent

Agreements which are entered into for promoting fraud are void. Thus, an agreement for the sale of goods for the purpose of smuggling them out of the country is void and the payment of the goods so sold can not be recovered.

Example: (a)A, B and C enter into an agreement for the division among them of gains acquired by them by fraud. The agreement is void as its object is unlawful.

(iv) If it involves or implies injury to the person or property of another.

The object or consideration of an agreement will be unlawful if it tends to injure the person or property of another. Thus, an agreement to pull down another's house is unlawful. The word 'injury' means criminal or wrongful harm. Loss which ensures to a trader as a result of competition by a rival trader is not injury within the meaning of this clause.

Example: A asks an editor of a newspaper to publish a defamatory article against B and promises to pay Rs. 4,000 for the work. The agreement is void as it involves injury to the person or B and, therefore, a suit can not be brought to recover Rs. 4,000 by the editor.

(v) If the Court regards it as immoral:

Where the consideration or object of an agreement is such that the court regards it an immoral the consideration is void. The world immoral means inconsistent with what is right. Rent due in respect of a flat let to a prostitute for the purpose of her trade can not be recovered. Similarly money lent for the purpose of assisting the trade can not be recovered. Similarly money lent for the purpose of assisting the borrower to visit brothers and bring in prostitutes can not be recovered in a court of law.

Example: A agrees to let her daughter to B for concubinage. The agreement is void because it is immoral.

(vi) If the court regards it as being opposed to Public Policy:

An agreement is unlawful if the court regards it as opposed to public policy. A contract which is opposed to public policy can not be enforced by either of parties to it. Any agreement which tends to promote corruption or injustice or is against the interests of the public is considered to be opposed to public policy. Public policy is that principle of law which holds that citizen can lawfully do that which has a tendency to be injurious to the public. Public policy is not capable of exact definition and, therefore, courts do not generally go beyond the decided cases on the subject.

1.6.2 Agreements Opposed To Public Policy

1.6.2.1 Trading with Enemy

Trading with enemy is clearly against public policy in so far as it helps the enemy to the detriment of the country. Besides, it is against national honour to indulge in such acts in times of national emergency. But where a contract is made during peace times and then war breaks out, one or the two things may result. Either the contract is suspended or it stands dissolved depending upon the intention of the parties.

1.6.2.2 Stifling prosecutions

An agreement to stifle a prosecution, i.e., to prevent proceedings already instituted from running their normal course or to compromise a prosecution is illegal and void. It is not open to the parties to take the administration of justice

out of the hands of the authorities and themselves determine what should be done. Thus, a pronote executed as consideration for compounding charge of grievous hurt is void. But an agreement for compounding of a compoundable offence is not void.

1.6.2.3 Maintenance and Champerty

Maintenance and champerty agreements are void as opposed to public policy Maintenance may be defined as an agreement whereby a person promises to maintain a suit in which he has no interest. Champerty is an agreement whereby a person agrees to share the results of litigation.

Example: An advocate entered into an agreement with his client which was embodied in his client's letter to him. The letter read, "I hereby engage you with regard to my claim against the Baroda Theatres Ltd. for a sum of Rs. 9,400. Out of the recoveries you may take fifty percent of the amount recovered. " The Supreme Court held that a contract of this kind was highly objectionable for a lawyer and void.

1.6.2.4 Traffic relating to Public Offices

Agreements concerning the sale of public offices are bad as they promote corruption, Section 6(f) of the Transfer of Property Act provides that a public office cannot be transferred nor can the salary of a public officer.

Example: A paid B, a public servant, a certain amount inducing him to retire from service, thus paving way for a to be appoint in his place. The agreement was held to be void.

1.6.2 .5 Agreement tending to create interest of posted to Duty

An agreement which tends to create an interest in favour of a person which would conflict with his duty is illegal on the ground that is opposed to public policy. It is the essence of public that servant must be deterred from doing his duty. Thus, an agreement by a person in Government service for the purchase of land situated within his circle is illegal as opposed to public policy.

1.6.2.6 Marriage breakage Agreement

A marriage breakage agreement is an agreement where a person promises for reward to procure the marriage of another. Such agreements are void being against public policy. Thus if A pays B, a stranger, a certain sum of money to procure a wife for him, he cannot enforce the agreement as it is clearly against public policy.

1.6.2.7 Agreements tending to create Monopolies

An agreement to create monopoly is void as opposed to public policy. There can be monopoly rights given to one person to the exclusion of others. e.g. In matters like- selling of vegetables.

1.6.2.8 Agreements to influence Elections to Public Offices

An agreement with votes tending to influence them by improper means and any agreement with third person to influence voters by indirect means are all valid. Similarly, an agreement between rival candidates that one shall withdraw in consideration of a promise by the other to appoint him to office is void.

Example: A promises B, the owner of newspaper, Rs. 500 in consideration of the publication by B, in his newspaper of false statement in regard to a candidate for election. B published them. The agreement is void as opposed to public policy.

1.6.2.9 Agreement in Restraint of Personal Liberty

A contract which restricts the liberty of an individual is illegal.

Harwood v/s Miller's Timber and Trading Co, A borrowed money from a money lender and agreed that he would not without the lender's written consent leave his job, borrow money, dispose of his property or move from house. It was held that the contract was illegal as it unduly restricted the liberty of A.

6.2.10 Agreement interfering with Marital Duties

Agreements which interfere with the preference of marital duties are void as being opposed to public policy. Thus an agreement to lend money to a woman in consideration of her getting a divorce and marrying the lenders, is void.

1.6.3 Void Agreements

All agreements may not be enforceable by law. Only those agreements which fulfil the essentials laid down in Section 10 can be enforced. In addition to these The Contract Act provides for certain Types of agreements which have been specially declared to be void. These are:

1.6.4 Agreement in Restraint of Marriage

An agreement in restraint of a person other than a minor, is void. Every person has the freedom to marry. A person is bound by law to marry; by an agreement restraining a person not to marry, is contrary to public policy and illegal.

1.6.5 Agreements in Restraint of Trade

An agreement seeking to restraint a person from exercising a lawful profession, trade or business of any kind is void to that extent. Public policy requires that every person should be at liberty to work for himself and nobody else can deprive him from this right of using liberty for himself or the stole of his labour skill or talent by any contract have that he enters into.

1.6.6 Service Agreement

An agreement of contract of service by which an employee binds himself during the term of his agreement not to complete with his employer directly by carrying on similar business, or accepting any other employment during the term of his agreement is not in restraint of trade. The employer can prevent the employees from working elsewhere during the period covered by the agreement.

Example: A agreed to become assistant for 3 years to B who was a doctor practising at Zanzibar. It was agreed during the term of the agreement that A was not to practise on his own account in Zanzibar. At the end of the one year, A ceased to act as B's assistant and began practice on his own account. It was held that the agreement was valid and A could be restrained by an injunction from doing so.

1.6.7 Trade Combination

An agreement between different firms in the nature of a trade combination in order to maintain a price level and avoid understanding is not illegal. Further, an agreement between certain ice-manufacturers not to sell the ice below a certain minimum price has been held to be valid, Because mutual benefit is not the purpose. But an out and out monopoly is sought to be created, the Section 24 hits at the agreement as void.

1.6.8 Agreement in Restraint of Legal proceedings

An agreement which purports to oust the jurisdiction of the courts in country to public policy are void. Section 28 provides that every agreement by which a party is restrained absolutely from enforcing his rights under a contract by ordinary legal proceedings or which limits the time within which he can enforce his rights is void to that extent. Thus, here a servant agrees not be sue for wrongful dismissal is void under this section.

1.6.9 Uncertain Agreements

Section 29 provides that an agreement, the meaning of which is not certain or capable of being made certain void. If there is ambiguity in the wording of the contract, it is not possible to read the exact intention of the parties to the contract. Where the term in an agreement is vague in the extreme and might be interpreted in as many ways as there are interpretations thereof the agreement is certainly one which is void because of uncertainty. Thus, an agreement to sell at a concessional rate is void for uncertainty. Similarly, an agreement to pay rent in case without the rate being definitely fixed is void for uncertainty.

1.6.10 Agreements by way of a wager

An agreement by way of wager is void. No suit will lie for recovering anything alleged to be won on any wager or entrusted to any person to abide by the results on any game or other uncertain even on which any wager is made.

Wage means a bet. A wager may be defined as an agreement to pay money or money's worth on the happening of a specified uncertain event. All agreements by way of wager are void. A wagering contract being only void and not illegal. A collateral contract can well be enforced by law. An agreement for actual purchase and sale of any commodity is not a wagering agreement. But sometime it becomes difficult to determine whether a particular transaction was in fact a contract of purchase and sale of a wagering contract for the payment of differences.

1.6.11 self check activity

1. what are agreement opposed to public policy
2. what is trade combination.

1.6.12 Summary

The lesson discusses the legality of object and void agreements. An agreement of which the object or consideration is unlawful, is void, Object means purpose or design of the contract. It implies the manifestation of intention. Thus, if a person, while in insolvent circumstances transfers to another for consideration some property with the object of defrauding his creditors. The consideration of the contract is lawful but the object is unlawful. Both the object and the

consideration of agreement must be lawful, otherwise the agreement would be void. The word lawful means "permitted by law". Section 23 of the contract act speaks of three things: i) Consideration for the agreement; (ii) Object for the agreement; and (iii) Agreement

1.6.12 Key Words

Uncertain Agreements

An agreement, the meaning of which is not certain or capable of being made certain void. If there is ambiguity in the wording of the contract, it is not possible to read the exact intention of the parties to the contract.

Fraudulent Agreements

Agreements which are entered into for promoting fraud are void. Thus, an agreement for the sale of goods for the purpose of smuggling them out of the country is void and the payment of the goods so sold can not be recovered.

Trading with Enemy

Trading with enemy is clearly against public policy in so far as it helps the enemy to the detriment of the country. Besides, it is against national honour to indulge in such acts in times of national emergency.

