Department of Distance and Continuing Education

University of Delhi

दूरस्थ एवं सतत् शिक्षा विभाग

दिल्ली विश्वविद्यालय

B.Com. (Programme) / B.Com. (Hons.)

Semester-I

Course Credit - 4

DSC-2

BUSINESS LAWS

(Department of Commerce)

As per the UGCF - 2022 and National Education Policy 2020

ISBN : 978-93-95774-43-7

Ist edition: 2022

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Published by:

Department of Distance and Continuing Education under
the aegis of Campus of Open Learning/School of Open Learning,
University of Delhi, Delhi-110 007

Printed by:
School of Open Learning, University of Delhi

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UNIT 1

LESSON 1

INDIAN CONTRACT ACT, 1972

STRUCTURE

1.1 LEARNING OBJECTIVES

- To help the students to understand the basic rules of agreements and contracts.
- To help the students to understand basic rules of Offer, Acceptance, Consideration, Capacity/Competency to contract & rules governing Consideration in The Indian Contract Act, 1872.
- To let students, know about void agreements and how they are different from void contracts.
- To create an ability to apply basic concepts and rules relating to the field of business law in the students.

1.2 INTRODUCTION

The Indian Contract Act came into force on 1st September 1972. It was enacted mainly with a view to ensure reasonable fulfilment of expectations created by the promise of the parties and also enforcement of obligations prescribed by an agreement between the parties. The object of the Act is also to determine the circumstances in which promises made by the parties to a contract should be legally binding.

The Acts is neither retrospective nor exhaustive. It deals mostly with the general principles embodying contracts. The Act does not cover the whole field of contract law. Besides the Contract Act, there are various other laws regulating different types of agreements, e.g., the Transfer of Property Act deals with agreements relating to transfer of immovable property; the Sale of Goods Act deals with contracts of sale of goods; the partnership Act deals with partnership agreements, the Information Technology Act deals with contracts made through electronic medium, etc. The present Contract Act also does not affect particular customs and usages of trade, which are not inconsistent with any of the provisions of law, for example, usages relating to Hundies as negotiable instruments. The Law of Contract is different from other branches of law in as much as that the contracting parties are at liberty to make rules and regulations about the enforcement of their rights and fulfilment of their duties.

1.3 APPLICATION OF THE ENGLISH LAW

In case, a particular matter is not covered by any section of the Contact Act or by any other law in force in India, the courts may follow the principles of English Common Law, provided they are not inconsistent with Indian conditions and circumstances.

Indian Contract Act applies only to those agreements which are valid and enforceable by law. Further, the law of Contract is not the whole law of agreements nor is it the whole law of obligations. An agreement which does not give rise to any legal obligations e.g., marriage, conveyance of gifts, etc., which are not enforceable by law as contracts. Obligation to maintain one's wife and children does not arise out of contract. Agreements which result in the transfer or the destruction of rights are not covered by the, Contract Act.

1.4 MEANING AND NATURE OF CONTRACT

A contract has been defined as follows: Salmond defines a contract as "an agreement creating and defining obligations between the parties".

Agreement = Offer +Acceptance

Sir William Anson observes, "A contract is an agreement enforceable at law made between two or more persons, by which rights are acquired by one or more to acts or forbearances on the part of other or others".

According to Sir Fedrick Pollack, "Every agreement and promise enforceable at law is a contract". Sec 2(h) of the Indian Contract Act defines a contract as "An agreement enforceable at law".

Contract = Agreement +Legal Enforceability

These definitions resolve themselves into two distinct parts: First, there must be an agreement. Secondly, such an agreement must be enforceable by law and an agreement to be enforceable by law and an agreement to be enforceable must be coupled with obligation.

1.4.1 Contract requires:

i) **Two Parties:** There must be two parties to constitute a contract. A contract can only be bilateral and the same party cannot be a party from both the

sides. Hence, there cannot be a contract between A on one side and A on the other. Nor can a partner be a servant of his own firm as a man cannot be his own employer. A person cannot enter into a contract with himself.

The person who makes the promise is known as the "promisor" and the person to whom the promise is made is known as the "promisee". As a matter of fact, in a contract each party is a promisor as well as promisee. For example, when a promises to sell his car for a sum of Rs. 20,000 to B, A is a promisor because he has promised to sell his car while he is also a promisee because there is a promise from B to pay a sum of Rs. 20,000 to him. The same is the position of B.

ii) **An agreement:** A proposal from the side of one party to do or abstain from doing a particular act and its acceptance by the other party are the two essential elements of an agreement. An agreement occurs when two minds meet for a common purpose; they mean the same thing in the same sense at the same time. The meeting of the mind is called consensus ad idem, i.e., consent to the matter.

For example, if A says to B that he is willing to sell his car for Rs. 20,000 and B gives his assent to this offer, the agreement will come into being.

An agreement means every promise and every set of promises, which forms consideration for each other. And as per Sec. 2(b), a promise means "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise". It simply means that an agreement is an accepted proposal. Therefore, to form an agreement, there must be a proposal or offer by one party and its acceptance by the other.

iii) **An Obligation**: An obligation is the legal duty to do or abstain from doing something. An agreement to a contract should give rise to some legal obligation i.e., which is enforceable at law. Agreements which give rise only to social or domestic obligations cannot be termed as contracts. Thus, an agreement to go to a picture or attend a dinner is not a contract as it was not intended to give rise to any legal obligation. Similarly, an agreement to agree in future is not a contract because unless all important terms of the contract are settled, there cannot be any binding obligation. Such agreements are void for want of

certainty. For example, if A agrees to sell I00 bales of cotton to B at a price to be settled in future.

All Agreement are not Contracts

Agreement is a much wider concept than a contract. Agreements in which the intention to create legal obligation is absent are not contracts. Therefore, agreements relating social matters are not contracts. For example, an agreement between two persons together for a walk, or a cinema show does not create any legal obligation on their part to abide by it.

Also, agreements which the parties declare not to be binding do not constitute a contract. They may be just "honored pledges" and expressly stated to "outside the jurisdiction of any court". *(Rose Frank Co. v. Cromption Brs. (1925).*

All Obligations also do not constitute contracts

Any obligation, which arises independently of an agreement, cannot be the basis of a valid contract, A domestic arrangement with no intention to create legally binding relations will not constitute a contract, such as a promise by a father to pay pocket money to his son. In the words of Lord Atkin, "The most usual form of agreements, which do not constitute a contract, are the agreements made between husband and wife". They are not contracts because the parties do not intend that they should be attended by legal consequences.

Leading Case- *Balfour v, Balfour (1919)*

Mr. Balfour left his wife in England on medical grounds and left for Ceylon, the place of his appointment. He had promised to pay £30 P.M. to his wife until she returns. Subsequently, he stopped sending money to her and decided to live apart. The wife sued the husband for the recovery of the amount promised for, on the ground that her consent to the agreement was enough to constitute valid consideration for the contract. The court did not agree with the views of the wife and dismissed her claim. It was held that it was only a domestic arrangement and not a legal contract because domestic arrangements are outside the realm of contract altogether.

However, parties standing in domestic or social relationship may enter into an enforceable contract if they intend their agreements to have legal consequences. *Merrit V Merrit (1970).*

Therefore, to sum up, a contract results from a combination of agreement and obligation between the parties to the agreements. An agreement may exist without any legal obligation, but a contract cannot. Agreements giving rise to social obligations will not constitute binding

contracts. Obligations arising from a trust or a decree or from statutes do not fall within the scope of the Contract Act. Thus, an agreement is the genus of which contract is the species, and therefore, all contracts are agreements, but all agreements are not contracts. Hence, "the law of contract is not the whole law of agreements nor is the whole law of obligations. It is law of those agreements which create obligations, and those obligations which have their sources in agreements." -*Sir John Salmond.*

1.4.2 Essential Elements of a valid Contract- Defined

An agreement to be enforceable at law must satisfy the essentials of a valid contract, According to Section 10 of the Act. "All agreements are contracts, if they are made by the free consent of parties, competent to contract, for a lawful consideration and with a lawful object, and not hereby expressly declared to be void."

Thus, the following are the essential elements of a valid contract:

(i) Agreement, i.e., Proposal and Acceptance.

(ii) Intention to Create Legal Relationship.

(iii) Free Consent

(iv) Competent Parties

(v) Lawful Consideration

(vi) Legal Object

(vii) Not Expressly Declared Void by Law

(viii) Possibility of Performance

(ix) Compliance with Legal Formalities

a) ***Agreement:*** An offer or proposal by one party and an acceptance of that offer by another party is called an agreement. An agreement has been defined by the Act as "every promise or every set of promises forming considerations for each other." The acceptance of the offer must be according to the mode prescribed and must be communicated to the proposer. Further, the intention of the agreement must be to create legal relationship between the parties. Agreement must be capable of performance with term which are clear and certain. It should not be suffering from either a fundamental mistake or impossibility of performance.

b) **Intention to create legal relationship** when an agreement is made between the parties, their intention should be to create legal relationship. Absence of such an intention creates no contract between the parties. Social or domestic agreements do not involve creation of legal relationship so, they are not contracts.

Example: A husband made a promise to pay his wife £ 30 every month as domestic expense. Sometime later, husband and wife separated and the husband stopped paying monthly expense. Subsequently, wife filed a suit for the allowance for expenses. It was held that it was a domestic agreement and this was outside the contract. This was decided in the case of *Balfour V Balfour*.

c) ***Free consent****:* Two or more persons are said to have consented when they agree upon the same thing in the same sense. Thus, if two persons enter into apparent contract concerning a particular person or thing and it turns out that each of them was misled by a similarity of name and actually each had a different person or thing in mind, no contract would exist between them. For example, A has two cars, one blue and the other red. He wants to sell his blue car, B, who knows of only A's red car, offers to purchase A's car for Rs. 20,000. A accepts the offer thinking that it is for his blue car. There is no consent because both the parties are not understanding the same thing in the same sense. Besides, to make a contract valid not only consent is necessary but the consent must also be free. According to Sec. 14, consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake. A clear distinction must be made between 'no consent' and 'no free consent'. In the case of 'no consent' there is no identity of mind and therefore, in the absence of consent the agreement is void abinitio--from the very beginning. In the latter case of 'no free consent' consent is there but it not free, the agreement is voidable at the option of the party whose consent is not free.

A thief who deprives a person of his goods without his consent cannot claim any title whatsoever in the goods. But a dacoit who goods obtains from the other person by obtaining his consent at the point of pistol (coercion) can retain the goods until the real owner claims them back. The possession of the thief is void for want of consent but the possession of the dacoit is voidable at the option of the real owner, i.e., valid unless challenged by the real owner because it has been obtained with the consent of the real owner though the consent had not been free.

d) ***Competent Parties:*** At least two parties are essential for every valid contract. A person cannot enter into a contract with oneself except in a different capacity, e.g., a partner

may purchase goods from his own firm. In order that an agreement may be a binding contract, the parties must have the legal capacity of entering into the contract. According to Sec. 11 of the Act "Every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject". Thus, a contract entered into by a minor or by a lunatic is void, In India, a person who has not completed his 18th year of age is considered to be a minor. However, a lunatic can enter into binding contracts during his lucid intervals. The legal presumption is that every party to a contract has the capacity to contract unless contrary is proved and the presumption is rebutted.

e) ***Lawful Consideration****:* Consideration is an essential element of valid contract. An agreement without consideration is a bare promise and is not binding on the parties. Contracts result only when a promise is made for something in return. This something in return is termed as consideration. "Consideration is the price paid by the promisee for the obligation of the promisor. Consideration need not be a benefit to the promisor. If the promisee has suffered some loss of detriment, it will be taken as sufficient consideration for the promisor to fulfil his promise.

Example: A agrees to sell his car to B for a sum of Rs. 10,000. For A's promise, the consideration is a sum of Rs. 10,000 while for B's promise' consideration is the car. Consideration is also the necessary evidence required by law about the intention of the parties to establish legal relationship. Consideration must be real, and not illusory or illegal. Consideration may be past, present or future. It may move from the promise or any other person but it should always be furnished at the desire of the promisor. Consideration must be valid in the eyes of law, i.e., it must result in some gain to one party and detriment to the other.

f) ***Legal object:*** The agreement must not relate to a thing which is contrary to the provisions of any law or has expressly been forbidden by any law or which is opposed to policy or is immoral. All agreements which are not lawful cannot be enforced by law. This is because courts will not allow polluted hands to touch the pure fountains of justice. No agreement can be allowed to defeat the provisions of any law or to cause injury to the person or property of any person or to achieve fraudulent objects.

Example: A agrees to sell certain goods to B. A knows that the goods are to be smuggled out of the country. The contract is unlawful and not enforceable.

g) ***Not expressly declared void:*** The agreement must have not been expressly declared void by any law in force in the country. In India agreements in restraint of trade, in restraint of marriage, or to do things which are impossible or are in the nature of marriage agreements, etc., are expressly declared void by the Indian Contract Act.

Example: A and Bare competitions in a business. B agreed to pay A a sum of money if he would close his business. A did so but B refused to pay him the money. Here, the agreement was void because it was in the nature of restraint of trade and therefore, money could not be recovered.

h) ***Certainty and possibility of performance.*** The agreement entered into by the parties must be certain and not indefinite. If the agreement is vogue or indefinite and the ascertainment of the meaning of the agreement is not possible, such an agreement cannot be enforced.

Example: A agrees to sell to B one thousand meters of cloth. This does not indicate what kind of cloth is intended to be sold. This agreement is void and unenforceable because of uncertainty.

i) ***Compliance with Legal Formalities:*** If any legal formalities of writings, registration, etc., are necessary by law, these must be satisfied. In the absence of these legal formalities, agreements will not be enforceable in courts of law.

Contracts which must be registered

(i) A promise made without consideration on account of natural love and affection between parties standing in near relation to each other.

(ii) Documents of which registration is compulsory under Sec. 17 of the Registration Act, 1908.

(iii) Contracts relating to the transfer of immovable properties under the transfer of Property Act 1882.

(iv) Memorandum and Article of Association, debentures, mortgage and charges under the companies Act, 1956.

IN-TEXT QUESTIONS

1. The Indian Contract Act came into force on _____.
2. One party can enter into a contract with itself. **True / False**
3. Which of the following is not an essential element of a valid Contract:
   a) Agreement b) Lawful consideration
   c) Illegal objective d) Free Consent
4. A contract is an agreement enforceable at law made between two or more persons. **True/ False**

1.4.3 Kinds of Contracts:

1. **On the basis of enforceability:**
   (a) Valid Contracts
   (b) Void Contracts
   (c) Voidable Contracts
   (d) Illegal Contracts
   (e) Unenforceable Contracts
2. **On the basis of mode of creation:**
   (a) Express Contracts.
   (b) Implied Contracts.
3. **On the basis of extent of execution.**
   (a) Executed Contracts
   (b) Executory Contracts.
4. **On the basis of the form of the Contract:**
   (a) Formal Contracts.
   (b) Simple Contracts.

1. Classification on the basis of enforceability:

(a) **Valid Contracts**: Contracts which satisfy at the essentials of a valid contracts. Only valid contracts are enforceable in a court of law.

(b) **Void Contracts**: An agreement may be enforceable at the time when it was entered

into but later on due to certain reasons, for example impossibility or illegality of the contract, it may become void and unenforceable. Such contracts are called void contracts. Technically the words "void contracts" are a contradiction in terms. Such contracts can appropriately be termed as "contracts which have become void" in place of "void contracts".

Example: X, by exercising coercion over Y, makes him agree to sell his house worth Rs. 50,000 for a mere sum of Rs. 1,000. The agreement is voidable at the option of Y In case Y decides to rescind the contract, it becomes void between X and Y

Void Agreement: A void agreement is one which is deficient in essentials and is therefore, destitute of legal effect. Sec. 2(g) defines it as an "agreement not enforceable by law is said to be void". A void agreement is non-existent in the eyes of law. So, it cannot be enforced and confers no rights on either party. All illegal or immoral agreements are void. An agreement with a minor is void.

Example: A agrees with B to draw two parallel lines in such a way so that they cross each other for consideration of Rs. 500. The agreement is impossible to perform and hence void.

Void Agreement and Void Contract

Thus, void agreement is void from the very beginning i.e., void abinito, while a void contract was a valid at the time when it was made but becomes void later on because of certain reasons.

An agreement void ab initio or which becomes void subsequently will have these effects:-

(i) The agreement shall be unenforceable.

(ii) Money paid or property transferred is recoverable subject of the condition that both the parties were ignorant about the illegal or void nature of the agreement when it was made.

(iii) Collateral transaction shall not become void unless the agreement has also been illegal.

(iv) All lawful promises shall remain valid in case they are severable and can be enforced.

(c) **Voidable Contract***:* As per Sec. 2(i) "An agreement, which is enforceable by law at the option of one or more of the parties thereto, but not at the option of other or others, is a

voidable contract". Agreement induced by coercion, undue influence, fraud or misrepresentation are voidable at the option of the party whose consent has been so obtained. The contract shall remain valid so long as it is not repudiated by the aggrieved party entitled to do so. The aggrieved party is entitled to get damages for any loss suffered by him. Similarly; if he has received some benefit under the contract, he must restore such benefits to the persons from whom it was received.

(d) **Illegal Agreements***:* An agreement is illegal when it is contravention of statutory provision. An illegal agreement is destitute of legal effects ab initio-from the very beginning. All the transactions collateral to illegal agreements become tainted with illegality and are, therefore, not enforceable. For example, if A promises to pay a sum of Rs. 100 to B if he (B)gives a good beating to C.B gives a good beating to C and A, in order to pay B borrows from D a sum of Rs. 100. D knows the purpose of borrowing. The agreement between A and B being illegal, the collateral transaction between A and D will be void, D cannot recover his debt of Rs. 100 from A. Parties to an unlawful agreement cannot get any help from a Court of law, for courts expect a person to come to them with clean hands. Law does not permit a guilty man to take advantages of his guilt.

(e) **Unenforceable contracts***:* Certain contracts become void because they cannot be enforced due to certain technical defects i.e., non-observance of legal formalities of writings, registration, etc. These contracts are valid in the eyes of law but since they are incapable of proof, law courts will not enforce them. Many of the contracts, in the absence of writings, are quite good but cannot be enforced in a court of law until the written evidence is furnished. Some of them can be enforced if the technical defect is removed.

Difference between void agreements and voidable contracts

1. The term "illegal agreement has wider conception than void agreement. All illegal agreements are void but all void agreements are not necessary illegal, e.g., wagering agreements is void but not illegal or an agreement with a minor is void but not illegal. Illegal agreements are prohibited by law. Void agreements are declared non-enforceable in a court of law. If the parties wish to perform, they can perform void agreements.
2. Though the legal effects of both are the same, i.e., void abinitio. But a void agreement does not affect the performance of collateral transaction, but illegality of the original contract will make even the collateral transaction tainted with illegality.

3. For entering into a void agreement, there is no penalty on the parties. But for an illegal agreement the parties may be punished.

2. Classification of contracts on the basis of mode of creation

(a) **Express Contracts**: Contracts entered into between the parties by words spoken or written, are termed as express contracts. In such contracts, parties make oral or written declaration of their intentions and of the terms of the transactions.

(b) **Implied Contracts**: Contracts which come into existence on account of the conduct and acts of the parties are termed as implied contracts. For example, if a person takes a seat in a bus, he has entered into an implied contract that he will pay the specified fare to the bus owner for taking him to his destination.

3. Classification of contracts on the basis of the extent of execution

(a) **Executed Contracts**: When both the parties to the contract have fulfilled their respective obligations, contract is said to be executed.

(b) **Executory contracts**: When one of both the parties to the contract has still to do certain things in future, the contract is termed as an executory contract. For example: A agrees to sell a radio set to B for Rs. 200, B pays the price in advance. The contract is executed as regards B, but executory as regards A, for he is yet to deliver the radio set to B:

On the basis of execution, contracts may also be divided as:

(a) Unilateral contracts

(b) Bilateral contracts

(a) Unilateral contracts: A contracts is said to be unilateral where one party has performed his obligation either before or at the time when the contract comes into existence, whereas the other party is yet to perform his obligation.

Example: A, coolie, puts B's luggage in the carriage. A has performed his obligation. It is now for B to perform his obligation by paying the charges to the coolie.

(b) Bilateral contracts: a contract is bilateral if the obligations of both the parties are outstanding at the time of the formation of the contract. They are executory or bilateral contracts.

Example: A agrees to sell his car to B after a month, B promises to pay the price on the delivery of the car. The contract is bilateral.

It is to be noted that the contract comes into existence on the date on which it is entered into between the parties and not from the time its performance is due.

4. Classification of contracts on the basis of form

(a) **Formal Contracts**: (i) Contracts under seal and (ii) contracts of record have been recognized as formal contracts under English law. Their validity depends upon their form alone. Consideration is not necessary for such contracts. They are required to satisfy certain legal formalities in order to be valid and binding.

(b) **Simple contracts**: All contracts other than formal contracts are known as simple contracts. They will be valid only when they are supported by consideration. The Indian Law does not recognise formal contracts. If recognises only simple contracts which must be supported by consideration except in circumstances specifically laid down in the Act.

1.5 OFFER AND ACCEPTANCE

Offer or Proposal Essential Elements of a Valid Contract discussed in detail

Section 2(a) defines an offer as, "a proposal made by one person to another to do an act or abstain from doing it." The person who makes the offer is known as the promisor or offer or and the person to whom an offer is made is known as the promisee or the offeree.

An offer may require a unilateral act or an act by two or more parties. Thus, if X gifts Y his horse, it is an offer of unilateral acts as Y has to do nothing or pay nothing to X in return of the gifts of X. But in case of offers of bilateral acts or requiring actions by two or more persons, then the offeree is supposed to act or respond in a specified manner. Now suppose X offers to sell his horse for Rs. 1000 to Y then here Y also is expected to pay Rs. 1000 to X. It is only the second type of offers about which we are concerned in the Indian Contract Act. Thus, an offer can be analysed into two parts comprising of: -

(a) a promise by the offeror, and

(b) a request to the offeree for something in return of the offer.

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

1.5.1 Determination of an Offer (Test of an offer)

Every proposal made by an offeror is not legally regarded as an offer. Three tests are applied to determine whether or not an offer has actually been made:

1. Does the offer show a clear intention on the part of the offeror to be bound by it.
2. Whether the proposal is definite?
3. Whether the offer is communicated to the offeror?

Offer must be distinguished from

(i) ***Mere invitation to an offer***. Offer should be distinguished from a mere invitation to an offer. Catalogue of goods, an advertisement inviting tenders or application for a job, a prospectus of a company; an auctioneer's request for bids or display of goods in showcase with prices marked upon them etc., are mere invitations to offers and not actual offers. A statement of the lowest price at which a landowner is prepared to sell has been held not to be an offer thus, when an owner of property says he will not accept less than Rs. 5,000 he does not make an offer, but merely invites offer. Similarly, a term in a partnership deed that any of the parties wishing to sell his share will sell to the others at the market value is not an offer but an undertaking to make an offer. Thus, in such cases the person who responds to an invitation to an offer, makes the actual offer. The party issuing an invitation for the offers has a right to accept or not to accept the offers received. As such in a case where brokers in Bombay wrote to merchants in Delhi stating their terms of business and the merchants afterwards placed orders with the brokers; no contract was made until the orders given by the brokers were accepted by the merchants. A bank's letter with quotation as to particulars of interest on deposits, in answer to an enquiry, is not an offer but only a quotation of business terms.

Example: A shopkeeper displays goods for sale in a shop with price tags attached to each article. This is only an invitation to an offer. The shopkeeper cannot be compelled to sell the goods at the price mentioned.

(ii) ***Mere statement of Intention****:* A declaration by a person that he has the intentions to do something does not amount to an offer. The person making the declaration will not be liable to the person who has suffered some loss because of reliance on the declared intention.

Seller cannot be held liable for any loss caused to a prospective buyer by not adhering to the advertisement for sale of goods by auction at a particular time and place because

the advertisement was a mere statement of intention (Hari V. Naickersor (1873). Similarly, the announcement made on loudspeakers do not result into any binding offers.

Examples: (a) T said in conversation to W that he would give Rs. 1000 to anyone, who married his daughter with his consent. W married T's daughter with his consent. Thereafter, T refused to pay Rs. 1000/- W filed a case against T for the alleged promise. It was held that words used by T were mere statement of intention and do not constitute an offer, therefore, W could not succeed in his claim (Weeks V. Tybald 1605).

(b) A father wrote to his would-be son-in-law that his daughter would have a share in all the assets that he would leave. It was merely a statement of intention and, therefore, neither the daughter nor the son-in-law can hold the promisor liable for anything if he does not leave any assets. (Farina V. Fickus) (1900).

1.5.2 Essentials of a Valid Offer

1. **The offer must disclose an intention to create legal relations:** If the offer does not contemplate to give rise to legal relationship, it is no offer in the eyes of law, e.g., invitation to a dinner which has no intention to create relationship. An offer must impose some legal duty on the party making it.