1.6.13 Self Assessment Questions/Exercise

1. Under what circumstances is the object of a contract unlawful?
2. Name the several types of agreements which are opposed to public policy
3. Write short notes:
   1. What is trading with enemy
   2. Explain uncertain agreements.

1.6.14 Further Readings

1. Business Regulatory Framework : Garg K.C.,Chawla R.C.
2. Mercantile Law : Kappor G.K.
3. Mercantile Law : Kappor N.D.
4. Principles of Mercantile Law : Singh Avtar
5. Business Laws : V.K. Sharma

LESSON NO. 1.7

DISCHARGE OF CONTRACTS AND REMEDIES FOR BREACH OF CONTRACT

Learning objectives:

The major objectives of this lesson are to discuss:

- Termination By Performance
- Termination By Agreement
- Operation of Law
- Insolvency
- Death
- Material Alteration
- Impossibility of Performance
- Exceptions

Structure :

1.7.1 Introduction

When the obligations which are created come to an end, we say that the contract is discharged or terminated. A contract may be terminated in any one of the following ways:

1. By performance
2. By agreement
3. By operation of law
4. By material alterations
5. By subsequent impossibility of performance
6. By breach of contract by one party.

Now we shall discuss all these points one by one.

1.7.2 Termination by Performance :

When the parties perform their respective promises, the contract is said to be performed thus obligations come to an end. In this way the contract is discharged. A refusal to accept offer to perform or render also discharges the contract. So even if there is a valid offer a party to a contractor to perform his promise but the offer is not accepted by the other party, obligation of the first party is terminated.

1.7.3 Termination by Agreement:

If all the parties by mutual agreement decide to terminate the contract, they can do so. They may also decide to substitute the original contract for a new one. In this case, the old contract is terminated.

(a) Novation : Novation can occur with the consent of all parties. When the parties by agreement substitute the old contract for a new one, this is called novation. This novation is created by exchange of old contract into a new one. This new contract may either be between the same parties or between the different parties. In this, the old contract is said to be discharged. Novation can only take place by agreement between the parties. Novation cannot be compulsory.

Novation may be between the same parties by substituting the contract but generally in this, there is change of parties but the contract remains the same. For example, O owes Y Rs. 1,000, Y owes Z Rs. 1,000. By mutual agreement, X, Y and Z enter into a contract i which X shall pay Rs. 1000 to Z, accepts X as his debtor. This is called novation.

(b) Alteration : When there is some change in terms of the contract, it is called alteration of contract. In alteration, there is no change in the parties. So it is different from novation in which there may be change of parties.

(c) Remission : It means acceptance of somewhat less than what was actually due under the contract. Sec. 63 says about this, "Every promise may dispense with or remit wholly or in part, the performance of the promise made to him, or may extend the time for such performance or may accept instead of it any satisfaction which he thinks fit. "We can give an example also. A owes B Rs, 5,000. B may accept Rs. 2,000 in full and final satisfaction of his claim of Rs, 5,000. Hence whole of the contract is discharged and the rest of the amount is remitted.

Now we shall tell you the meaning of the two English law terms—Accord and Satisfaction. In English Law, a promise to accept less than what is actual due under the contract is not enforceable. But if this is actually carried out, i.e., the sum is actually paid and accepted, the contract will be discharged. For example, A is to pay Rs, 1000 to B. B agrees to accept Rs. 80 is actually paid and it is also accepted by B, it discharges the contract. This is called accord and satisfaction. Accord means to accept less than what is due under the contract and satisfaction means the payment of lesser obligation. So in their satisfaction also, then it is enforceable. This role of accord and satisfaction is not applicable in India. Even the promise to pay loss is not enforceable.

(d) Recession : It means cancellation of the contract. A contract can be rescinded in any of the following ways :

(1) By mutual consent: The parties may enter into an agreement to rescind the contract before the breach of contract.

(2) Where one party does not perform the contract, the other party can rescind the contract and also apply for compensation.

(3) As we have already studied that in voidable contract, it is the option of one of the parties to rescind the contract.

(e) Waiver : It means intentionally relinquishing the rights under the contract. If in a contract a party has certain rights and that party abandons those, other party is discharged form the obligations.

(f) Merger : In one contract, a person has certain rights and also if he gets some superior rights, then inferior rights are merged in superior rights.

A person holding property under a lease, buys the property, his rights as a lessee vanishes. They are merged into the rights of ownership which he has now acquired.

1.7.4 Operation of Law

The termination or discharge of the contract can also be done by operation of law in case of insolvency, death or merger which we have just studied.

1.7.5 Insolvency

In the case of insolvency of a person, all the rights and liabilities of the insolvent are transferred to the official receiver or assignee. An insolvent is released from performing his part of obligations from his earlier contract.

1.7.6 Death

There are some contracts which involve personal skill of the promisor. This type of contract is discharged by the death of the promisee. But in other types of contract all the rights and liabilities of the promisor are passed on the legal representatives in case of death of promisor.

1.7.7 Material Alteration

Material alteration means any change in the document containing the terms of a contract by which there is direct effect on the nature of operation of the contract or it changes the validity of document. This alteration is made internationally and without the consent of the other party. For example, if one party changes the amount of money or the name of the party, it will be considered to be a material alteration. In such a case, the party making the alteration can not enforce the contract. But if there is some clerical error like spelling mistake etc., the change in the document will not amount to material alteration.

1.7.8 Impossibility of Performance

Impossibility may be of two types :

(i) Impossibility at the time of making the contract whether known or unknown to the parties.

(ii) Impossibility which arises after the contract is entered into.

In the first case, the contract is void ab-initio because of absolute impossibility, in case impossibility is known to both the parties. But if it is not known the case will be bilateral mistake for fact and hence void. Hence, we shall be dealing in detail with the second type of impossibility, i.e. supervening or subsequent impossibility. This arises after the contract is made. When the contract was entered into, it was capable of performance, but by some reasons it becomes impossible after some time, It is called doctrine of supervening impossibility. In this case, the contract becomes void when the act becomes impossible or unlawful.

The following are the causes by which the supervening impossibility may occur :

(a) By destruction of subject matter: When the contract is in respect to a subject matter that destroyed the fault of parties, the contract is discharged. Here we take the case of Taylor Vs Caldweil, In this case, a music hall was let out for a series of contracts on certain days. But the hall was burnt before the date of contract. It was held that the contract becomes void because of impossibility of performance.

(b) By nonexistence or non-occurrence of state of things necessary for performance : Sometimes the contract is entered into on the basis of continued existence of certain state of things. In this case, if the state of things changes, the contract is discharged. Here we take the example given in Sec. 56. A and B contract to marry each other. Before the time fixed for marriage, A goes mad and the contract becomes void. In a leading case, Krell Vs Henry, H hire room from K for two days in order to use the room to view the procession of King

Edward VII. Both parties knew the object of agreement. King fell ill and the procession was abandoned. Here the contract was discharged and H was excused from paying the rent.

(c) Death or personal incapacity: When the personal qualification is the basis of contract, the contract becomes impossible by either death or incapacity of the promisor, Now, we take another example given in Sec. 56. A contract to act at a theatre for six months in consideration of a sum paid in advance by B. On several occasions, A is too ill to act. The contract to act on these occasions becomes void.

(d) Declaration of War: Those contracts which are entered into during the war with alien enemies, are void ab-initio. The contracts which were entered into before the declaration of war between citizens of countries subsequently at war are suspended and cannot be enforced. But these can be enforced after the war is over. Of these contract which are in one way or the other for aiding the enemy, are cancelled.

(e) Change of Law: Sometimes due to change in law, the performance of the contract may become impossible. As in case of Reshipton Anderson & Co. Vs. Harrison Brus & Co., A Sold to B a specified parcel of wheat in a warehouse. Before delivery could be made, the own godown was sealed by the Government and the entire quantity was requisitioned by the Government. The delivery being legally impossible, the contract was discharged.

1.7.9 Exceptions

These are the ways in which supervening impossibility may occur. But there are many cases which are not covered by the Doctrine of supervening impossibility. We may call these exceptions to the above doctrine. Exceptions:

(i) Difficulty of Performance: Mere fact that performance is difficult or more expensive or less profitable does not discharge the contract. As in a leading case of Blackburn Bobbin Co. Vs. Allen & Sons, A sold to B certain quantity of Finland Timber to be delivered between July and September, 1914. No deliveries could be made before August when war broke out and transport was disorganised. So A could not bring any timber form Finland. Here B was not concerned with the way which a war going to affect the timber from Finland. So his possibility of getting timber from Finland did not excuse performance. Here A will have to compensate B for any loss he has incurred.

(ii) Commercial impossibility does not discharge the contract : Sometimes though the performance becomes very expensive or less profitable yet the contract can not be said to be impossible.

(iii) Strikes, Lockouts & Civil Disturbances : All these will not discharge a party from performance of the contract unless there is a clause in the contract regulating this provision. In the case of 'Jacob Vs Credit Lyonnias' a contract was entered into between two London merchants for sale of certain Algeria goods. Owing to riots and civil disturbance in that country, the goods could not be bought. Hence there was no excuse of no performance of the contract.

1.7.10 Doctrine of Frustration

When common object of the contract is no longer be carried out, the court may declare the contract be at an end. So according to the doctrine of frustration when the performance depends on continued existence of a person or things and it is known to both parties from the beginning, then in case of perishing of the person or things without default of parties, the performance of the contract will be excused. The promisor then need not perform the contract. So the law does not compel to do the impossible things. But this doctrine is not applicable to the case of commercial impossibility which we have already studied. Another thing to note here is that the contract can be discharged on the ground of frustration when the common object of the contract can no longer be carried out.

The doctrine of frustration of English law is really a part of law of discharge of contract. In fact, impossibility and frustration are used as interchangeable expressions. In India, doctrine of frustration is applied not on the ground that parties themselves agreed to an implied term which operated to release them from the performance. The court will form its own conclusion on the basis of evidence whether the changed circumstances have destroyed altogether the basis of contract and its object. So Indian and English law do not stand on the same footings as regards to doctrine of frustration.

1.7.11 Termination by Breach of Contract :

There are two ways in which breach of contract can arise : (a) Anticipatory breach of contract and (b) Actual breach of contract.

Anticipatory Breach : A refusal by the promisor to perform his part of the contract before the due date is known as anticipatory breach of contract. When one party repudiates the contract before the time due for performance or refuses to perform before the time due or by one's act-disables oneself from performing the contract, the breach so occurred is known as anticipatory breach of contract. It is also called constructive breach of contract. For example, A contracts to supply some goods to B on 1st June. Before this date A tells B that he is unable to supply the goods. This is anticipatory breach of contract.

Consequences of anticipatory Breach of Contract: In case of anticipatory breach, the aggrieved party has got the following remedies:

(a) He can treat the anticipatory breach as actual breach and sue for damages and claim other rights, as are available in case of actual breach. In this case, he need not wait for the arrival of due date for the performance of contract.

(b) He can wait until the time falls due for performance and then start legal proceedings.

(c) He can treat the contract as discharged so that he is no longer bound to any obligations under the contract.

Actual Breach of Contract: Actual breach of contract means the failure on the part of one party to perform when the performance of contract is due or

during the performance of the contract. It includes the refusal to perform. For example, A promises or fails to supply the wheat. This is actual breach of contract.

1.7.12 Remedies for Breach of Contract

When there is breach of contract, the injured or aggrieved party is entitled to any of the remedies :

(a) Recission of the Contract
(b) Suit for Damages
(c) Quantum Meriut
(d) Injunction
(e) Special Performance
(f) Restitution

1.7.12.1 Recission of the Contract : As already studied, if one party rescinds the contract, it means, setting aside of the contract. But the party rescinding the contract will have to restore all the benefits received by him under the contract to the other party. Of course, he will be entitled to get the compensation for the loss suffered by him. Damages may be of following kinds:

(i) Ordinary Damages
(ii) Special Damages
(iii) Exemplary or Punitive or Vindictive Damages
(iv) Nominal or contemptuous damages

(i) Ordinary Damages : These are damages calculated in such a way as to compensate the loss suffered by a party. These are calculated on the basis of circumstances prevailing on the date of breach of contract. These can also be called Compensatory Damages.

(ii) Special Damages : These are the result of breach of contract under some special circumstances. These arise due to indirect loss suffered. These types of damages must be known to both the parties at the time of entering into a contract. The example may be loss of profit caused by breach.

(iii) Exemplary or Punitive or Vindictive Damages : These are awarded by way of punishment. These are more than the actual loss suffered. The object of these damages is to prevent the party from committing the breach. These are awarded generally in the case of breach of contract to marry and dishonour of a customer's cheque by the bank without any proper reason.

(iv) Nominal or Contemptuous Damage: These damages are not granted for compensation and are of very small amount. These are in case where the loss is insignificant or negligible. These damages are awarded to recognize the right of the party to claim the damages for the breach of contract.

1.7.12.2 Suit for Damages

Rules regarding the determination of amount of damages :

Now the main point to discuss here is determination of damages, i.e., how much damages should be granted to the injured party. The rules are summarised as follows:

1. In general, only actual loss suffered is allowed as damages.
2. Where a party suffers a loss by breach of contract, he is to be placed in the same situation with respect of damage if the contract had been performed.
3. When the amount of damages is calculated, the court takes into only that loss which is fairly and reasonably considered as arising naturally and in the usual course of things from the breach.
4. Court may allow remote damages i.e., damages not arising naturally from the breach. These are also called special damages. To clarify all these points a student is expected to read all the illustrations given under Section 73 of Indian Contract Act. For the sake of convenience we can take here an example. A delivers to B, a common carrier, a machine to be conveyed without delay, to A's mill, informing B that his mill is stopped for want of the machine. B unreasonably delays the delivery of the machine and A, in consequences, losses a profitable contract with the amount of profit which would have been made by the working of the mill during the loss of the delivery of it was delayed; but not the loss sustained through the loss of the Government contract.
5. If the damages are difficult to calculate, it does not mean that the damages can not be recovered.
6. It is the duty of the injured to intimate the loss.
7. If already it has been agreed upon between the parties about damages, only the agreed amount will be paid as damages and not more than that. But the court may allow less.

In the following cases, injured party is entitled to get the interest on the payment he is to receive:

(i) Where the contract provides the payment of interest.

(ii) If there is custom of trade to pay interest.

(iii) Under the provision of interest Act of 1839, the interest is allowed in two cases : (a) Where there is fixed date of payment on a written document then from this date of payment, (b) Where party demands the payment in case no date is fixed, in this case from the date of demand, interest will be payable.

1.7.12.3 Quantum Meriut : It means 'as much as merited' or 'as much as earned'. Sometimes a person does some part of work or supplies a part of goods and the contract is terminated or becomes void for some reason. In these circumstances, a person can claim compensation for the work he has done. This is called Doctrine of Quantum Meriut. It is applicable in the following ways :

(i) When there is a breach of contract the injured party can claim compensation for the work he has already done. For example, a contractor was engaged to build a house, when half of the house was completed, the house was destroyed. Here the contractor can claim for what he had done.

(ii) Sec. 65 explains that in case a contract becomes void for some technical defects, any person who had done something under the contract is entitled to reasonable compensation.

(iii) Sometimes there is an implied agreement to pay for the work done, goods supplied or services rendered. For example, A by mistake leaves his goods in B's house. He has no intention to give the goods to B. B knowingly uses the house. Here A can compel B for payment of the goods.

This doctrine of Quantum Meriut has some limitations which are as follows :-

(i) In a contract, which is not divisible into parts and a lump sum of money is to be paid for entire work, part performance does not entitle a party to claim any compensation. As in the case of Cutter Vs. Powell, a sailor was appointed on ship on Voyage from Jamaica to Liverpool on a lump sum payment. After two third of voyage was completed, he died. It was decided that his legal representatives can not recover anything.

(ii) A person guilty to breach of contract can not recover by way of claim any payment for the work done.

1.7.12.4 Injunction: It means the order of the court. When the contract is of negative nature, i.e., a person has promised to do something and he commits a breach, the injured can apply to the court for getting negative injunction. It means court will issue and order to the other person prohibiting him for doing something. So court will order a person to refrain from some act which has been the subject matter of contract. Here we take the case of Metropolitan Electric Supply Co. Vs. Ginder. In this case, G agreed to buy electricity from the other company. Upon doing so, he was restrained by an injunction (order) from buying electricity from any other company.

1.7.12.5 Specific Performance: In those cases, where money is not the adequate remedy or the actual damages can not be correctly determined, courts may order for the specific performance of a contract. In this case, court gives an order to the party guilty of breach of contract directing him to perform what he promised to do. It is not allowed in contracts of personal nature, e.g. contract of marriage etc. In contract for the sale of land or rare articles, court generally orders for the specific performance of the contract.

1.7.12.6 Restitution: Sec. 64 provides that in case of voidable contract, if the person on whose option is voidable, rescinds the contract, then he must restore any benefit received the contract under the contract. For example A, by undue influence enters into a contract with B for the sale of house and gives B some money as advance payment. Now if B rescinds the contract he must pay back that money. Sec. 65 deals with the contract which becomes void. It says that when an agreement is discovered to be void, then any person who has received any benefit must restore or make compensation for into the person from whom he received that. For example, A pays B Rs. 1,000 in consideration of B's

promising to marry, C, A's daughter. C is dead at the time of promise. The agreement is void but B must repay to A the 1,000 rupees.

1.7.13 Quasi Contract

A contract is the result of an agreement enforceable by law. It comes into existence from the action of the parties. The parties make actual promises knowing fully well that legal relationship will come into existence. But sometimes there is no intention on the part of the parties to enter into a contract, but obligation resembling those created by a contract are imposed by law. A quasi contract is a kind of contract by which one party is bound to pay money in consideration of something done to the suffered by the other party. Though no contractual relation exists between the parties law makes out a contract for them and such a contact is called a quasi contract. The basis of the quasi contract is to prevent unjust enrichment or unjust benefit. No man should grow rich out the another person's loss.

The Indian Penal Code recognises such types of contract and Section 68-72 deal with such contracts. They are as follows :

(1) Claim for necessaries supplied to person incapable of contracting or on his account (Section 68).
(2) Reimbursement of person paying money due to another in the payment of which he is interested (Section 69).
(3) Obligation of person enjoying benefit of non-gratuitous act (Section 70).
(4) Responsibility of finder of goods (Section 71).
(5) Liability of person to whom money is paid or goods delivered under mistake or coercion (Section 72).

(1) Claim for necessaries supplied (Section 68)

If a person, incapable of entering into a contract or any one whom he is legally bound to support, by another person with necessaries suited to his condition in life, the supplier is entitled to recover the price from the property of the incapable person.

Example :

(a) A supplies to B, (a lunatic), with necessaries suitable to his condition in life. A is entitled to reimburse from B's property. A contract by a minor is wholly void and unenforceable. He cannot even satisfy it on attaining majority. But Section 68 of the Act provides an exception to this rule and makes the estate of the minor liable for necessaries supplied to him. In order to make an infant liable for necessaries supplied, the plaintiff must prove.

(1) That the goods supplied were reasonably necessary for supporting a person in his position; and
(2) That the infant had not already a sufficient supply to these necessaries.

(2) Payment by an interested person (Section 69).

This section provides that a person who is interested in the payment of money which another is bound by law to pay, pays it, is entitled to be reimbursed by the other.

Example

B holds land in Bengal on a lease granted A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the government under the revenue law, the consequence of such sale will be the annulment of B's lease. B to prevent the sale and the consequent of his own lease pays to the government the sum due from A. A is bound to make good to B the amount so paid. In order that Section 69 may apply, the following conditions must be satisfied :

(1) A person must by law be bound to pay some money.

(2) Another person must be interested in the payment of that money.

(3) The other person must have paid the money because of such interest.

A person who is interested in the payment of money with another is bound by law to pay it, he is entitled to be reimbursed by the other. If he has no interest in paying he cannot claim protection.