2. **The terms of offer must be clear and certain and not indefinite, lose or ambiguous:** The terms of the offer must be definite, unambiguous, clear and certain and not lose and vague. The offer must not be based on a condition which is uncertain or incapable of performance. Though the proposer is free to lay down any terms and conditions in his offer, but they should be certain and legal, otherwise its acceptance will amount to a vague agreement which the courts will not enforce. But, where an agreement contains its own machinery for clarifying vague term, the agreement will not be vague in Law. (Foley V Classque Coaches Ltd.) (1934). In some circumstances, the courts might imply a term based upon the presumed, intention to the parties.

   Examples:-(a) A says to B "I will sell you, my car. A owns four different cars. The offers are not valid because it is not definite.

   *(b)*A made a contact with B and promised that if he was satisfied with him as a customer, he would favorably consider his application for the renewal of the contract. The promise is too vague to create any legal relationship.

3. **Offer may be general or specific:** An offer may be made to definite person or persons

or to the world at large. When it is made to some specific person or persons it is called a specific offer. When it is made to the world at large it is called a general offer. A specific offer can be accepted only by the person to whom the offer has been made and, in the manner, if any specified in the terms of the offer.

But a general offer can be accepted by any persons having notice of the offer by doing what is required under the offer. The most obvious example of such an offer is where a reward is publicity offered to any about that object, who will recover a lost object or will give some information, there the party claiming the reward has not to prove anything more than that he has performed the conditions on which the reward was offered. The time table of railways is a general proposal to run trains according to the table, which is accepted by an intending passenger tendering the price of the ticket.

Carlill V Carbolic Smoke Ball Co. (1983). In this case, the Company advertised that a reward of £ 100 would be given to any person who contracted influenza after having used the smokeballs of the Company as directed. Mrs. Carlill used the smoke-balls according to the directions of the company. but contracted influenza. It was held, that the offer was a general one, and Mrs. Carlill had accepted it by acting in accordance with the advertisement, and therefore, the company could not get away from its responsibility by saying that they had not meant it seriously. She was entitled to the reward.

In India, the principle was applied in the case of Har Bhajan Lal Vs. Har Charan Lal. In this case offer of reward was made to any one tracing a lost boy and bringing him home. Harbhajan Lal who knew of the reward. found out the boy and took him to the Police Station. It was held that he was entitled to the reward.

4. **Offer may be express or implied:** An offer made by words, spoken or written is termed as an 'express offer'.

Example: If A says to B that he is willing to sell him his car for a sum of Rs. 10,000 it is an express offer.

'Implied offer' means an offer made by conduct, an offer may also be implied from the conduct of the parties or the circumstances of the case. This is known as an implied offer. When one person allows the other to perform certain acts under such circumstances that nobody would accept them without consideration it will amount to an offer by conduct and the permission of the party, who is benefitted by such performances, will amount to his acceptance.

Example: A bus company runs a bus on a particular route. This is an implied offer by the bus company to take any person on the route who is prepared to pay the prescribed fare. The acceptance of the offer is complete as soon as a passenger gets into the bus.

5. **Offer must be communicated:** The offer, to be valid must be communicated to the offeree. An offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject. An acceptance of the offer, in ignorance of the offer, is no acceptance and, therefore, no valid contract can arise.

6. **Statement of Price:** If a party makes a statement of price, it cannot be taken as an offer to sell at that price. The decision made in case of Harvey and Facey, is important to note in this connection.

   Example: A asks B, "Will you sell us Bumper Ball Pen? Telegraph lowest cash price-answer paid". B replies telegraphically "lowest price for Bumper Ball Pen £ 900".

   A respond by telegram "We agree to buy Bumper Ball Pen for the sum of£ 900 asked by you".

   It was held that no contract was concluded between A and B.

   Leading case: Lalman Shukla V. Gauri Dut (1913):

   In this case, Gauri Dut's nephew has absconded. He sent his munim Lalman Shukla in search of the missing boy. In his absence, Gauri Dut issued hand bills offering a reward of Rs, 501/- to anyone who might find out the boy, Lalman found out the boy before seeing the hand bills. Later on, he came to know of the reward and sued Gauri Dut for the reward. Here he could not claim the reward as he did not know about the offer.

7. **Offer must be made with a view to obtain the consent:** The offer must be made with a view to obtain the consent of the other party and not merely with a view to disclosing the intention of making an offer. A proposer cannot also dictate terms under which the offer can be refused. At best, he can lay down the mode of acceptance.

8. **Offer should not contain a term the non-compliance of which would amount to acceptance:** The offer should not contain a term the non-compliance of which would amount to acceptance for example a person cannot make such an offer that if the acceptance of the offer is not received upto Monday, the offer would be presumed to have been accepted.

9. **Special conditions attached to an offer must also be communicated:** Though an

offeror is free to lay down any terms and conditions in his offer, but it is the responsibility of the offeror to bring all the terms of the offer to the notice of the other party, the acceptor is bound only for those conditions which (i) have expressly communicated to him or (ii) have so clearly been written that he ought to have known them or (iii) have reasonable notice of the existence of those terms. He will also be bound by the conditions if he knew of their existence, though they are in a language unknown to him. It is his duty to get them explained.

Examples: (a)A passenger had purchased a ticket for a journey. On the back of the ticket, there were certain terms and conditions. One of the terms was that the carrying company was not liable for losses of any kind. But there was nothing on the face of the ticket to draw the attention of the passenger to the terms and conditions on the back of ticket. Held, the passenger was not bound by the terms and conditions on the back side of the ticket. (Henderson V. Stevenson) (1875).

(b)T, an illiterate, purchased a railway ticket on the front of which was printed "for conditions seek back". One of the conditions was that the railway company would not be liable for personal injuries to the passenger. An accident caused some injuries to T. Suit for damages brought by T was dismissed as he was bound by the conditions printed on the reverse of the ticket. (Thompson V. L. M. & S. Rly.) (1930).

Now it is the established law that wherever on the face of a ticket words to the effect "for conditions see back" are printed, the passenger concerned is bound by the conditions, it is immaterial whether he actually reads them or not. If conditions are printed on the back of the ticket, but there is nothing on the face of it to draw attention of the person to these conditions, he is not bound by the conditions.

Thus, it is to be noted that a person, who accepted without objection a document containing terms of the offer, which he knows or ought to have known, will be bound by those terms even if he had not read them. However, this rule will not be applicable if the conditions are so irrelevant for unreasonable that an assent to them cannot reasonably be presumed. Similarly, where a condition to an offer is against public policy, it will not be enforced merely because it has been accepted by the acceptor.

Example: A garment of B was lost due to the negligence of laundry owner. On the back of the laundry receipt, it was mentioned that in the event of loss only 15% of the market price or value of the article would be recovered by the customer. In a suit by R, it was held that the term being prima facie opposed to public policy it could not be enforced even though there

was tacit acceptance by the customer of the terms (Lily White V. Munnuswami) 1966.

The acceptor would be bound by the terms and conditions only when all the following conditions are satisfied:

1. The acceptor knows about the writing or printing on the ticket.
2. He also knew the writing or printing on the ticket contained conditions regarding terms of the contract.
3. The conditions must not be against public policy or the fundamental principles of contracts.
4. The offeror had done all that was reasonably sufficient to give the acceptor notice of the conditions. For example, if printing of the ticket is not clearly visible due to the smallness of the type it could not be taken that the carrying company had made sufficient arrangement for the communication of the conditions. (Richardson V. Rowntree) (1894).
5. The notice of the conditions should be given before or at the time of the contract but not afterwards. A subsequent notice about the conditions will not bind the other party.

   Example: A hotel put up a notice in a bed room. "The proprietors will not hold themselves responsible for articles lost or stolen unless handed to the manager for safe custody". Held, the notice was not effective as it came to the knowledge of the customer only after the contract had been made and the customer had already paid the rent.
6. Conditions must not be contained in a voucher or receipt for payment of money because they will not bind the person receiving the voucher or receipt (chapleton V. Barry U.D.C.) 1940.

1.5.3 Tender

A person may invite tenders for the supply of specific goods or services. Thus, a tender, in response to an invitation, is an offer. A tender may be either:

(i) A definite or single offer, or

(ii) A standing or an open offer.

Tender as a definite offer: If a tender has been submitted for goods or services in specified quantities it is termed as a definite offer, A binding contract comes into existence as soon as the tender is accepted.

Example: A invites tenders for the supply of 100 tons of local X, Y and Z submit the tenders.

A accepts Y's tender. There is binding contract between A and Y.

Tender as a standing offer. Standing offer or tender may be of the nature of a continuing offer. Thus, a tender to supply goods as and when required over a certain period amount to a standing offer. Here, the tenderer must supply whenever an order is placed. But he cannot insist on any order being made at all.

Example: (a) A tendered to supply goods upto a certain amount to B over a certain period. B's order did not come upto the amount expected and A sued for breach of contract. Held, each order made was a separate contract and A was bound to execute the orders made. B was under no obligation to make any order at all. *(Percival Ltd. VL.C.C.)* (1918).

(b) A railway company invited tenders for the supply of certain iron articles over a period of 12 months. W's tender was accepted. After supplying for sometime, W refused to execute on order placed during the currency of the tender. Held, W could not refuse within the terms of the tender. *(Great Northern Railway V Witam).*

1.5.4 Cross Offers:

Identical offers made by two parties in ignorance of each other's offer, are termed as cross offers.

They will not constitute acceptance of one's offer by the other. *(Tinn V Hoffinan)* 1873.

Example: A, by a letter offers to sell his car to B for Rs. 10,000 B, by a letter which crosses A's letter in the post, offers to buy it for Rs. 10,000. The offers are cross- offers and no binding contract will arise. Both A and bare ignorant of each other's offer. There can be no automatic acceptance of each other's offer, rather a new acceptance from either of the two parties would be required.

1.5.5 Acceptance

A contract comes into being from the acceptance of an offer. When the person to whom the offer is made signifies his assent thereto, the proposal is said to be accepted (Sec. 2(b). Thus, acceptance of the offer must be absolute and unqualified. It cannot be conditional.

Who can give acceptance?

When an offer is made to particular person or to a group of persons, it can be accepted only by that person or member of the group. If it is accepted by any other persons, there is no valid acceptance.

Example: B sold his business to P without disclosing the fact to his customers. J, who had a

running account with B, placed an order with B for supply of certain goods. The new owner without disclosing the fact of himself having purchased the business, executed the order. J refused to pay P for the goods because he, by entering into contract with B intended to set off his debt against B. Held, the new owner of could not recover the price. "The rule of law is that if you promise to make a contract with A, then B cannot substitute himself for A without your consent and to your disadvantage, securing to himself all the benefits of the contract".

When an offer is made generally to the public at large, any person or persons who have the notice of the offer, may come forward and accept the offer. By doing what is required to be done under the offer, offer is said to be as accepted and there will be valid contract, (Carlill V. Carbolic Smoke Ball Co. 1893).

Essentials of a valid acceptance

1. ***Acceptance must be absolute and unqualified****:* Section 7 of the Contract Act requires that the acceptance must be absolute and unqualified. It must correspond with all the terms of the offer. Conditional acceptance is no acceptance. If there is a variation in the terms of the acceptance, it is not an acceptance, but a counteroffer, which the proposer may or may not accept. A counter-offer destroys the original offer. Thereafter the offeree cannot revert to the original offer and purport to accept it. (Erollope & Colls Ltd. V. Atomic Power Construction Ltd. (1963)

   Example: A offers to sell his house for a sum of Rs. 20,000 B sends his acceptance to purchase it for a sum of Rs. 19,000. There is no acceptance. It will be taken as a new offer from B, which may not be accepted by A.

2. ***Acceptance must be in the mode prescribed:*** A proposal must be accepted according to its terms. If the proposal lays down a mode of acceptance, the acceptance must be according to the mode prescribed. Therefore, if the proposer choses to require that the goods shall be delivered at a particular place, he is not bound to accept delivery at any other place. It is not for the acceptor to say that some other mode of acceptance which is not according to the terms of the proposal will do as well. If the acceptance is not given in the made prescribed, the proposer may reject the acceptance and intimate the offeree within a reasonable time. But if he does not inform the offeree, he is deemed to have accepted the acceptance.

   If the proposer has not prescribed any mode of acceptance, it must be given and communicated in some usual and reasonable manner.

Example: An offer is made to take shares indicating that the acceptance is to come by a telegram. If the acceptance is sent by ordinary post, then it is not an acceptance according to the mode prescribed and the offer will be deemed to be not accepted. The offeror need not inform the offeree that the acceptance is not according to the mode prescribed.