Example

(a) A's goods were wrongfully attached to realise the arrears of Government revenue due by A. A pays the dues to save his property. He is entitled to recover the amount from B.

(3) Obligation of a person enjoying benefit of non-gratuitous act (Section 70)

Where a person lawfully does anything for another person or delivers anything to him not intending to do so gratuitously, and such other person enjoys the benefit restore the thing so done or delivered.

Example

(a) A tradesman leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them. Where, irrespective of any agreement or contract, a person lawfully does something for another person which was never intended to being gratuition and the other person enjoys the benefit of the thing done, the latter is bound to pay compensation to the former in respect of that.

(4) Responsibility of finder of lost goods (Section 71)

A person who is bound to take as much care of the goods found as a man of ordinary prudence would take of his own under similar circumstance. He cannot appropriate the goods without taking proper steps to find out the owner and should wait for a reasonable time so that the owner may turn up and take them. The finder of the goods is entitled to retain the goods against the owner until he receives compensation from him. The finder may sell the goods if the true owner

cannot be found after a reasonable search or if the true owner refuses to pay the compensation.

(5) Money paid by mistake or under coercion (Section 72)

A person to whom money has been paid for anything delivered by mistake or under coercion, must repay or return it.

Example

(a) A and B jointly owe 100 rupees to C. A alone pays the amount to C. and not knowing of this fact, pays 100 rupees over again to C. C is bound to repay the amount to B. Payment by mistake under this section must refer to a payment which was not legally due. The mistake is thinking that the money paid was due when infact it was not due. Thus, if money is sent to a wrong person by the money order due to bonafide mistake of fact, the sender can recover it. Similarly, a debtor can recover the amount of over payment to a creditor paid under a mistake. Payment made under coercion can be recovered like payment made under a mistake. Thus money paid as income tax under threat of attachment can be recovered. Similarly, where a consumer of electricity pays money to the electric company under protest on being threatened with disconnection in case of default the case is open of the coercion under Section 72.

Example

A had obtained decree against B but obtained an attachment against C's property and took possession of it to obtain satisfaction for the amount of the decree. C on being ousted from property paid the sum under protest. C then sued for refund of the money. It was held that C having paid the money under coercion within meaning of Section 72 was entitled to recover the sum.

Self check activity :

1. Explain Novation
2. What are the types of termination for breach of contract .

1.7.14 Summary

When the parties perform their respective promises, the contract is said to be performed thus obligations come to an end. In this way the contract is discharged. A refusal to accept offer to perform or render also discharges the contract. So even if there is a valid offer a party to a contractor to perform his promise but the offer is not accepted by the other party, obligation of the first party is terminated. When the obligations which are created come to an end, we say that the contract is discharged or terminated. A contract may be terminated in any one of the following ways: 1.By performance, 2. By agreement 3. By operation of law 4. By material alterations 5.By subsequent impossibility of performance 6. By breach of contract by one party. If all the parties by mutual agreement decide to terminate the contract, they can do so. They may also decide to substitute the original contract for a new one. In this case, the old contract is terminated.

1.7.15 Key Words

Injunction:

It means the order of the court. When the contract is of negative nature, i.e., a person has promised to do something and he commits a breach, the injured can apply to the court for getting negative injunction.

Restitution:

Sec. 64 provides that in case of voidable contract, if the person on whose option is voidable, rescinds the contract, then he must restore any benefit received the contract under the contract.

Recission:

If one party rescinds the contract, it means, setting aside of the contract. But the party rescinding the contract will have to restore all the benefits received by him under the contract to the other party.

1.7.16 Self Assessment Questions/Exercise

1. Explain the various modes, how a contract can be discharged?
2. What are the different remedies available against the breach of contract?
3. What are Quasi-Contracts? State and discuss their nature and kind.

1.7.17 Further Readings

1. Business Regulatory Framework : Garg K.C.,Chawla R.C.
2. Mercantile Law : Kappor G.K.
3. Mercantile Law : Kappor N.D.
4. Principles of Mercantile Law : Singh Avtar
5. Business Laws : V.K. Sharma

Attempt any four questions.

1. "Insufficiency of consideration is immaterial, but an agreement without consideration is void." comment.
2. Discuss the rule that a stranger to contract cannot sure on contract and the exceptions to the rule.
3. Discuss the provisions of law relating the contracts by minors.
4. Name the various persons who are incompetent to contract.
5. Under what conditions a consent is not said to be free. What is the effect of such consent in the formation of the contract?
6. Discuss the law relating to effect of mistake on contracts.
7. Under what circumstances is the object of a contract unlawful?
8. Name the several types of agreements which are opposed to public policy.
9. Explain the various modes, how a contract can be discharged?
10. What are the different remedies available against the breach of contract?
11. What are Quasi-Contracts? State and discuss their nature and kind.
12. Write short notes :
    (i) Compare void and voidable contracts.
    (ii) Quasi Contracts.

(iii) Adequacy of consideration.
(iv) Minor.
(v) Agreements opposed by public policy.

LESSON NO. 1.8 AUTHOR : DR. RITU LEHAL

INDEMNITY AND GUARANTEE

Lesson Structure

1.8.0 Objectives

The following lesson includes another type of contracts viz., contract of Indemnity and Contract of Guarantee. The chapter includes definition, nature and rights of indemnity holder, essentials of a valid contract of guarantee, kinds of guarantee, surety and his liabilities etc. We will discuss these two types of contract one by one. First of all the whole portion of indemnity and then the content related with Guarantee has been discussed.

1.8.1 Introduction of Indemnity

A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person, is called a contract of Indemnity. To Indemnify means to make good the loss of the other party. The person who promises/undertakes or agrees to compensate the loss is called indeminifier and the persons whose loss will be made good is called Indemnity holder.

A contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of Rs. 200. This contract is a contract of Indemnity.

Definitions

Definition in English Law : In English law the word Indeminity means to save a person harmless from the consequences of an act.

In Admamson v Jarvis

The Plaintiff, an auctioneer, sold certain cattle on the instruction of the defendant. It came in light after sometime that the livestock does not belong to defendant, but to another person, who made the auctioneer liable and the auctioneer in his turn sued the defendant for indemnity for the loss he had thus suffered by acting on the defendant directions.

The court laid down that the plaintiff having acted on the request of the defendant was entitled to assume that, if, what he did, turned out to be wrongful, he would be indemnified by the defendant.

Definition under Section 124

The English definition of indemnity is wide enough to include a promise of indemnity aganist loss arising from any cause whatsoever e.g. loss caused by fire or by some other accident. Infact every contract of insurance, other than life insurance is a contract of indemnity. But the definition of indemnity in Section 124, of the Indian Contract Act is somewhat narrower. Section 124 says that A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person is called a contract of indemnity.

Thus the scope of indemnity is by the very process of definition restricted to cases where there is a promise to indemnify against loss, caused by the promisor himself or by another person.

The definition excludes from its perview, cases of loss arising from accidents like fire or perils of the sea. Loss must be caused by some human agency. The cases like Adamson v. Jarvis and the case of loss arising from an act done at the request of the promisor are covered by section 223 of the Act which provided for indemnity between principal and agent. The promise of indemnity may be expressed or implied.

Decision given by 'Privy Council' in Secretary of State v. Bank of India Ltd., was

an example of implied indemnity.

A note with forged endorsement was given to a bank which received it for value and in good faith. The bank sent it to the Public Debt office for renewal in their name. The true owner of the note recovered compensation from the state and the state was allowed to recover from the bank on an implied promise of indemnity.

Like any other contract, a contract of indemnity must fulfil all the essentials of a valid contract viz. consideration, free consent, capacity of parties, lawful object and lawful consideration etc.

A contract of fire and marine insurance is always a contract of indemnity. But a contract of life insurance is not a contract of indemnity. Because in case of loss of life, nobody can compensate the same.

Self Check Exercise 1

X asks Y to burn the house of A, promising to compensate Y against the consequences. Y sets the house of A on fire and was fined Rs. 20,000. Can Y recover this amount form X ?

1.8.1.1 Right of Indemnity Holder

Section 125 includes the rights of an indemnity holder. Following are the rights of indemnity holder.

(i) All damages which he may be compelled to pay in any suit in respect of any matter to which the promise of indemnity

(ii) All costs he may be compelled to pay in such suit if, in bringing or defending it, he did not cntravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.

(iii) All sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prodent for the promisee to make in the absence of any contract of indemnity, or if the promisor athorised him to compromise the suit.

An indemnity holder shall be entitled to all these rights provided he acts within the scope of his authority. It appears from above that an indemnity holder can only recover the amount that he had to pay to third party.

1.8.1.2 Rights of the Indemnifier

The Indian contract Act is silent regarding the rights which the indemnifier has, on carrying out his promise to indemnity. It has been held, however that his rights, in such cases are similar to the rights of a surety under section 141 of the contract Act.

Commencement of Liability

Another question in the contract of indemnity is, when does the indemnifier become liable to pay or when is indemnity holder to recover his indemnity. The

orginal English rule was that indemnity was payable only after the indemnity holder had suffered actual loss by paying off the claim. The maxim of law was 'you must be indemnified before you can claim to be indemnified'. But presently the law is different. In a decision given by Bombay High Court, it was explained that under the English common law no action could be maintained until the actual loss had been incurred. It was very soon realised that indemnity might be worth very little indeed if the indemnified could not enforce his indemnity till he had actually paid the loss. If a suit was filed against him he had actually to wait till the judgement was pronounced and it was only after he had satisfied that judgement that he could sue on his indemnity. The High Courts of Allahabad, Madras and Patna have all expressed their concurrence in the principle that as soon as the liability of the indemnity holder to pay becomes clear and certain, he should have the right to require the indemnifier to put him in a position to meet the claim.

Contract of indemnity includes a contract by which one party promises to save the other from loss caused to him by anyone. To indemnify means to make good the loss.