3. ***Acceptance must be communicated to the offeror****:* Acceptance must be communicated to the offeror to create a binding contract. Mental acceptance is no acceptance in the eyes of law. But where the offer is to be accepted by being acted upon, no communication to the offer will be necessary.

   Example: The manager of a railway company received a draft agreement. The manager wrote the word "approved" and put the draft in the drawer of his table. By some oversight the document remained in the drawer and was never communicated. It was held that there was no contract as the acceptance had not been communicated. (Brogden V. Metropolition Rly. Co.) (1877).

4. ***Silence cannot be prescribed as mode of acceptance***: The offer cannot frame his offer in such a way as to make the silence or inaction of the offeree to operate as an acceptance. In other words, the offeror can prescribe the mode of acceptance but not the mode of rejection.

   Leading case: Felthouse V. Bindley (1863). F offered by letter to buy his nephew's horse for £30 adding, "If l hears no more about it, I shall consider the horse as mine for £30. Nephew did not give any reply, but he told an auctioneer who was selling his horses not to sell that particular horse because it was sold to his uncle. By mistake auctioneer sold the horse. Held: F had no claim against the auctioneer because the horse had not been sold to him and the horse did not belong to F. Silence cannot be prescribed as a mode of acceptance because if that was so the offeree will be put to a great deal of inconvenience because he shall have to unnecessary write in clear terms that he is not accepting the offer.

5. ***Acceptance must be given within the time stipulated or within a reasonable time if time is not mentioned.*** Further, acceptance must be given before the offer lapses or before the withdrawn.

6. ***There can be no acceptance before the communication of the offer***. There can be no acceptance of an uncommunicated offer. Acceptance cannot precede an offer. A person who has no knowledge of an offer cannot be said to have accepted it merely because he

happened to act just by chance in the manner prescribed by the offer. (Lalman V. Gauri Dutt).

7. ***Acceptor must in indicate intention to fulfil the promise***. Acceptance, in order to be valid, must be made under circumstances which would show that the acceptor is able and willing to fulfil the promise. Acceptance must show an intention on the part of the acceptor to fulfil the promise. If no such intention is present, the acceptances is not valid.

8. ***If the proposal is made through an agent, it is sufficient if the acceptance is communicated to him****:* If A sends the offer to B by an agent C, and B give his acceptance to C, the acceptance is complete resulting into a valid contract. It is immaterial whether C communications the acceptance of B to his principal A or not.

9. ***Acceptance of the proposal will mean acceptance of all the terms of the offer.*** Acceptance subject to contract, when an offer is accepted by an offeror "subject to contract" or subject to formal contract" or "subject to contract to be approved by solicitors," the matter is known to be at the negotiation stage and the parties do not intend to be bound until a formal contract is made and signed by them.

   Agreement to agree in future. If the parties have failed to agree upon the terms of the contract but have made an agreement to agree in future, there is no contract, example: An actress was engaged by a theatrical company for a certain period. One of the terms of the agreement was that if the party was, shown in London, she would be engaged at a salary to be mutually agreed upon. Held, there was no contract. (Luftus V. Roberts, (1902) 18 T.L.R. 532).

1.5.6 Communication of offer: Acceptance and Revocation

An offer and its acceptance, to be valid must be communicated to the other party.

Communication of offer: (Se.4)

The communication of an offer is complete when it comes to the knowledge of the person to whom it is made. When an offer is made by post, its communication will be complete when the offeree receives the letter.

Example: A proposes, by letter, to sell a house to B at a certain price. The communication of the proposal is complete when B receives the letter.

Communication of Acceptance (Sec.4)

The communication of an acceptance is complete: -

(i) as against the proposer, when it is put in the course of transmission to him, so as to be out of the power of the acceptor to withdraw, and

(ii) as against the acceptor, when it comes to the knowledge of the offeror.

Example: B accepts A's proposal by a letter sent by post. The communication of the acceptance is complete as against A, when the letter is posted; as against B when the letter is received by A.

Communication of Revocation: (Sec.4)

The word 'revocation' means "taking back". Both an offer as well as an acceptance may be revoked. The communication of Revocation is complete:

(i) as against the person who makes it, when it is put into the course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it;

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

Example: Thus, in the above example:

A revoke his proposal by telegram. The revocation is complete as against A, when the telegram is dispatched. It is complete as against B when B received it.

B revokes his acceptance by telegram. B's revocation is complete as against B when the telegram is dispatched, and as against A when is reaches him.

The time during which an offer or acceptance may be revoked is dealt with in Sec.5 as follows:

Revocation of a proposal

According to Sec.5 "proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards".

Example: A proposes, by a letter sent by post, to sell his house to B.

B accepts the proposal by a letter sent by post. A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards.

In an auction sale, a bidder may withdraw his bid at any time before the any time before or at the moment when B posts his letter of acceptance, but not afterwards.

In an auction sale, a bidder may withdraw his bid at any time before the fall of the hammer (acceptance).

Revocation of an Acceptance

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

Example: In the above example, B may revoke his acceptance at any time before or at the moment when the letter communicating it (acceptance) reaches A but not afterwards.

In case, the letter of acceptance and the letter of revocation of acceptance reach simultaneously, which of the two is opened first will decide the issue. When the letter of revocation reaches prior to the letter of acceptance, the acceptance will be treated as revoked.

1.5.7 Modes of Revocation or lapse of offer

Sec.6 deals with various modes of revocation of offer, these cases are as follows:

1. *By communication of the notice of revocation:* An offer may be revoked by the communication of the notice of revocation. It may be revoked only before its acceptance is complete as against the offeror. The acceptance is complete as against the offeror when the letter of acceptance is put in transmission to him. Notice of revocation will take effect only when it comes to the knowledge of the offeree.

2. *By lapse of specified time*: If time is mentioned in the offer for its acceptance, it is revoked by the lapse of time. If no time is mentioned then it lapses on the expiry of reasonable time.

   Example: M applied for shares of a company in June. Allotment was made in November held, the offer had lapsed, because period of five months was not a reasonable time. So, M could not be treated as shareholder of the company.

3. *By the failure of the acceptor to fulfil a condition precedent to the acceptance:* An offer lapses if the offeree fails to fulfil a condition precedent to the acceptance.

   Example: A offers to sell his car to B for a sum of Rs. 10,000 provided B sends an advance of Rs. 500 with his acceptance. B accepts the offer but does not send the advance. The offer may be taken as revoked.

4. *By the death or insanity of the proposer.* The death of the proposer puts an end to the offer, provided the fact of death or instantly comes to the knowledge of the acceptor before acceptance. If the proposer dies after the acceptance of the offer, the legal representatives of the proposer shall be bound by the contract. The acceptance of an offer in ignorance of the death or insanity of the proposer is valid. But according to

English Contract Law, no notice of death is required to the offeree. An offer shall automatically stand revoked in the case of death or insanity of the proposer.

No provision has been made in the Act for a case where the person to whom the proposal is made dies before the acceptance for the obvious reason that the proposal can never be meant to be made to a dead or his executors.

In addition to the above-mentioned cases dealt with in Sec.6 following two more cases should also be added.

5. A counter offer also amounts to a revocation of the original offer
6. If an offer is not accepted according to the mode prescribed it will lapse provided the offeror gives notice for the offeree that the acceptance is not according to the prescribed mode.

It is to be noted here that the rejection of a proposal by the person to whom it is made is wholly distinct from revocation.

Contract through Post:

When the contracting parties make contracts through post, i.e., by letter or telegram, it is observed that "The Post Office is the servant employed by the party making the offer to deliver the offer and receive the acceptance."

The rules of contract by post may be summarized as follows: -

(a) An offer is made only when it reaches to the offeree and not before.

(b) An acceptance is complete when the letter of acceptance is put in the course of transmission, so as to be out of the control of acceptor. If the letter of acceptance is properly addressed, stamped and posted, it is immaterial whether it reaches the offeror or not. Loss of letter in the post, late delivery or miscarriage etc. will not affect the validity of the contract. It was observed in Dunlop V. Higgins (1866)". If the party accepting the offer puts his letter into the post on the correct day, has he not done everything that he was bound to do? How can be responsible for that over which he has no control?

(c) An offer may be revoked before the letter containing the acceptance is posted and not thereafter.

(d) An acceptance may be revoked before, it reaches the offeror. But the acceptor will be bound by his acceptance only when the letter of acceptance has reached the proposer.

In English law an acceptance cannot be revoked, once the letter of acceptance is properly posted, the contract is concluded for both the parties.

Contracts over telephone:

Contracts over telephone or telex are treated on the same principles as those when the parties are facing each other. In both cases offer is made and oral acceptance is expected.

The Supreme Court, in the case of Bhagwandas Goverdhandas Kedia V. Girdharilal Purshottam Dass & Co. (1966) ruled by a majority judgement that post office rules of communication are not applicable to contracts over telephone or telex. In case of such contracts, the contract will be complete only when the acceptance has been communicated to the offeror and not when it is put in the transmission as in the case of post.

In case a person makes an offer to another person and in the course of his reply the line goes dead, on account of which the offeror does not hear the offeree's words of acceptance there is no contract at that time. If the whole conversation is repeated and the offeror hears the words of acceptance, the contract is complete (Kanhaiyalal V. Dineshwar Chand's (1959). Contract will come into existence at the place where the acceptance has been recieved.

Ananson has beautifully compared an offer with a train of gunpowder and acceptance with a lighted match in the following words"-Acceptance is to an offer what a lighted match is to a train of gunpowder. It produces something which cannot be recalled or undone. But the powder may have laid until it has become damp, or the men who has laid the train may remove it before the match is applied. So, an offer may lapse for want of acceptance or be revoked before acceptance. Acceptance converts the offer into a promise and then it is too late to remove it."

Just as when the lighted match is brought near the gunpowder, it explodes. Similarly, an offer when accepted becomes a contract and will give rise to legal obligations. Further, explosion can be prevented if the gunpowder becomes damp or is removed before the lighted match is brought near it. Similarly, no contract arises if the offer has already lapsed on account of no acceptance, or acceptance not being given within a reasonable or fixed time or it has been withdrawn by the offeror before its acceptance.

1.6 CAPACITY OF PARTIES

Section 10 of the Contract Act requires that an agreement to be enforceable by law must be made by the parties competent to contract.

Section 11 of the contract Act provides that "every person is competent to contract, who is of the age of majority according to the law to which he is subject, and who is of sound mind and is disqualified from contracting by any law to which he is subject."

This Section deals with personal capacity in three distinct branches:

(a) Disqualification by infancy, i.e., minors.

(b) Disqualification by insanity, i.e., lunaties.

(c) Other special disqualifications by personal laws, such as insolvency, conviction etc.

1.6.1 Disqualification by Infancy

Age of Majority: A valid agreement requires that both the parties to the contract should understand the legal implications of their conduct. They must have mature mind. They should be major in age.

According to Indian Majority Act, 1875, every person domiciled in India shall be deemed to have attained his majority when he shall have completed his age of eighteen years and not before. In case, guardian has been appointed to the minor or where the minor is under the guardianship of the court of wards, the person shall become major on the completion of the age of 21 years.

1.6.2 Law Relating to Minor's Agreement

The Act makes it essential that all contracting parties should be competent to contract, and if a person is incompetent to contract by reason of infancy, he cannot make a contract within the meaning of the Act. Therefore, an agreement with a minor is void and a minor can neither sue nor be sued upon it. The Contract is also not capable of ratification in any manner. The parents of a minor are not legally responsible for his contracts unless he acts as their agent.

Following important provisions govern agreements made with a minor.

1. Agreement is absolutely void: An agreement by or with a minor is void-ab-initio. It is considered to be a nullity and non-existing from the very beginning. Thus, if a party who has parted with goods, can trace them with the minor then he can recover damages for the breach of contract or recover their price. Nor can money lent to such a minor be recovered because if that were to be allowed it would tantamount of enforcing the contract.

   Leading case: Mohiri Bibi V. Dharmodus Ghosh.

   In this case a minor executed a mortgage for Rs. 20,000 and received Rs.8,000 from the

mortgagee.

The minor sued for setting aside the mortgage. The mortgage claimed the sum which he had actually paid, i.e., Rs. 8,000. The Privy Council held that as the minor's contract was absolutely void, and no question of money could arise in these circumstances.

However, if the minor has carried out his obligations, he can bring a suit against the other party for the enforcement of the other party's obligations.

Example:

A, a minor, advanced money to B against a mortgage. It was held that the mortgage was enforceable by him or by the other person on his behalf, (Satyadev V. Tribeni) (1936). But the contract is enforceable only when the minor has performed his part, the agreement is unenforceable.

Example:

M entered into a contract on behalf of a minor with S to purchase some immovable property. On S's non-fulfilment of his promise, the minor filled a suit against S. It was held that the agreement was void because the contract is still executory. Therefore, his plea could not be accepted. (Mir Sawargan V. Fakhrudin Md. Chowdhry) (1912).

2. *No ratification*: Since the contract is void ab initio it cannot be ratified by the minor on attaining the age of majority. However, a minor who, on attaining majority, takes up and carries on transaction commenced while he was under disability, will bind himself for the whole transaction.

Example :(A)

F, an infant speculated on the stock exchange and became liable to the stockbrokers for £547. After attaining the age of majority, he gave two bills for £50 each in satisfaction of the original debt. Held F was not liable on the bills (Smith V. King, (1892) 2 R.B. 543).

Example :(B)

A, a minor, takes a loan of Rs. 1,000 from B during his minority. After attaining age of majority,

A applies for a fresh loan of Rs. 1,000 B gives the loan and obtain from A, a combined promissory note of Rs.2,000. This will be taken as a new contract and will therefore, be

enforceable.

3. *No restitution*: When a contract becomes void, it is not to be performed by either party. But if any party has received any benefit under such a contract from the other party, he must restore it or make compensation for it to the other party. This is called restitution.

   A minor is not liable to repay any money or compensation for any benefit that he might have received under a void contract. Court, may however, in certain cases, while ordering for the cancellation of an instrument at the instance of the minor, require him to pay compensation to the other party to the instrument under Sec. 33 of the Specific Relief Act.

4. *No Estoppel*: A minor is not bound by his mis-representations. If a minor procures a loan or enters into any other agreement by representing that he is of full age. He cannot be prevented from pleading his minority in his defence. He will not be held liable under the contract. It was held in Sadiq Ali Khan V. Jai Kishore (1928) that a deed executed by a minor is a nullity there can be no estoppel against a statue, Thus the rule of estoppel as per Sec.115 of the Evidence Act, 1872 is not applied against a minor.

5. But this does not mean that the minors are allowed to cheat and to enjoy the fruits of their fraud. According to Sec.33 of the Specific Relief Act, 1963 Court will order, on equitable considerations for restitution if the minor is still in possession of the money or things purchased out of it. The minor shall have no liability if the money or things cannot be traced out in his hands.

Examples:

(a) A minor borrowed Rs. 1000 on a fraudulent representation that he was a major, and he spent the whole of the money in a picnic tour of Kashmir. In this case the creditor cannot sue for the realisation of the money so advanced by him.

A minor fraudulently over states his age and takes delivery of a motor car after executing a promissory note in favour of the trader for its price, though the minor cannot be compelled to pay on the promissory note; but the court on equitable grounds may order the minor to return the car to the trader, if it is still with the minor.

Minos liability for necessities: All contracts relating to the necessities supplied to a minor according to this status in life are valid. But only the minor's property is liable for necessities, and no personal liability is incurred by him.

Necessities must be things which the minor actually needs; therefore, it is not enough that

they be of a kind which a person of his condition may reasonably want for ordinary use, they will not be necessities if he is already sufficiently supplied with things of that kind, and it is immaterial whether the other party knows this or not. Objects of mere luxury cannot be necessities nor can objects which, though of real use, are excessively costly. The fact that buttons are normal part of any kinds of clothing, but it will not make pearl or diamond buttons necessities.

Example:

A grocer supplies monthly rations for 6 months to B who is aged 17 years. On B' failure to pay, he sues him for the realisation of his dues. In this case B's property is liable for the payment of credit rations consumed by B during the period of his minority.

Costs incurred in successfully defending a suit on behalf of a minor in which his property was in jeopardy are "necessities".

6. *Minor as a beneficiary:* All such contracts under which the minor is to receive some benefit, or which are beneficial to him are valid. These contracts include agreements which provide for the teaching, instruction or employment of a minor. It is to be noted that only his property is liable for liabilities arising out of such contracts. In no case he will be personally liable.

English law has expressly made a contract for the minor's benefit enforceable. But in India all contracts made by minors are void. Still majority of the contracts for the benefit of minor have been held to be enforceable on the ground that it will be unjust in the circumstances to deprive a minor of a benefit which he may be entitled to get under a contract.

7. *Minor as Agent:* A minor can be appointed as an agent. He can represent his principal in dealings with other parties. Since minor does not incur any personal liability, he cannot be held responsible for his any act of negligence or fault. Therefore, the principal will be responsible to the third parties for the acts of his minor agent. He cannot hold the minor agent personally liable for any wrongful acts. Thus, the principal runs a great risk.

8. *Minor as a partner:* A minor cannot be a partner of a firm. An agreement of partnership making a minor a full-fledged partner is invalid between all partners. However, he may be admitted to the benefits of an already existing partnership firm with the unanimous express consent of all the existing partners. Such an agreement may be entered into by his guardian on his behalf with the partners.

A minor admitted to the benefits of partnership, has a right to share the property and profits of the firm in the proportion agreed upon by him with the other partners. Further, he has a right to have access to and inspect and copy any of the accounts of the firm but not the books of accounts of the firm. Her liability is limited to the extent of his share in the firm.

9. *Minor as a member of a company*: A minor cannot be a member of a company since he is incompetent to enter into a contract.

   A minor may be allotted shares. His name may remain on a company's register of members, but during minority he incurs no liability. On attaining majority and becoming aware of the presence of his name in the register of members, the major has the option to repudiate his shares within a reasonable time. Where he does not do so he may safely be taken to have accepted his position. His liability as a shareholder then commences.

   However, it a minor has been allotted shares through ignorance and his name has been entered in the Register of members both the company and the minor, can repudiate the allotment of shares during his minority.

10. *Surety for a minor*: A person who stands as a surety for a loan taken by the minor will be liable to the creditor for payment of the loan, even though minor was not liable.

11. *Mortgages and sales in favour of minors*: A sale or mortgages of his property by a minor is void. But a duly executed transfer by way of sale or mortgage in favour of a minor who has paid the consideration money is not void and it is enforceable by him or any other person on his behalf. A minor, therefore, in whose favour a deed of sale is executed is competent to sue for the possession of the property conveyed thereby.

12. A minor cannot be declared as an insolvent even for his necessities of life. Only his property is liable even for necessities of life and he, personally, is not liable for the same.

Thus, the contract made with the minors can be under three heads.

(i) *Valid Contracts*: They include (a) contracts for necessities which include goods as well as services. (b) Contracts for loans taken to purchase "necessities".

(ii) *Voidable Contracts*: This category of voidable contracts is not recognised our country. This category includes those contracts in which minor is a beneficiary. Only minor is entitled to enforce but not the other party. They can be reasonably called as contract

voidable at the option of the minor.

(iii) *Void Contracts:* All contracts by a minor other than those referred to above shall be void. Salmond has defined the position of a minor in the following words:

"The law protects their persons, preserves their rights and estates, excuses their laches and assists them in their pleadings, the judges are their counsellors, the jury are their servants and law is their guardian."

1.6.3 Disqualification by insanity

According to Sec.12, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgement as to its effect upon his interests."

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

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

Example:

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

(b) A sane man, who is delirious from fever, or who is so drunk that he can not understand the terms of a contract or form a rational judgement as to its effect on his interests, can not contract during such delirium or drunkenness.

Thus, idiots, lunatics and drunkard are not considered to be persons of sound mind.

(i) *Idiot*: A person who is devoid of any faculties of thinking or rational judgement. All agreements, other than those for necessaries of life, with idiots are absolutely void.

(ii) *Lunatic:* A person whose mental powers are derange is called a lunatic. Lunatic is not a person who is continuously in state of unsoundness of mind but he may have lucid intervals. period in which he is to his senses. Agreement with lunatics are void except those made during lucid intervals and made for necessities of life. However, for necessities of life, the property of such persons is liable. He does not have personal liabilities.

(iii) *Drunkards:* A person under the influence of drink or drugs, stands on the same footing

as lunatic. Mere drunkenness affords no ground for resisting a suit to enforce a contract. But where the judgement of one party was, to the knowledge of the other part, seriously affected by drink, equity will generally refuse specific performance at the suit of the other. And, where the court is satisfied that a contract disadvantageous to the party affected has been obtained by "drawing him into drink" or that three has been real unfairness in taking advantage of his position, the contract may be set aside.

Persons disqualified by any other laws: Certain types of people are specifically disqualified by special statues from entering into valid contracts.

(I) *Alien Enemies:* A person who is not an Indian citizen is an alien. An alien may be either an alien friend or an alien enemy. An alien friend is one, whose state or Sovereign is at peace with India. He has full contractual capacity like an Indian Citizen subject to certain restrictions put by the Government of India, e.g., and alien can not acquire any ownership interests in any Indian ship. On the declaration of war between India and alien's country he becomes an alien enemy. A contract with an enemy becomes unenforceable on the outbreak of war. With regard to a contract with an alien enemy following rules will apply:

(i) Since trading with an alien enemy is considered illegal, no contract can be made with an alien enemy during the subsistence of war except with the prior approval from the Central Government.

(ii) Contracts entered into before the outbreak of war will be suspended during the course of war. They will be performed after the war is over.

(II) *Foreign Sovereigns and Ambassadors:* Foreign sovereigns and accredited representatives of foreign states, i.e., Ambassadors. High Commissioners. enjoy a special privilege in that they can not be used in Indian courts, unless they voluntarily submit to the jurisdiction of Indian courts. Though they can enter into contracts through agents residing in India. In such cases the agent becomes personally liable for the due performance of the contracts.

Corporations: A corporations is only an artificial person created by law, e.g., a company registered under the Companies Act, public bodies created by statue such as Industrial Finance Corporation of India, A corporation exists only in contemplation of law, it has no physical body or form. It can hold property, can sell or purchase goods and can sue or be sued in relation to any of the contracts entered into by it. Being a mere creature of law, it cannot go beyond those objectives which have been laid down in the charter of its creation, i.e.,

Memorandum of Association. Further, its capacity and powers to contract are also limited by its charter. Any contract beyond such powers is ultra vires and void. Such ultra vires contracts can not be ratified even by the unanimous vote of all its members.

Besides that, a Company etc. can not make certain contracts at all e.g., a contract to marry.

(III) *Convicts*: While undergoing sentence a convict is incapable of entering into a contract. This inability comes to an end on the expiration of the sentence or if he has been "pardoned".

(IV) *Profession/a persons:* In England barristers-at law, are prohibited by the etiquette of their profession from suing for their fees. So also, are the Fellow Members of the Royal College of Physicians. In our country no such professional disqualification exists.

1.7 CONSIDERATION

Consideration is an essential element of a valid contract. A promise without consideration cannot be enforced by law except under certain circumstances. Consideration is the necessary evidence by law of the intention of the parties to affect their legal relations. Consideration, broadly speaking, is the price paid by the promisee for the obligation of the promisor. The term 'consideration' is used in the sense of "something in return", i.e., quid pro quo. An agreement without consideration is a bare promise and *exnudo pacto non aritio actio, i.e.*, cannot be held to binding on the parties.

1.7.1 Definition of Consideration

Sir Frederick Pollock has defined consideration, "It is the price for which the promise of the other is bought, and the promise thus given for value is enforceable."

In the case, Curie v. Misa the term was defined, "A valuable consideration in the sense of the law may consist either in some right, interest, forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other."

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

Example: A offers to sell his house to B for a sum of Rs.50,000. B accepts the offer. In this contract, for A's promise, the consideration is a sum ofRs.50,000 while for B's promise

consideration is the house.

1.7.2 Essential Elements of Consideration

1. *Consideration must proceed at the desire of the Promisor*. The act constituting the consideration must have been at the desire or request of the promisor. An act done at the desire of a third party is not a consideration. Voluntary acts also would not constitute good consideration in the eyes of law. If A rushes to B's help whose house is on fire, there is no consideration here. It is a voluntary act of A. But if A goes to B's help at B's request who promises, to give a reward for the help then there is consideration. It is not necessary that the promisor himself should be benefited by consideration. It is sufficient if the act or forbearance constituting consideration was done or given at the promisor's request.

The promise to pay subscription to a charitable trust of religious organisation would have been without consideration if no liability had been incurred and nothing substantial had been done by the trust or the organisation on the faith of the subscriber's promise.