Definition : This part includes the definition under English law as well as under Indian Law. Section 124 of Indian Contract Act deals which the definition of indemnity. The scope of indemnity is restricted to the cases where there is a promise to indemnity against loss caused by the promisor himself or by another person.

Rights of indemnity holders are included in section 125. Indian Contract Act is silent regarding the rights of the indemnifier. The above lesson also gives the answer to the question that when does not liability commence. Different decision given by courts have been discussed in this context.

1.8.2 Introduction to Guarantee

Section 126 of contract Act defines it as “A contract of guarantee is a contract to perform the promise, or discharge the liabilities, of a third person in case of his default. The person who gives the guarantee is called “Surety”, the person in respect of whose default guarantee is given is called the “Principal debtor”, and the person to whom the guarantee is given is called the ‘creditor’.

Guarantee is a promise to pay the debt of a third person if he is not able to make the payment. In business world, money is the back bone of business activities and if it's not available with a particular person, he may borrow it from somebody else. But whether the person who has borrowed money is able to refund it within the time limit agreed is a very risky affair. So, in order to cover this risk part, the person who gives the loan requires the undertaking of a third party that if principal debtor is not able to make the payment, this third party can be held responsible for this payment.

For example A gives the loan of Rs. 50,000 to B and C promises to A if B does

not repay the loan, C will make the payment. This is a contract of guarantee. Here B is principal debtor, C is surety and A is the creditor. There must be three parties for creating a contract of guarantee viz. a creditor, a principal debtor and a guarantor (or surety). There must be two contracts. First between the principal debtor and the creditor. Then another contract should be between guarantor and the creditor in which guarantor gives the guarantee for repayment of debt by him. In addition to these two contracts, there must be another contract between principal debtor and surety.

In a contract of guarantee there must be a conditional promise to be liable on the default of the principal debtor. A liability which is incurred independently of a 'default' is not a guarantee within the definition.

In 'Birkmyr V. Darnell, the court had decided that the statements like – Let him have the goods. I will be your pay master' or I will see you paid, is not a guarantee but only an undertaking given.

So, in a contract of guarantee the surety must specify that in case of default, I will make the payment.

1.8.1.8 Essential features of guarantee

Principal debt.

Existence of debt is compulsory for a contract of guarantee. If there is no principal debt, there can be no valid guarantee.

Case – Swan v. Bank of Scotland

A bank had given overdraft to a customer. This owerdraft was guaranteed by D. The overdraft had some legal and technical fault, which made it void. When the customer defaulted, D was sued for the loss. It was held that D was not liable to make any payment to the bank as surety because the debt was void and not in existence.

Self Check Exercise No. 2

A was a minor and he took some loan from B. C gave the guarantee of the amount. If A makes any default in making payment to B, can C be sued ?

Consideration

Consideration is needed in a contract of guarantee as it is needed in case of every other contract. Anything done or any promise made, for the benefit of a principal debtor, may be a sufficient consideration to the surety for giving the guarantee. But direct consideration is not needed for a contract between the surety and the creditor.

For example : A sells goods to B, C then requests A to forbear to sue B for the year, for this debt. He also promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. It is a sufficient consideration for C's promise.

No Misrepresentation or Concealment

There should be no misrepresentation or concealment of fact. Any guarantee

obtained by means of misrepresentation made by creditor or with his knowledge and assent, concerning a material part of the transaction, is invalid. On the same lines, a guarantee which is obtained by creditor by means of keeping silence to material circumstances is invalid.

Case – London general Omnibus Co. v. Holloway. A person gave the guarantee for the honesty of a servant. The fact was, the servant was dismissed earlier by the former employer for dishonesty. But this fact was never disclosed to the surety. The servant committed another embezzlement. The surety was not held liable, because he was giving the guarantee for a presumably honest man, not for a known thief.

Writing not necessary

A guarantee may be either oral or written. It may be expressed or implied from the conduct of parties. Written agreement is not necessary.

1.8.3 Kinds of Guarantee

(a) Absolute and Conditional Guarantee

An absolute guarantee is one by which the guarantor unconditionally promises payment in case of default by the principal debtor. Conditional guarantee is given but on happening of some contingency.

(b) General and Special Guarantee

A general guarantee can be accepted by general public. Special guarantee is addressed to a particular person. Surety can be held liable for the default in payment of that person only.

(c) Limited and Unlimted Guarantee

A limited guarantee is given for a single transaction. In case of unlimited guarantee, there is not limitation as to time or amount or number of transactions.

(d) Continuing Guarantee

This type of guarantee is given for a series of transactions. It is extended to indefinite time or it will come to an end through revocation.

1.8.4 Extent of Surety's Liability

Section 128 of contract of guarantee deals with the extent of surety's liability. Liability of surety is co-extensive with that of the principal debtor. The surety is liable for what the principal debtor is liable. The liability of surety will be equal to the liability of principal debtor. The only exception is when the guarantee is given for a lesser amount. But in any case it can be greater than the liability of principal debtor.

e.g. A has taken a loan from B for Rs. 10,000 and C gives the guarantee for Rs. 7,000/- only. A case A makes any default in payment C will pay upto Rs. 7000 only. So, in such a case surety can be held liable for the amount he has guaranteed i.e. Rs. 7000.

In case of a conditional guarantee, surety can not be held liable unless the condition is first fulfilled.

e.g. If a has taken loan of Rs. 10,000 from B. C gives the guarantee with the condition that if B makes any default in payment then surety should be served with a separate demand. If a separate demand is created only then C is liable for making payment.

Self Check Exercise No. 3

A takes a loan of Rs. 30,000 from B. C gives the guarantee with the conditon that two other persons will also sign the papers as guarantor. One of them did not sign the guarantee papers. In case of a default, can C be held liable ?

1.8.5 Rights of Surety

A surety has three kinds of rights.

1.8.5.1 Right against creditors

Sec 141, deals with the right of surety against creditors.

(a) Right to Securities

Every security which the creditors has taken from the debtor at the time when the contract was entered in, a surety has the right to take the benefit of such securities. If the creditor loses or sells any part of such security without the consent of surety, the surety is discharged to the extent of the value of the security.

e.g. A gives loan to B for Rs. 2,000 on the guarantee of C. A further has a security for Rs. 2000 by mortgage of B's furniture. After sometime, A cancels the mortgage. B becomes insolvent and A sues C on the basis of his guarantee. C is discharged from liability to the amount of the value of the furniture.

(b) A surety is entitled to the benefit of every security which creditor has taken when the contract was entered into, whether the surety knows of the existence of such security or not.

(c) The surety is entitled, on being sued by creditor, to rely on any set off or counter-claim which the debtor might possess against the creditor.

1.8.5.2 Right's against Principal Debtor

(a) Right of Subrogation

As soon as the surety makes the payment on behalf of the debtor, the surety steps into the shoes of creditor. This right is known as right of subrogation. Whatever rights were earlier given to the creditor against the principale debtor, now after making the payment, surety can exercise all such rights. He will get the position of the creditor now.

Self Check Exercise No. 4

A takes loan from B for Rs. 10,000. C gives the guarantee. After sometime A fails to make the payment and C as surety pays Rs. 10,000 to B on behalf of A. Now can C ask A to make the payment of Rs. 10,000 directly to him ?

(b) Right to Indemnity

If surety has paid any sum under the contract of guarantee, he has the right to recover such amount from the principal debtor. The surety can not only recover the actual amount from the debtor but also interest thereon. It becomes the duty

of teh principal debtor to make good the loss of the surety, once he makes the payment to the creditor.

But a surety can not claim more than whatever he has actually paid to the creditor. He cannot claim amount which he has paid because of his own negligence and he cannot claim even the amount which he has paid wrongfully.

1.8.5.3 Rights against Co-sureties.

In a contract of guarantee, more than one person can also give the guarantee. They are known as co-sureties. Any one co-surety can be compelled to make the payment of the entire debt in case of default by principal debtor. There is a principal of equality of burden. The co-sureties are to pay in equal share unless they agrees to contribute otherwise.

e.g. If A, B and C are the co-sureties to D for an amount of Rs. 6000. If principal debtor makes any default, A, B and C will pay Rs. 2000 each as co-sureties.

1.8.6 Discharge of Surety

Discharge of surety means when the liability of a surety comes to an end. The surety will be discharged under the following circumstances.

1.8.6.1 Revocation

It is possible only in case of a continuing guarantee, a surety is discharged from his liability when he gives the notice to the creditor that he would not be responsible for future transactions. He shall, however, continue to remain liable in respect of transactions already entered in.

1.8.6.2 Revocations by death

In the absence of a contract to the contrary, the death of surety operates as a revocation of the continuing guarantee. The termination becomes effective only for the future transactions, the surety's nominees/heirs can be sued for the liability already incurred.

1.8.6.3 Discharge by variation

If without the consent of a surety, principal debtor and creditor makes any variation regarding the terms of the contract, the surety is discharged from the liability for the transactions made after the variation.

Case - Bonar v. Mc Donald

The defendant gave the guarantee of the conduct of a manager of a bank. After some time the bank incresed the salary of the manager with the condition that he will be personally liable for one fourth of the losses on discount allowed by him. The surety was never communicated of this new arrangement. The manager allowed a customer to overdraw and the bank lost some money. It was held that surety can not be sued to make good the loss as the variation in the terms of agreement discharges him of his liability.

But if a surety is responsible for the performance of several and distinct contracts or duties, a change in one those contracts or duties will not affect the surety's liability as to rest. Again if a surety gives his consent for such variations, he will not be discharged. Surety is discharged from the contract even if the alternation

is innocently made for his benefit.

1.8.6.4 Discharge of Principal Debtor

The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequences of which is discharged of the principal debtor. If the creditor makes any contract with the principal debtor by which the latter is discharged of his liability, surety is also discharged. Any release of the principal debtor by which the latter is discharged of his liability, surety is also discharged. Release of the principal debtor is also a release of the surety.

e.g. C gives the guarantee in a contract to build a house by A for B. After sometime B releases A from the performance of the contract. The liability of C as surety shall also come to an end.