Example: (a) Mohamedan promised to subscribe Rs. 500/- to a fund to rebuild a mosque and no steps were taken to rebuild the mosque, it was held that the promise was without consideration and that the subscriber was not liable (Abdul Aziz V. Masum Ali) (1914).

(b) In another case of similar nature, where the Secretary had acted on the faith of the promise and incurred a liability, the court enforced the claim for the recovery of the amount to the extent of the liability incurred by the promise. (Kedar Nath V. Gauri Mohamed) (1886).

Thus, mere willingness to utilise a donation for the purpose of a trust which was proposed to be set up for promoting technical or business knowledge including knowledge of insurance cannot be regarded as consideration within the definition of Sec. 2(d). (Dr. Lakshmanswami Mudaliar V. LIC 1963).

2. *Consideration may move from the promisee or any other person*: In English Law consideration must move from the promisee. Under the Indian Contract Act, consideration may proceed from the promisee or any person. Thus, consideration furnished by a third party will also be valid if it has been done at the desire of the promisor. But it does not follow that the third party can sue on the agreement.

Leading case

Chinaya V Ramayya (1881): In this case, A, by a deed of gift, made over certain property to

her daughter, with a direction that the daughter should pay an annuity to A's brother, as had been done by A. On the same day the daughter executed a writing in favour of the brother agreeing to pay the annuity. The daughter declined to fulfil her promise and the brother sued to recover the amount. The defendant (sister) contended that no consideration from the brother, and that he being the stranger to the consideration had no right to sue. Held, it is not necessary that consideration must move from the promised himself. A contract can be supported can be supported even by a consideration from a person other than the promised. Therefore, the brother was entitled to maintain the suit.

3. *Privity of Contract*: The general rule is that only the person entitled to the benefits or bound by the obligations of a contract are entitled to sue or be used upon it. Thus, a stranger to contract, cannot file a suit to enforce any of the rights arising out of the contract. Therefore, if A for good consideration agrees with B that he will not sue for C's negligence, the latter will not be able to set up the promisee of A to be as defence.

Example: (a) *Tweddle V Atkinson* (1861): In this case, the father of a boy and the father of the girl who was to be married to the boy, agreed that each of them shall pay a sum of money to the boy, and after marriage the husband should have full power to sue for such sums. After the death of both the contracting parties the husband sued the executors of the wife's father upon the above agreement, but the action was held not to be maintainable because the husband was not a party to the contract.

Dunlop Tyre Co. V Selfridge Ltd. (1915): In this case, D supplied tyres to a wholesaler X, on the condition that any retailer to whom X resupplied the tyre should promise X, not to sell to the public below D's list price. X supplied the tyres to S, a sub-dealer, S sold two tyres at less than the list price, and thereupon, the Dunlop Co., sued him for breach of the contract. Held, Dunlop Co., could not claim the benefit of the contract as against S, a sub-dealer, there was no privity of contract between the two.

Exceptions to the doctrine of privity of contract

(a) *Beneficiaries in the case of trust:* A beneficiary under an agreement to create a trust can sue upon the agreement, though he was not a party to the contract between the settler and the trustees.

Example: A creates a trust for the benefit of B, and appoints X, Y and Z as trustees. B can sue for benefits available to him under the trust though he is not a party to the contract.

(b) *In case of provision in marriage settlement of minors*: A child in a contract of marriage is treated as a party who has given consideration, and he is entitled to enforce any contract to settle property, which a marriage settlement may contain.

In Khwaja Muhammad V Hussaini Begum (1910), it was held that where a lady sued her father. in-law to recover the arrears of allowance payable to her by him under an agreement between his and her father in consideration of her marriage, she could enforce the promise in her favour though she was a stranger to the contract. The Privy Council observed that it might occasion serious injustice to apply the common law doctrine of privity of contract in a country like India where marriages are contracted for minors by parents or guardians.

(c) *In case provision is made for the marriage or maintenance of a female member of the family on the partition of Hindu Undivided family*: The female members though not parties to the contract, possess an actual beneficial right which places them in the position of beneficiaries under the contract, and can, therefore, enforce the promise.

(d) *Assignee of a contract:* An assignee under an assignment made by the parties, or by the operation of law, e.g., in case of death or insolvency, can sue upon the contract for the enforcement of his rights and interests. A debt can be assigned by a creditor to a third person without the consent of the debtor. But a mere nominee cannot sue e.g., the person for whose benefit another has insured his own life cannot sue.

(e) *Where a charge is created on certain specific immovable property in favour of certain person:* Such charge is enforceable at the instance of the beneficiary entitled, though he may be a stranger to the document creating the charge.

(f) *Estoppel:* Where one party has by his words or conduct made to the other a promise or assurance which was intended to affect the legal relations between them, then once the other party has taken him on his words and acted upon them, the party who gave the promise shall be estopped from denying his liability arising from the promise.

(g) Contracts which are entered into through an agent, can be enforced by the principal.

4. **Consideration may be a promise to do something or abstain from doing something**: Example: A is indebted to B to the extent of Rs. 1000. The debt falls due and A fails to pay.

C promises to stand surety to the debt if B does not file a suit against A, to which B agrees. B's promise regarding forbearance to sue A is a good consideration for C's standing as a surety. Mutual agreements to avoid further litigations are held to be

supported by valid consideration. Consideration, therefore may be an act or an abstinence.

5. **Consideration may be past, present or future**

Past consideration: Where the promisor had received the consideration before the date of the promise, the consideration is termed as "Past consideration."

Example: A teaches the child of B at B's request. After six months B agrees to pay A a sum of Rs.600/- for his teaching. For B's promise the services of A will be taken as past consideration.

Present consideration: When the promisor receives consideration simultaneously with his promise, the consideration is termed as Present Consideration.

Example: A purchased goods from a shopkeeper of the worth of Rs. 100/- A pays money to the shopkeeper. Consideration will be taken as "Present consideration".

Future consideration: Where the promisor has to receive consideration in future for his promise, the consideration is said to be "future".

Example: A promises to sell his house to B for a sum of Rs. 15,000/- after a week. B also promises to pay A Rs. 15,000/- after a week on Tuesday. Consideration is future for both the parties.

6. There must be independent consideration to support each independent promise

There must be as many considerations as the number of contracts. A single consideration cannot support two agreements between the same parties.

7. **Consideration must have some value in the eyes of Law though it need not be adequate**

Inadequacy of consideration will not invalidate a contract. It is open to the parties to fix their own price. For example, if A voluntarily agreed to sell his car for Rs. 500/- to B, it will be a valid contract despite the inadequacy of the consideration. It is to be noted here that though inadequacy of consideration will not invalidate a contract but may be taken into account by the court in determining the question whether the consent of the promisor was freely given.

8. Consideration must be real and not illusory, impossible uncertain, ambiguous, fraudulent, immoral or opposed to public policy.

Consideration is always given in exchange of some benefit accruing or to make good injury caused to the other party. Consideration should not be fraudulent, forbidden by law or immoral or opposed to public policy. It should not cause injury to any person or property if allowed to be exchanged.

Further, consideration must be something more than the mere promise to do an act for which the promise is already bound to do for the promisor. Thus, an agreement to perform an existing obligation made with the person to whom the obligation is already owed is not made for consideration. For example, if promise to pay an existing debt punctually if the creditor gives a discount is without consideration and the discount cannot be enforced or an agreement by a client to pay his lawyer after the latter has been engaged, a certain sum of money over and above the fee, in the event of success of the case would be void, being without consideration, (Ram Chandra Chintaman V. Kalu Raju) (1879). But a person promises to do more than what he is legally bound to do, such a promise, if not opposed to public policy, shall be good and a valid consideration. Thus, where police were requested to arrange for stationery guard for the safety of some property on payment of reasonable remuneration in a case where police had though surveillance by a mobile force to be sufficient, the promise to pay the remuneration shall not be without consideration because the acceptance by the police to provide more protection than what was deemed to be necessary is a good consideration for the promise to pay remuneration.

1.7.3 When no consideration is necessary

The general rule is that contracts made without consideration are void. But Section 25 of the Contract Act lays down the undermentioned exceptions which make a promise without consideration valid and binding.

1. Promise made on account of natural love and affection

(i) When a contract is made on account of natural love and affection between the parties.

(ii) The parties are standing in a near relation to each other, and

(iii) The contract is in writing and registered under the law for the time being in force for the registration of documents.

(a) Examples: A, out of his love and affection, promises to give his wife, Rs.10,000. This promise is put into writing and is registered. It will be a valid contract without consideration.

(b) After persistent quarrels and disagreement between husband and his wife, the husband promised in writing to pay his wife, a sum of money for her maintenance and separate residence. The agreement was also registered. It was held that the promise was not enforceable because it was not entered out of natural love and affection. (Rajlusmi Dabee v. Bhootnath) (1900).

2. Promise to compensate for voluntary services: When a contract is made to compensate a person who has already done something voluntarily for the promisor, or done something which the promisor was legally compellable to do. Here two conditions must be fulfilled. First, the act must have been done voluntarily and for the benefit of the promisor, secondly, the intention of promisor must have been to compensate the promisee. This contract may be oral or written. Thus, services voluntarily rendered but not with gratuitous intention can form valid consideration for a promise given to compensate him.

3. **Promise to pay a time barred debt*:*** According to section 25(30, a promise by a debtor to pay a time barred debt is enforceable it is made in writing and is signed by the debtor or by his agent generally or specially authorised in that behalf. The promise may be to pay the whole or any part of the debt. The debt must be such, of which the creditor might have enforced payment but for the limitation of suits.

   For example, A owes B Rs. 2,000 but the debt is barred by the Law of Limitation. A sign written promise to pay B Rs. 1,000 on account of the debt. This is a contract.

4. **Agency:** - Consideration is not necessary to create an agency.

5. ***Complete gift***: - The rule 'no consideration, no contract' does not apply to completed gifts. According to explanation to section 25, nothing shall affect the validity, as between the donor and donee of any gift actually made.

1.7.4 Stranger to Contract:

According to general rule of law only parties to a contract my sue and may be sued on the contract. This rule is based on the doctrine of the privity of contract. This means relationship subsisting between the parties to a contract. It means mutually of will and creates a legal bond or tie between the parties to a contract. The consequences of the doctrine of privity of contract are:

(1) Any person who is not a party to a contract cannot sue upon it even though the contract is for his benefit and he supplied consideration.

(2) A contract cannot give rights or impose obligations arising under the contract on any person other than the parties to it.

But there are certain exceptions to the rule that a stranger can sue, i.e., a stranger can sue in certain cases. This is possible in cases of trust or charge. Similarly, a stranger may sue in case of marriage settlement, partition or other family arrangements. A stranger can also be sued in case of acknowledgement or estoppel. Where the promisor by his conduct, acknowledge or otherwise constitutes himself as an agent of the Third party, a binding obligation is thereby incurred towards him. Similarly, in case of assignment of a contract, the assignee of rights and benefits under a contract not involving personal skill can enforce the contract subject to the equities between the original parties.

1.8 LAWFUL CONSIDERATION OR OBJECTS

An agreement, the consideration or the object of which is not lawful, cannot be enforced by law. This is because courts will not allow polluted hands to touch the pure fountains of justice. According to Sec. 23, "The consideration or object of an agreement is lawful unless: -

(a) it is forbidden by law; or

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

(c) is fraudulent; or

(d) involves or implies injury to the person or property of another; of

(e) the court regards it as immoral, or opposed to public policy.

In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void."

The objects and the consideration of an agreement shall be unlawful in the following cases.

I. If it is forbidden by law: An act is said to be forbidden by law if it has expressly been declared to be unlawful by any of the laws of the country for the time being in force. And, for this purpose, both the parties are presumed to know the law. If a contract can be performed in one of the two ways, i.e., legally or illegally, it is not an illegal contract, though it is unenforceable at the suit of a party who chooses to perform it illegally.

Examples:

(a) A, Band Center into an agreement for the division among them of gains acquired, or to

be acquired, by them by fraud. The agreement is void, as its object is unlawful.

(b) A promise to obtain for B an employment in the public service, and B promises to pay 1,000 rupees to A. The agreement is void, as the consideration for it is unlawful.

2. If it is of such a nature that, if permitted, it would defeat the provisions of law: The term "Law" includes any enactment or rule of law for the time being in force in India. This may be considered under three heads:

(i) An agreement which defeats the provisions of any legislative enactment

Example:

An agreement by which an insolvent who had obtained his personal, but not his final discharge, settled the claim of one creditor without notice to the official assignee or his other creditors and by which that creditor agreed not to oppose his final discharge, was void as inconsistent with the policy of the statute.

(ii) If it defeats the rules of Hindu and Mohomedan Law

The rules must of course be such as are recognised and enforceable by courts of law; they do not include rules of exclusively religious character.