The surety is also discharged by an act of omission of the creditor, the legal consequences of which is the discharge of the principal debtor.

e.g. There is a contract for the construction of a building, for which surety has given the guarantee of performance. If the creditor has to supply the building material, any omission on his part will discharge the contractor and as a result the surety will also be discharged.

1.8.6.5 Composition, Extension of time and promise not to sue

Section 135 provides three modes of discharge from liability viz. composition, promise not to sue and promise to give time.

If the creditor makes a composition with the principal debtor Without consulting the surety, he is discharged. Composition includes variation in the original contract.

In general, the creditor has no right to give time to the princial debtor, without the consent of surety. If creditor allows extension in time of payment, it will discharge the surety from his liability.

e.g. The Price of a car was to be paid in instalments, the buyer fell into arrears and the dealer settled that the buyer can pay certain sun immediately and the balance by the end of the month. This new arrangement resulted in discharge of surety.

If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.

1.8.6.6 By impairing surety's remedy

A surety is discharged if the creditor does any act which is inconsistent with the rights of the surety or omits to do any act which is the duty of surety.

e.g. A surety gives the guarantee for integrity or honesty of a cashier with the condition that employer will check the work of the cashier regularly. If employer neglects to do so and the cashier makes any embazzelement, the surety is not liable.

1.8.6.7 By Concealment/Misrepresentation

Where a surety is induced to enter in a contract of guarantee either by concealing the facts from him or by misrepresenting the facts to him, he will be discharged of

his liability. Thus, where the fact that a part of the loan would be applied towards payment of an old debt was concealed from one surety, the surety was held discharged.

1.8.7 Summary

Section 126 of contract Act says that in a contract of guarantee, one party takes some loan from other and a third party promises that in case of any default in payment by the first party, he will make the payment. The person who borrows money is known as principal debtor, the person who gives guarantee is known as surety and the person whom the guarantee is given is called the creditor.

Essential features of a contract of a guarantee include principal debt, consideration, no concealment of fact or misrepresentation etc.

There are four types of guarantee viz, Absolute and Conditional General and Specific, limited and unlimited and continuing guarantee. The extent of surety's liability has also been discussed. Rights of surety include rights against creditors, right of subrogation, right to indemnity, rights against co-sureties. In the end of chapter explains the circumstances, which will discharge the liability of a surety.

1.8.1.8 Key Words

	Words	Meaning
1.	Minor	A person who has not attained the age of 18 years
2.	Implied	Not expressed but implied from conduct of parties
3.	Forbearance	Kindness
4.	Indemnify	To make good the loss
5.	Consent	Permission given to someone to do something
6.	Omission	Something that has not been included
7.	Prudent	Sensible or careful
8.	Concurrent	Agreement to something
9.	Indemnify	To make good the loss
10.	Plaintiff	Who brings the case to the court
11.	Defendant	Against whom the case of filed

1.8.8 Exercise

1. what are the Right of Idemnity ho;der?
2. What is Guarantee? Explain essential features of Guarantee.
3. Write short notes:
    1. How Principa Debtor is discharged.
    2. Explain Revocation.
    3. Write Right of subrogation.

1.8.10 Suggested Readings

1. Principles of Mercantile Law by Avtar Singh
2. Commercial and Labour Laws by Chawla, Garg and Sareen
3. Mercantile Law by N.D. Kapoor.
4. Elements of Business Law by Chawla and Garg

1.8.10 Answer to Self Check Exercises

Ans.1 Y can not recover the amount from X. Because for making a contract valid, the object and consideration should be lawful. In this case the object of the contract is not lawful.

Ans.2 C cannot be sued because a contract with a minor is void and hence not operative, If contract is void, it means debt is not in existence, so surety can be sued.

Ans.3 C cannot be held liable, as it was a conditional guarantee and the conditon of signatures of other 2 persons was not fulfilled.

Ans.4 Yes, C can ask A to make the payment as after making the payment to creditor, C is clothed with all the rights of the creditors.

LESSON NO. 1.9

BAILMENT AND PLEDGE

Learning objectives:

The major objectives of this lesson are to discuss:

- Essentials of a Contract of Bailment
- Classification of Bailment
- Duties of Bailee and Bailor
- Finder of goods
- Right of Finder of Goods
- Obligation of the Finder of Goods

Structure:

1.9.1 Introduction

Contracts of bailment and pledge are dealt within section from 148 to 181 of Indian Contract Act 1872. The Contract Act does not deal with all types of bailments. So there are separate acts for special types of bailments like Carrier Act 1865, The Railways Act 1890, The Carriage

of Goods by Sea Act 1925. The Indian Contract Act deals only with the general principles of bailment.

Meaning

The word 'bailment' is derived from the French word 'bailer' which means 'to deliver'. Section 148 defines it as :

> "The delivery of goods by one person to another for the purpose upon a contract, that they shall, when the purpose is accomplished be returned or otherwise be disposed off according to the direction of the person delivering them."

The person who delivers a television set to B, to be set right (repaired). The person to whom goods are delivered is called the 'bailee'. There are certain examples of bailment:

(a) A delivers a television set to B, for repair. There is a contract of bailment between A and B.

(b) Lucky lends a book to Anil to be returned after examination. There is also a contract between them.

(c) A sold goods to B but B left them in possession of A. The relationship between A and B is that of bailor and bailee.

In certain cases, bailment may also be without entering in a contract. For example, when a person finds goods belonging to another, a relationship of bailor and bailee is automatically created between the finder and the owner; for Example.

In the case of Basavyak D. Patil V/S State of Mysore. B's ornaments were stolen and recovered by the police, disappeared from the police custody. Held the state was liable, the contract of bailment having been implied.

1.9.2 Essentials of a Contract of Bailment

Contract : Bailment is usually created by agreement between the bailer and the bailee except in certain cases, as the bailment is implied by law between the finder of the lost goods and the real owner.

Delivery of Possessions: A bailment must involve the delivery of possession of goods by bailor to bailee. The basic features of possessions are control and intention to exclude others. A mere custody of goods does not create relationship of bailor and bailee.

As the case of KALIPERUMAL V/S VISALAKSMI (1983). A lady employed a goldsmith for melting her old ornaments, the job was not finished and she put that in the box of goldsmith's premises and kept the key of the box with herself. One night jewellery was stolen from the shop. Held there was no bailment as the goldsmith had redelievered

the jewellery to the lady or bailor. Delivery of goods may be actual or constructive. Actual delivery is made by physically handing over the goods to the bailee. Constructive delivery is transferring possession to the bailee without physically handing over the goods.

For some purpose: The delivery of goods from bailor to bailee must have some purpose. Goods delivered by mistake does not create bailment.

Return of Specific goods: Bailor and bailee agree that when the purpose is achieved the goods shall be returned or disposed off according to the directions of the bailor. If the goods are not returned then there is no bailment. It means that the bailment includes, passing of possession passes from bailor to the bailee only and not the ownership.

1.9.3 Classification of Bailment

It may be classified as under :

According to the benefits derived by the parties :

(1) Bailment for exclusive benefits of the bailor : It is the delivery of some valuables to a neighbour for safe custody, without charge.

(2) Bailment for exclusive benefits of the bailee : It is the lending of a thing to a friend for his use, without charge.

(3) Bailment for the mutual benefits of the parties : It is hiring of something or giving something for repair. In such case, consideration passes between the bailor and bailee.

It may also be classified as :

Gratuitous and non-gratuitous bailment : When the bailee keeps the goods without reward for the bailor, it is gratutious bailment. When some consideration passes between parties, it is non-gratutious bailment for reward.

1.9.4 Duties of Bailee and Bailor

1.9.4.1 Duties of Bailee

Duty to take reasonable care of the goods : According to Section 151, the bailee is bound to take as much care of goods bailed to him, as a man of ordinary prudence in similar circumstances can take. The bailee is not liable or such type of loss or damage of goods which occured inspite of his reasonable care. It is clear in Section 152 also.

As in the Case of Clarke V/s Earnshaw, Some goods were bailed between B and C. C forgot to lock the goods bailed while locking up his own similar goods. Held he was laible.

As the case of Jain & Son V/s Cameror, It was decided that the liability of a hotel keeper or innkeeper in respect of goods of guests is that of bailee of goods.

Duty not to make unauthorised use : The bailee should not use the goods bailed in a manner which is inconsistent with the terms of the contract, otherwise he will be liable inspite of his full care. For example, if I hire a horse in Mansa to march to Bathinda. I ride with full care, but marches to Patiala. The horse accidentlly falls and gets injuries. I am liable to compensate the owner of the horse.

Duty not to mix bailor's goods with his own goods : The bailee should not mix the bailor's goods with his own goods, without the consent of the bailor. If he mixes the goods without the bailor's consent and if goods can not be separated or divided, the bailee is bound to bear the expenses of separation or division as well as loss arising from the mixture. It is clear in Sec. 156.

With the bailor's consent : in this case both shall have a proportionate interest in the mixture thus produced. It has been made clear in Sec. 155.

Without the bailor's consent : The bailee must keep goods on behalf of the bailor. He cannot deny the right of bailor to bail goods and receive them back. If bailee delivers the goods bailed to a person other than the bailor, he may prove that such person had a better right to have them as against the bailor.

To return any accretion to the goods : According to Section 163, in the absence of any contract the bailee is bound to deliver to the bailor or according to this direction, any profit or increase which have accrued from the goods bailed. For example :

S leaves his cow in the custody of T to take care of . This cow then has a calf. T is bound to deliver the calf as well as the Cow.

To return the goods : Bailee should return or deliver the goods according to the bailor's directions as the fixed time comes, or as and when the specific purpose has been achieved. If he fails to do so, he is responsible for any type of loss to goods from that time.

1.9.4.2 Duties of Bailor

To disclose known faults : It is the first duty of the bailor to disclose the known faults of the goods bailed. If he does not do so, he is responsible for any type of loss of bailee accrued due to these faults. In the case, where goods are bailed on hire, the bailor is responsible even for those faults which are not known to him. In gratutious bailment the bailor is responsible only for the faults which are known to him and not disclosed by him.

To bear the extraordinary expenses of bailment : All the ordinary and responsible expenses of bailment are borne by the bailee but for extraordinary expenses, only bailor is responsible. According to Section 157, in gratutous bailment all the necessary expenses of bailment must be repaid to bailee by bailor.

To receive back the goods : Bailor himself should receive his goods back as soon as the purpose has been achieved or the time has expired. If bailor refuses to do so, he will be liable for the expenses of custody of goods made by bailee.

To indemnify the bailees : If any loss occurs to the bailee due to the defective title of the bailor regarding the goods bailed, then the bailor is bound to indemnify the bailee for that particular loss.

1.9.5 Finder of goods

According to Section 71, "A person who finds goods, which belong to some other person and takes them into his custody, is subject to the same responsibility as a bailee." There are also some rights of the finder of goods.

1.9.5.1 Right of Finder of Goods

Right of Lien : It is the right of the finder to have lien over the goods for expenses. He can retain the goods until the compensation of expenses relating to goods and to find the true owner. But according to Section 168, he has no right to sue the owner for any such compensation.

Right to sue the reward : If the owner has offered some rewards for the return of goods, then finder can claim it. Section 168 says that he can retain the goods until he receives the rewards.

Right of Sale :

A finder of goods may sell the goods in certain cases as :

(i) If the true owner of the goods cannot be found reasonably.
(ii) If the owner refuses to pay the legal charges relating to goods.
(iii) If the goods are perishable.
(iv) If the charges of the finder are equal to the two thirds of the value of the goods (Section 169).

1.9.5.2 Obligation of the Finder of Goods

(1) He must take reasonable care of the goods.
(2) He must not use the goods for his own use.
(3) He should not mix the goods with his own goods.
(4) He should try to find the true owner of the goods.

1.9.6 Termination of Bailment

The bailment can be terminated as follows :

(1) On the expiry of the Period : If the contract of bailment contract is entered in for specific period, then it can be terminated on expiry of that very period.

(2) On the achievement of the Object : If the bailment is for specific purpose, it is terminated on the fulfilment of that object.

(3) If the bailee does something inconsistent to the contract of bailment, bailment is terminated.

(4) If the bailment is gratuitous, it may be terminated by bailor, even before the specific time or before accomplishing the purpose.

(5) Due to the death of the bailor or bailee, the bailment is considered to be terminated.

1.9.7 Pledge

Pledge is a specific kind of bailment. It is a bailment of goods where security is created for the payment of a debt or for the fulfilment of a specific purpose. For example, A lends Rs. 350 to B and takes B's watch as a security of the prepayment of the debt.

1.9.8 Requisites of Pledge

Section 172 defines some essentials of a Pledge. These are :

(1) Delivery of Goods : Delivery of goods is most important in pledge. It may be actual or constructive for pawnee.

(2) The delivery of goods should be by way of security : Contract of pledge must be supported by a valid consideration. The pawner must give something to pawnee as security of the loan.

(3) The Security being for the payment of a debt or the performance of a Promise: In a pledge, debt and obligations are secured by delivery of some security. Debt may be present, past or future. Pawnee does not achieve the right of ownership on goods pledged. If we compare pledge and bailment, in pledge, bailment is made as a security for the due discharge of legal obligation which is not required in an ordinary bailment. If we compare pledge and mortgage, In mortage, property/goods are passed but possession remains with the mortgagor, Delivery of possession is must in a pledge. As for as a comparison of lien and pledge is concerned, Lien is a right of the creditor to retrieve the property of a debtor. Pledge gives a special property in the things pledged.

1.9.9 Rights of the Pawnee

Right of Retainer : According to Section 173, the pawnee can retain the goods pledged not only until his dues are paid but for interest and expenses incurred in respect of the possession or for the preservation of the goods pledged also.

Right of Retainer for subsequent advances: Section 174 says that if pawnee tends money to the same pawnee after the date of pledge, then it is considered that the right of the retainer over pledged goods also extends to subsequent advances. This presumption can be rebutted only by a contract to contrary.

Right to extraordinary expenses : It is clear in Section 175 that pawnee can claim from pawnor the extraordinary expenses incurred by the pawnee for the preservation of the pledged goods, fro such expenses, he cannot retain the goods he can only sue to recover them.

Rights against true owner, when the Pawnor's title is defective : When the Pawnor has achieved the possession of pledged goods by a voidable contract as fraud, coercion etc., but the contract has been resigned to the time of the pledge. The pawnee achieved goods title to the goods, provided he acts in goodfaith.

Pawnee's right where pawnor makes defaults: When the Pawnor fails to redeem his pledge, the pawnee can use these rights:

(i) He may file a suit against pawnor upon the debt or promise and may retain the goods pledged as collateral security.

(ii) He may sell the goods after giving a reasonable notice to the pawnor.

(iii) He can recover any deficiency arising as the sales of the goods of by him from pawnor. He shall also have to cover the surplus from the sale of goods.

1.9.10 Right of the Pawnor

(1) Right to redeem debt : According to Section 177, if the pawnor has not made the payment of the debt or has not fulfilled the promise upto the date of pledge, he can redeem his goods before their actual sale by giving additional amont of exspenses occured by default to payment.

(2) Preservation & maintenance of the goods : Pawnee has to preserve the pledged goods properly which is consideration the right of the pawnor.

1.9.11 Self Check exercise

1. Explain delivery by possession.
2. How bailment is classified.
3. Explain Right of Lien.

1.9.12 Summary

Bailment is usually created by agreement between the bailer and the bailee except in certain cases, as the bailment is implied by law between the finder of the lost goods and the real owner.A bailment must involve the delivery of possession of goods by bailor to bailee. The basic features of possessions are control and intention to exclude others. A mere custody of goods does not create relationship of bailor and bailee. Contracts of bailment and pledge are dealt within section from 148 to 181 of Indian Contract Act 1872. The Contract Act

does not deal with all types of bailments. So there are separate acts for special types of bailments like Carrier Act 1865, The Railways Act 1890, The Carriage of Goods by Sea Act 1925. The Indian Contract Act deals only with the general principles of bailment.Bailor and bailee agree that when the purpose is achieved the goods shall be returned or disposed off according to the directions of the bailor. If the goods are not returned then there is no bailment. It means that the bailment includes, passing of possession passes from bailor to the bailee only and not the ownership.

1.9.13 Key Words

Pledge

Pledge is a specific kind of bailment. It is a bailment of goods where security is created for the payment of a debt or for the fulfilment of a specific purpose. For example, A lends Rs. 350 to B and takes B's watch as a security of the prepayment of the debt.

Gratuitous and non-gratuitous bailment :

When the bailee keeps the goods without reward for the bailor, it is gratutious bailment. When some consideration passes between parties, it is non-gratutious bailment for reward.

Finder of goods

According to Section 71, A person who finds goods, which belong to some other person and takes them into his custody, is subject to the same responsibility as a bailee.

1.9.14 Self Assessment Questions/Exercise

1. Explain the contract of Bailment.
2. What are the different rights of finder of the goods?
3. What are the Requisites of Pledge?
4. Write short notes:
    1. What are the power of Pawnor.
    2. Explain Pledge.
    3. Explain duty of Bailee regarding regarding return of good.

1.9.15 Further Readings

1.	Business Regulatory Framework	:	Garg K.C.,Chawla R.C.
2.	Mercantile Law	:	Kappor G.K.
3.	Mercantile Law	:	Kappor N.D.
4.	Principles of Mercantile Law	:	Singh Avtar
5.	Business Laws	:	V.K. Sharma

LESSON NO. 1.10

AGENCY

Learning objectives:

The major objectives of this lesson are to discuss:

- Creation of agency
- Relationship of Principal and Agent
- Right of an Agent
- Relation of Principal with third party
- Termination of Agency.

Structure:

1.10.1 Introduction

Agency is a relationship that exists between two persons, one who is consenting, should represent him or act on his behalf. The relationship of principal and agent exists by virtue of the express or

implied assent of both principal and agent, except cases of necessity in which the relationship is imposed by operation of law.

1.10.2 Creation of agency:

The relationship of principal and agent may be created in any one of the following ways:

1.10.2.1 By express appointment :

Any person who has capacity to contract may appoint any person as his agent and may authorize him to contract for him, the appointment may be expressed in writing or it may be oral.

1.10.2.2 By Ratification :

The principal may ratify a contract entered into by the agent on his behalf without his authority. Where an agent enters into a contract without the authority of his principal, the principal may subsequently ratify this, and thus he is responsible for benefit and liabilities of the contract made on his behalf. The principal has an option to adopt the act by ratification or he may disown it. Ratification is thus a kind of affirmation of unauthorized acts. Ratification may be expressed or implied.

The rules which govern ratification may be summarized as under:

The Agent must purport to act for the principal :

The agent must profess to act as an agent and on behalf of an identifiable principal. If the agent act in his own name and makes an illusion to agency, his act cannot be ratified by any other person, even if the agent in his secret mind intended to act for another.

The principal must be in existence:

If the intended principal wants to ratify the contract, he must have been in existence and ascertainable at the time contract was made.

The Principal must be competent to contract :

The agent must contract for such things as the principal can and lawfully may, do both at the time of the contracting and at the time of ratification.

The act must be lawful and valid :

A transaction which is valid in itself and not illegal can be ratified. A forgery of signatures being a crime, cannot be ratified. Contracts which are void cannot be ratified. Similarly acts which become injurious to others, by ratification cannot be ratified. It may be made clear by the following illustration. A holds a lease from B, terminable within three months. C, an unauthorized person gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

The principal must ratify the whole of the transaction. He cannot ratify a part of the transaction which is beneficial to him and repudiate the

rest. Ratification of a part of transaction operates as a ratification of the whole transaction.

A ratification to be effective must be made within reasonable time. Where a time has been fixed for performance of the contract, ratification must be made before the expiry of the time fixed otherwise it will be too late.

Ratification establishes the relationship of principal and agent between the person ratifying and the person doing the act. It brings the principal into contractual relationship with the third party.