An agreement that would defeat the provisions of Hindu Law would be unlawful within the meaning of the present clause.

Example:

(a) A contract to give a son in adoption in consideration of an annual allowance to the natural parents. A suit will not lie to recover any allowance on such a contract, though the adoption has been performed.

(b) An agreement entered into before marriage between Mohamedan wife and husband by which it is provided that the wife shall be at liberty to live with her parents after marriage is void.

(iii) Other rules of law in force in India

Example:

An engagement of a Chartered Accountant to be paid on the basis of a percentage of the relief obtained in an income-tax case of an assesee is opposed to the provision of the Chartered Accountants Act.

3. If it is fraudulent: When the object of an agreement is to cheat the other party by concealment of any material fact or otherwise, it is said to be fraudulent. An agreement to defraud revenue is illegal, including the revenues of a foreign country.

Example:

When the object of an agreement between A and B was to obtain a contract from the Commissairate Department for the benefit of both, which could not be obtained for both of them without practicing fraud on the Department. Held, that the agreement was fraudulent and, therefore, void.

4. If it involves or implies injury to the person or property of another: The consideration or object of an agreement is unlawful when it involves or implies injury to the person or property of another.

Example:

An agreement which compels a debtor to do manual labour for the creditor as long as the debt is not repaid in full is void.

(2) (a) If the court regards it as immoral: The definition of the word immoral has been kept limited only to those acts which the court regards as immoral. This shows that what is 'immoral' depends upon the standards of morality prevailing at a particular time and as approved by courts. In most cases the meaning is restricted to sexual immorality.

A landlord cannot recover the rent of his house knowingly let to a prostitute who carries on her vocation there. Similarly, money lent to a prostitute expressly to enable her to carry on her trade cannot be recovered. Likewise, money advanced by the plaintiff to the defendant to enable the defendant to continue cohabitation with a dancing girl cannot be recovered. Ornaments lent by a brothel keeper to a prostitute for attracting men and encouraging prostitution cannot be recovered back.

A promise to pay for the past co-habitation has been held to be legal (Dhiraj Kumar V Bikramjit Singh). But where co-habitation - even not adulterous is also not enforceable. An agreement to pay maintenance for an illegitimate child is not illegal. A loan made for the purpose of teaching to dancing girls has nothing immoral in its object.

Example:

A agrees to let her daughter to B for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code.

(b) *Agreement which are considered by the courts to be opposed to public policy:* The principle of public policy is this: ex dolo malo non oritur actio- No court will lend its aid to a man who found his cause of action upon an immoral or an illegal act. No exhaustive list can be prepared of all the agreements opposed to public policy. Anything which goes against the interest of general public will be deemed to be opposed to public policy.

The doctrine of public policy was summarised by the Supreme Court in *Gherual Parek V Mahadeodas* (1959).

"Public policy or the policy of the laws is an illusive concept; it has been described as "untrustworthy guide", "variable quality", "uncertain one", "unruly horse", etc.: the primary duty of a court of law is to enforce a promise which the parties have made and to uphold the sanctity of contracts which from the basis of society, but in certain cases, the court may relieve them of their duty on a rule founded on what is called the public policy."

The law relating to public policy is not a fixed and immutable matter, rather it is alterable by the passage of time.

The general head of public policy covers wide range of topics. Some of these are:

(i) Trading with the enemy: Those contracts which tend either, to benefit an enemy country or to disturb the good relations of a country with a friendly country, are against public policy. Contracts made before the outbreak of hostilities may be performed after the cessation of hostilities unless already cancelled by the parties or the Government.

(ii) Stifling Prosecution: Agreements for shifting prosecution are a well-known class of those contracts which the courts refuse to enforce on this ground. The principle is "that you shall not make a trade of a felony". If a person has committed an offence he should be punished and, therefore, "no court of law can countenance or give effect to an agreement which attempts to take the administration of law out of the hands of the judges and put it in the hands of private individuals." (Sudhindra Kumar

V. Ganesh Chandra (1939). Thus, a criminal offence cannot be arbitration. but an agreement to refer a civil dispute to arbitration is perfectly valid.

Example:

A promises B to drop a court case which he has instituted against B for robbery and promises to restore the value of the things taken. The agreement is void, as its objects is to stifle

prosecution.

(iii) *Agreements for improper promotion of litigation*: In this connection there are two types of agreements (a) Maintenance and (b) champerty.

(a) Maintenance: When a stranger agrees to render assistance by money or otherwise to another person in a suit in which that third person has himself no legal interest, for its prosecution or defence, it is called maintenance.

(b) Champerty: Champerty is a species of maintenance. It is a bargain whereby one person promises to assist another in recovering property in consideration of the latter giving the former a share in the property so recovered.

According to English Law, all Maintenance and Champerty agreements are illegal and unenforceable. But in India, they are perfectly valid if they are made with the bonafied object of assisting a claim believed to be just and the amount of compensation is reasonable. In Bhagwat Dayal Sing V. Debi Dayal Sahu, it was held that "An agreement champertuous according to English Law is not necessarily void in India, it must be against public policy to render it void here."

Thus, a fair agreement to supply funds to carry on a suit in consideration of having a share of the property it recovered ought not to be regarded as being per se opposed to public policy. But agreements of this kind ought to be carefully watched and when found to be extortionate and unconscionable so as to be inequitable against the party, or to be made, not with the bonafide object of assisting claim, but for improper objects, as for the purpose of gambling in litigation so as to be contrary to public policy. The quantum of the share which the financier would get under the agreement is an important matter to be taken into consideration in judging the fairness or otherwise of the agreement.

Examples:

(a) A claim was of a simple nature and in fact no suit was necessary to settle it, an agreement to pay Rs. 30,000 to the plaintiff for assisting in recovering the claim was held to be extortionate and inequitable (Harilal Nath V Bhailal Pranlal, 1940).

(b) R agreed to file an appeal in the name of A with the terms that in case of success A would pay half the costs to R and half the purchase price. Held that an agreement to share the property half and half the purchase price. Held that an agreement to share the property half and half is hampertous and opposed to public policy and, therefore, void.

(iv) *Agreements to interfere with course of justice:* An agreement for the purpose or to the

effect of using improper influence of any kind with judges or offices of justice is void. Thus, an agreement whereby one person agreed to assist another in carrying out litigation for the purpose of delaying execution of a decree as held to be unenforceable.

(v) *Agreements to vary the period of limitation:* Agreements the object of which is to curtail or extend the period of limitation prescribed by the Law of Limitation, are void. Agreements cannot be allowed to defeat the provisions of Law unless otherwise so provided in the law itself.

(vi) *Marriage brokage contracts:* An agreement to procure marriage for reward is void. Of course, validity of marriage will not be affected but money actually paid cannot be recovered or, if not paid, suit for the recovery of the promised award cannot be maintained.

Example:

(a) A promise to a purohit to pay Rs. 20 in consideration for procuring a second wife for A. The promise is illegal.

(b) An agreement to pay money to parents or the guardians in consideration of his giving his daughter in marriage is void.

(vii) *Sale of public offices:* Traffic by way of sale of public offices and appointment obviously tends to the prejudice of public service. Such agreements are void. An agreement to pay money to public servant to induce him to retire, and thus, make way for the appointment of the promisor is virtually a trafficking with reference to an office, and is void. Similarly, a promise to make an annual payment to a person on condition that he withdraws his candidature for a public office in favour of the promisor is unenforceable. Where money is paid under such an agreement, it cannot be recovered back from defendant, though he has failed to procure employment for the plaintiff in public service.

(viii) *Contracts in restraint of marriage and marriage agreements against public policy:* A contract in general restraint of marriage is unenforceable on the ground of public policy. Such agreements may relate to not to marry at all or not to marry any particular person or class of persons. An agreement to marry is illegal as against public policy if one of the parties at that time is married. But the contract is enforceable if at the time the contract was made one of the parties was unaware of the fact. Money paid by a person to obtain a divorce by another is money paid for an illegal or immoral purpose.

(ix) *Agreements in restraint of parental rights:* father is the natural guardian of his minor child and in the absence of father, mother has this authority. This right of guardianship is in the nature of sacred trust and, therefore, cannot be bartered away by any agreement. He may, in his discretion, as guardian entrust the custody and education of his children to another. But this agreement is essentially a revocable one, in the welfare and interest of the child, therefore, an agreement, in which a father agreed to transfer guardianship of his two minor children in favour of a lady, was held to be void, though the father agreed not to revoke the authority of the lady. Giddu Narayanish V. Mrs. Annie Besant (1907).

(x) *Agreements tending to create interest against duty*: An agreement with public servant which might cast upon the public servant obligations inconsistent with his public duty is void. An agent must not deal in the subject matter of the contract of agency on his own account, as it is against his duty. A person should not place himself in such position where his duty will come in clash with his interest.

(xi) *Agreements to create Monopolies*: Agreements having for their object the as creation of monopolies are void as opposed to public policy.

(xii) *Agreements, the consideration of which is unlawful in part:*

(i) If the legal part of the agreement cannot be separated from the illegal part, then.

(ii) If there are several objects but several considerations, the agreement is void if any one of the considerations is unlawful. (Sec. 24)

(iii) Where there is reciprocal promise to do things legal and also other things illegal the legal part which can be separated from the illegal part can constitute a valid contract and the illegal part shall be void (Sec. 57).

Example: A agrees that he will sell to B a house for Rs. 10,000, but if B uses the house for gambling purposes, he shall pay Rs. 50,000, to A. The first part of the agreement shall be valid and binding. But the second part shall be void and unenforceable.

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

Example:

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

Agreements to defraud creditors or revenue authorities. If the object of an agreement is to defraud the creditors or the revenue authorities, that agreement is not enforceable, because it is opposed to public policy. If a transfer of property is made and the transfer is declared insolvent on a petition presented within two years of the date of the transfer, this transfer is void against the official receiver or assignee, provided transfer is not made (i) before and in consideration of marriage, or (ii) to a buyer in good faith and for valuable consideration.

IN-TEXT QUESTIONS

5. On the basis of "mode of creation" contracts can be classified as?
6. "Every person is competent to contract, who is of the age of majority according to the law to which he is subject, and who is of sound mind and is disqualified from contracting by any law to which he is subject." **True/False**
7. List the cases when consideration is not necessary in a contract from the following.
   a) Charity b) Love and affection
   c) Agency d) Stranger involved
8. When offer is given to another person neither in writing nor in oral, it is known as an _____ offer.

1.9 FREE CONSENT

Contracts are usually described as valid, void and voidable. Valid Contract is an agreement enforceable at the law courts. Those agreements which are not enforceable at the law courts, i.e., for the enforcement of which legal recourse cannot be taken, are known as Void Contracts. In between the valid and the void contracts are the voidable contracts. Such contracts are the outcomes of Flaw in Consent. At an early stage you have read that, "an agreement can be called a contract provided it is made with the Free Consent of the parties, competent to contract for a lawful consideration and for a lawful object and is not expressly declared to be void". When we analyze this statement, we come to know that to be a contract, an agreement must be made with the Free Consent of the parties to the contract. Here is the importance of "Free Consent" which is very much necessary for the validity of the contract. The genuineness of the consent implies that the parties to the contract must mean something

in the same sense and not only that but they should mutually agree voluntarily. If their minds do not meet at the same thing in the same sense voluntarily, then their consent shall not be called Free or Voluntary. The consent in such case might have been obtained under Fraud or Misrepresentation or Coercion or undue influence. In such a case the party giving his consent under any of these four elements shall have a right to withdraw his consent. Such a contract where the consent of a party or parties to the contract is caused by any of the elements stated above, i.e., Fraud Misrepresentation, Coercion or Undue Influence/shall be called a Voidable Contract and shall be enforceable at the option of the aggrieved party or parties and not at the option of the other or others.

Let us make our point clear with the help of an example. Suppose A is willing to sell his car to B for Rs. 15,000, but Bis willing to purchase it for Rs. 10,000 only. A tells B if he (B) refuses, to purchase the car for Rs. 15,000 he (A) shall fire upon him. Due to this threat of getting himself hit by A's gun, B gives his consent to purchase the car for Rs.15,000 only. Here B's consent cannot be said to be obtained freely or voluntarily. It is cause by threat to the injury of B's person. Therefore, B has a right to withdraw his consent even at a later stage. B's consent shall be said to be caused by Coercion. Such similar examples can be multiplied. Thus, Free Consent plays a very important role in the validity of a Contract. If there is no Consent, there is no Contract. Sir John Salmond has called flaws in Consent as 'Error in Causa'. According to him error has been made in causing consent of one of the parties to the agreement which has become responsible for vitiating the validity of the contract. Error in Causa is created by the cause of either Coercion, or Undue Influence or Fraud or Misrepresentation.