Ratification relates back to the date on which the agent first contracted. Thus the act is valid from the date on which it was done.

1.10.2.3 By Implied Agreement:

Implied agency arises from the conduct or the situational relationship of the parties. Whenever a person places another in a situation in which the order is understood to represent or to act for him, he becomes an implied agent, this may happen in three ways (a) by estoppel, (b) by a legal presumption in the case of co-habitation (e) by necessity.

1.10.2.4 Estoppel :

Where a person permits or represents another to act on his behalf, so that a reasonable man would infer that relationship of principal and agent that had been created, he will not be permitted to relieve himself of his obligations to a third party by proving that no such relationship in fact existed. Provided that the third party acted in reliance on this assumption, and to his determent, the principal will be estopped from denying his agent's authority.

1.10.2.5 Cohabitation:

Where a married woman is cohabitating with her husband there is a presumption of fact that she has authority to pledge his credit for necessaries in all domestic matters ordinarily entrusted to a wife. The authority of the wife extends to such goods and services as are suitable in kind sufficient in quantity and necessary in fact according to the condition in which they live.

1.10.2.6 Necessity:

In certain circumstances the law confers an authority on the person to act as an agent for another without requiring the consent of the people. Such an agency is called agency of necessity. However, the term agency of necessity is often applied to case where, after the parties have created the relation, the law, in view of some unforeseen emergency allows the agent to exceed the authority which has been conferred upon him. Thus a carrier of good or a master of a ship, may under certain circumstances, in the interest necessary and will be

considered to have his authority to do so. In order that this agency of necessity should arise, it must be shown :

(i) That the course taken was the only practicable one in the circumstances.

(ii) that he had no opportunity and time available for communicating to his principal

(iii) that he acted honestly and in the interest of the principal.

1.10.2.7 By operation of Law:

Sometimes an agency arises by operation of law. When a company is formed, its promoters are its agents by operation of law. A partner is the agent of partnership firm the purpose of business of the firm, and the act of a partner, which is done to carry on, in usual way, business of the kind carried on by the firm, binds the firm.

1.10.3 Relationship of Principal and Agent:

Mutual rights and duties of principal and agent may be expressly provided in the agreement. But the following duties of general nature are imposed by law upon every agent unless they are modified by special contract.

1. Duty to execute mandate of principal
2. Duty of following instructions or customs
3. Duty to use reasonable care and skills :

An agent is always bound to act with reasonable diligence, and to use skill as the processes; and to make compensation to his principal in respect of the direct consequences of his own, neglect, want of skill or misconduct but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

4. Duty to avoid conflict of interest : An agent occupies fiduciary position and, therefore it is his duty to do anything which would bring his personal interest and his duty to the principal in conduct with each other. This confict arises when the agent is personally interested in the principal's transaction for example, where he buys himself the property he is appointed to sell.

5 Duty not to make secret profit : Secret profit means any advantage obtained by the agent and above his agreed remuneration and which he would he would not have been able to make but for his position as agent.

6. Duty to emit Sums: The agent is bound to pay to his principal all sums received on his account.

7. Duty not to delegate: The principal chooses a particular agent because he has trust and confidence in his integrity and competence. Ordinarily,

therefore, the agent cannot further delegate the work which has been delegated to him by his principal. But in the following circumstances agent may delegate the work which had been delegated to him by his principal. But in the following circumstances agent may delegate the work to another :

(a) Nature of work : Sometimes the varied nature of work makes it necessary for the agent to appoint a sub-agent for proper execution of the work.

(b) Principal's Consent : The principal may expressly allow his agent to appoint a sub-agent.

1.10.4 Right of an Agent :

The following are some of the important rights of an agent :

Right to remuneration: Every agent is entitled to his agreed remuneration. If there is no agreement, he is entitled to a reasonable remuneration. The payment of remuneration to agent, as a rule, becomes due at the completion of the act.

Right of retainer : The agent has the right to retain his principal's money until the claims, if any, in respect of his remuneration or advances made or expresses incurred in conducting the business or agency, are paid.

Right of lien : The agent has the right to retain goods and papers and money of the principal till the amount due to him is paid.

The right of indemnity : The principal is bound to indemnify his agent for the consequences of all lawful acts done by such agent on exercise of the authority conferred upon him.

Right of Compensation : The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

1.10.5 Relation of Principal with third Parties :

The act of the agent within the scope of his authority can bind the principal Contracts entered into through an agent, and obligation arising from an act done by an agent, may be enforced in the same manner and will have the same legal consequences as if the contract had been entered into and the acts done by the principal in person.

It is necessary for this effect to follow that the agent must have done the act within the scope of his authority. The authority of an agent means his capacity to bind principal by the acts done by him. It refers to “the sum total of the acts it has been agreed between principal and agent that the agent should do on behalf of the principal. When the agent does any of the such acts. It is said he had acted within his apparent authority.”

Actual Authority:

Actual authority of an agent is the authority conferred on him by the principal. It is of two kinds, namely expressed or implied.

Where the authority is conferred by words spoken or written, it is called expressed authority.

An authority is said to be implied when it is inferred from the circumstances of the case gathered from the conduct of the parties.

Extent of Authority :

An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. An agent having an authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such duty.

Ostensible Authority :

The apparent or ostensible authority of an agent is, as it appears to others. It often coincides with actual authority but sometimes it exceeds actual authority. A representation of authority has to estimate from the conduct of the principal. Thus, where principal once authorizes his servant to purchase iron on credit and paid for it, he will be liable when on a subsequent occasion he sends the servant with ready cash, but the servant again incur credit.

Liability for Agent's Wrongful acts

Mis-representation made or fraud committed by agent acting in the course of their business for the principals have the same effect on agreements made by such agents as if such mis-representation or frauds had been or committed by the principals, but mis-representation made, or frauds committed, the agents, in matters which do not fall within their authority, do not affect their principals.

Personal liability of agent :

In the absence of any contract to the contrary, an agent cannot personally enforce contracts entered into by him, on behalf of his principal nor he is personally bound by them. But there are certain circumstances in which the agent incures personal liability. The section then goes on to provide that such contract is presumed in the following cases :

Foreign Principal :

When the agent contracts for a merchant abroad.

Principal un-named

Where an agent contracts for un-named principal or undisclosed principal.

Non-existent or incompetent principal :

When an agent contracts for non-existent principal or incompetent principal

1.10.6 Termination of Agency :

The relationship of principal and agent may be terminated in any of the following ways:

By revocations: The principal may revoke his agent's authority and he puts an end to the agency.

Renunciation by agent: An agent may renounce the business of agency and it puts an end to agency.

Completion of business: An agency is automatically and by operation of law terminated when its business is completed.

Death or insanity: An agency is terminated automatically on the death or insanity of the principal or agent.

Principal's insolvency: An agency ends on the principal being adjudged insolvent.

On expiry of time: Where an agent has been appointed for a fixed term, the expiration of the terms puts an ends to the agency.

self check exercise

1. Explain Ratification
2. What is Estoppel.

1.10.7 Summary

The lesson discusses the law of agency. Any person who has capacity to contract may appoint any person as his agent and may authorize him to contract for him, the appointment may be expressed in writing or it may be oral. Agency is a relationship that exists between two persons, one who is consenting, should represent him or act on his behalf. The relationship of principal and agent exists by virtue of the express or implied assent of both principal and agent, except cases of necessity in which the relationship is imposed by operation of law. The principal may ratify a contract entered into by the agent on his behalf without his authority. Where an agent enters into a contract without the authority of his principal, the principal may subsequently ratify this, and thus he is responsible for benefit and liabilities of the contract made on his behalf. The principal has an option to adopt the act by ratification or he may disown it. Ratification is thus a kind of affirmation of unauthorized acts. The agent must profess to act as an agent and on behalf of an identifiable principal. If the agent act in his own name and makes an illusion to agency, his act cannot be ratified by any other person, even if the agent in his secret mind intended to act for another. A transaction which is valid in itself and not illegal can be ratified. A forgery of signatures being a crime cannot be ratified. Contracts which are void cannot be ratified. Similarly acts which become injurious to others, by ratification cannot be ratified. The principal must ratify the whole of the transaction. He cannot ratify a part of the transaction which is beneficial to him and repudiate the rest. Ratification of a part of transaction operates as a ratification of the whole transaction. A ratification to be effective must be made within reasonable time.

Where a time has been fixed for performance of the contract, ratification must be made before the expiry of the time fixed otherwise it will be too late. Ratification establishes the relationship of principal and agent between the person ratifying and the person doing the act. It brings the principal into contractual relationship with the third party. Ratification relates back to the date on which the agent first contracted. Thus the act is valid from the date on which it was done.

1.10.8 Key Words

Agency

Agency is a relationship that exists between two persons, one who is consenting, should represent him or act on his behalf. The relationship of principal and agent exists by virtue of the express or implied assent of both principal and agent, except cases of necessity in which the relationship is imposed by operation of law.

Estoppel

Where a person permits or represents another to act on his behalf, so that a reasonable man would infer that relationship of principal and agent that had been created, he will not be permitted to relieve himself of his obligations to a third party by proving that no such relationship in fact existed.

Agency of Necessity

In certain circumstances the law confers an authority on the person to act as an agent for another without requiring the consent of the people. Such an agency is called agency of necessity.

1.10.9 Self Assessment Questions/Exercise

1. What is the object and nature of law of agency? Elaborate.
2. Discuss the Relationship of Principal and Agent.
3. Discuss the modes of Termination of Agency.
4. Write short note:
   1. Explain Termination of Agency .
   2. Explain relationship between Principal and Agent.
   3. What is agency by necessity.

1.10.10 Further Readings

1.	Business Regulatory Framework	:	Garg K.C.,Chawla R.C.
2.	Mercantile Law	:	Kappor G.K.
3.	Mercantile Law	:	Kappor N.D.
4.	Principles of Mercantile Law	:	Singh Avtar
5.	Business Laws	:	V.K. Sharma

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