Let us now take up these elements, i.e., Coercion, Undue Influence, Fraud and Misrepresentation responsible to vitiate Free Consent one by one.

1.9.1 Coercion (Section 15)

Meaning: It is committing, or threatening to commit, any act forbidden by the Indian Penal Code (XLV of 1860), or the unlawful detaining or threatening to detain, any property to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Explanation: It is immaterial whether the Indian Penal Code (XL V of 1860) is or is not in force in the place where coercion is employed.

Characteristics:

The above definition as stated by Sec. 15 of the Indian Contract Act specific certain

characteristics of the term 'Coercion' which vitiates the consent of the parties to a contract. These characteristics are:

Example: An agent refused to hand over the account books to a business man to a new agent unless the principal released him from all liabilities. The principal had to give a release deed as demanded.

It was decided in Muthia vs Muthu Karuppa (1927, 50 Mad. 786) that the release deed was given under Coercion and the principal could avoid it. It is necessary that the Indian Penal Code is in force at the place where Coercion is employed.

Example: A on a ship on the high sea threatens to murder B, if he (B) does not write a note in his (A's) favour A's act amounts to Coercion, although Indian Penal Code does not apply on the high seas.

Coercion by threat need not necessity be directed by a party to the contract. It may or may not emanate from a stranger to the contract. Similarly, it may be aimed at any person. either a party to the contract or a strange to the contract. But the idea or intention of the party resorting to coercion should be to cause a person to enter a contract.

Example:

(a) A threatens to Kill C (B's son), if B does not lend Rs. 10,000 to A. B agrees to lend the aforesaid amount. The agreement is caused by Coercion.

(b) A threatens to Kill B if B does not lend Rs. 10,000 to C.B agrees to lend the amount to C. This agreement is made under Coercion.

Effect of Coercion

Coercion vitiates Free Consent. The party or parties whose consent is taken under the effect of Coercion get a right to avoid the contract, if he so likes. However, if the aggrieved party has received any benefit under the contract which he is avoiding on the basis of Coercion, he has to return that benefit to the other party or parties (Section72). The point can be made clear by the following example:

A enters into a contract with B to sell his horse for Rs. 5000 B takes A's consent under Coercion. A at the time of entering into an agreement receives Rs. 1000 as an advance from B. Later on, A avoids the sale of the horse on the basis of Coercion. A has to return Rs. 1000 to B. He cannot retain the money received as an advance from B.

Burden of Proof The party avoiding the contract has to prove that Coercion was exercised

upon him and his consent received is not voluntary or he has not exercised his consent freely.

Threat to commit suicide: It is an important question whether threat to commit suicide amounts to 'Coercion? The act of committing suicide is forbidden by the Indian Penal Code and on this basis Madras High Court has decided in Amiraju vs Seshamma (1918, 41 Mad. 33) that threat to commit suicide amounts to Coercion and the party affected is entitle to avoid the contract. Wallis, C.J and Seshhagiri Iyer J. held the threat of suicide amounted to Coercion The learned judged observed, "it was impossible to hold that an act which it is made punishable to abet or attempt is not forbidden by the Indian Penal Code, especially as the absence of of any section punishing the act itself is due to the fact that the suicide is in the nature of things beyond the jurisdiction of the Court." However, Old Field

J. gave a dissent. He held that the section should be strictly construed and that an act not punishable under the Penal Code could not be said to be forbidden by the code.

However, it is not a well-recognized fact that threat to commit suicide is an offence punishable under the Indian Penal Code and amounts to Coercion.

The facts of the case are as under:

Amiraju held out a threat to commit suicide to his wife and son, if they did not execute a release in favour of his brother in respect of certain properties. The wife and the son executed the release deed under the threat. Later on, the wife and the son took the plea of Coercion to avoid the release deed.

Coercion and Duress distinguished

(a) Coercion is the term applied under the Indian law of Contracts while Duress is the term applied under the English law of Contracts. (b) Coercion has a wide scope than Duress, Coercion includes threat to property also while Duress includes actual act of violence over the person and not of property. (c) Coercion can be applied by even a stranger, while Duress must be applied by a party to the Contract upon the other party or to his wife or patent or child.

1.9.2 Undue Influence (Sec.16)

Definition as per Sec.16:

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

(2) In particular and without prejudice to the generality of the foregoing principle, a person

is deemed to be in a position to dominate the will of another.

(a) where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or

(b) when he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

(3) Where a person who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the fact of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

Nothing in this sub-section shall affect the provision of section III of the Indian Evidence Act

1872.

Illustrations

a) A, a man enfeebled by disease or age, is induced, by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his profession services. B employs undue influence.

b) A being in debt to B, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by indue influence.

Salient Features

The above definition has got the following salient features: -

(1) One of the two parties to the contract is in a position to dominate the will and mind of the other party. This is presumed when the parties to the contract have a real or apparent authority over the other or one of the parties has got a fiduciary relationship which puts him in a position to win over the mind of the other party. Such position or relationship exists in the cases of minor and guardian; trustee and beneficiary; son and father, wife and husband or vice-versa.

The position is also presumed where the party is disabled or infirm and has to depend upon the other party to the contract. Mentally deficient and physically disabled people

can take the plea of undue influence in avoiding the contract.

(2) The dominating party should have obtained an unfair advantage from the weaker party: and

(3) The transaction between the contracting parties is unconscionable. The bargain is called 'unconscionable' where the two parties are not on equal footing and one of them is making an exorbitant profit of the other's distress.

Unless all the three above stated conditions exist, the contract can not be avoided on the pretext of Undue Influence. In the words of Sir Samuel Romilly undue influences is presumed in "all the variety of relations in which dominion may be exercised by one person over another".

Effect of Undue Influence (Sec 19-A)

A contract vitiated by undue influence is voidable at the option of weaker party. The court can set aside such contract-

(i) either wholly: or

(ii) where the weaker party has enjoyed some benefit under the terms of the contract, then upon just and equitable terms

Examples

(a) A's son has forged B's name to a 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.

A, a moneylender, advances Rs. 100 to B, an agriculturist, and by undue influence induces B to execute a bond for Rs. 200 with interest at 6 per cent per month. The Court may set the bond aside, ordering B to repay Rs. 100 with such interest as may seem just.

Burden of Proof

The weaker party has a right to avoid the transaction on the plea of Undue Influence. It is the other party who is to prove that he has not exercised any undue influence in getting the consent of the weaker party. If the other party is unable to prove it, the court shall set aside the transaction. (Refer to example (b) given after definition of Undue (Influence).

(a) Parties suffering with physical or mental distress e.g., a patient suffering with acute pain entering into a contract with a doctor.

(b) Parties having confidential relations. Confidential relationship is presumed in between parent and child; guardian and ward; solicitor and client; managing clerk of an attorney and his client; trustee and cetstui que trust; doctor and patient Chela (disciple) and a Guru (spiritual advise; fiancé and fiancée. There is no undue influence in the relationship of mother and daughter; husband and wife; grandfather and grandson and landlord and tenant; creditor and debtor.

Rebuttal: all cases of prescribed Undue Influence can be rebutted on the following grounds:

(i) full disclosure of material facts was made to the weaker party;

(ii) adequate consideration existed; and

(iii) the weaker party received independent legal advice.

The Privy Council has stated in 1931 in Tara Kumari Vs Chandra Mauleshwar that the principles to be applied to transactions with such women are not merely deductions from the law as to undue influence but have to be founded upon wider basis of equity and good conscience. A good number of cases have been decided not only by the privy Council but also by the Indian High Courts over the point.

1.9.3 Distinction between Coercion and Undue Influence

We can distinguish between Coercion and Undue Influence. The distinction can be made on the following basis:

(a) Definition, Coercion is an act punishable under the Indian Penal Code, while Influence is not a penal act.

(b) Nature of force used, Coercion requires physical force exercised by one of the parties to contract, while undue influence requires moral force.

(c) Parties Even a stranger's act may account to coercion, but undue influence can be exercised only by one of the parties to the contract. Stranger has no place in undue influence.

(d) Effect. Coercion gives a right to the effected party to repudiate the contract in full but under undue influence court may set aside the contract absolutely or modify the terms of the contract on such terms which it feels just and equitable.

1.10 FRAUD AND MISREPRESENTATION

1.10.1 Fraud

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

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

(2) the active concealment of a fact by one having knowledge or belief of the fact;

(3) a promise made without any intention of performing it;

(4) any other act fitted to deceive; any such act or commission as the law specially declares to be fraudulent.

Explanation

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

Examples

(a) A sell, by auction to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud by A.

(b) B says to A "If you do not deny it, I shall assume that the horse is sound". Here, A: s silence is equivalent to speech. Here, the relation between the parties would make it A: s duty to tell B if the horse is unsound.

(c) Bis A's daughter and has just come of age. Here the relation between the parties would make it A's duty to tell B if the horse is unsound.

(d) A and B, being traders, enter upon a contract. A has private information of a change in prices which would after B's willingness to proceed with the contract. A is not bound to inform B.

Characteristics

From the above definition we can state the following characteristics of Fraud:

(1) The act done by the party is done with an intention to device.

(2) The act may be done by the party himself or with his connivance by someone else or by his agent.

(3) The act amounting to fraud may be a suggestion of fact (suggestion false) i.e., the statement being made is without belief to its truth.

(4) The act may amount to an active concealment of a fact (uppression veri) i.e., the party has concealed a fact which was duty bound to disclose.

(5) The act amounting to fraud is in the form of a false promise.

(6) The act or mission is declared fraudulent by the Court or regarded by the Court as a deceit.

(7) The act committed must have deceived the other party and the party has suffered the damage on account of it. If the party does not suffer a damage on account of the fraudulent act committed by the other party, it shall not amount to fraud.

Is silence a Fraud?

Explanation to Sec.17, states in clear terms that mere silence is not fraud. Where silence amounts to active concealment, it shall amount to fraud. Thus, generally silence does not amount to fraud. However, where a party chooses to speak, he must do so clearly and fully. He should not make a partial and fragmentary statements of fact, so that the other party is misled. The court has decided in Bimla Bai vs Shankarlal (AIR 1959 M.P. 8) that a partial statement verbally accurate may be as false *a state*ment as if it has been misstated fully. A father called his illegitimate son, a 'son' at the time of fixing his marriage. It was held that the statement was false and thereby fraudulent.

Effects of Fraud

Fraud gives the following rights to the aggrieved party.

(1) He can avoid the contract and file a suit on the other party for damages; or

(2) He can revoke the contract, or

(3) He can refuse to fulfill his part of the promise and defend the suit filed by the other party for the breach of contract for damages or specific performance, or

(4) He can treat the contract as a valid one and ask for the specific performance, or for damages in addition to the substitution of the original contract.

1.10.2 Misrepresentation (sec18)

Misrepresentation has been defined by the Act as follows: "Misrepresentation" means and includes: -

(a) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true;

(b) any breach of duty which without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him.

(c) causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

Characteristics

The ingredients of a contract vitiated by misrepresentation are:

(a) There must be a misstatement of a material fact.

(b) The statement must not be a mere opinion, or hearsay, or commendation, because praise carries no obligation.

(c) The mis-statement must be made with the intention that the other party shall act upon he contracts.

(d) The other party must have been induced by the mis-statement.

(e) The statement being made is a wrong one, although the party making it has not known it to be false.

(f) The statement has been made by the party to the contract or his agent and not by a stranger.

Kinds

The term misrepresentation as defined by Sec.18 is quite exhaustive as can be seen by the words "Means and Includes". Misrepresentations may be of any of the three kinds: -

(1) It may take the form of an unwarranted positives statement which is not true, but the party believes it to be true; or

(2) It may take form of breach of duty on the part of one party which misleads the other party to his prejudice or to the prejudice of anyone claiming title under him. This kind

of misrepresentation includes such cases which are named as 'Constructive Fraud' by the Courts of equity. The party getting a benefit under the Act even under an obligation is not making full disclosure of facts but his non-disclosure misleads the other party.

(3) It may take the form of causing a party to the contract to make a mistake as to the subject matter of the contract. For example, if erroneous statement is made as to the tonnage of a ship, the contract can be avoided on the basis of misrepresentation. This decision was given in Oceanic Steam Navigation Co., vs Soonderdas (1890, 14 Bomb.92).

Effect of Misrepresentation

The party being affected by misrepresentation has got the following rights:

1) He can avoid or revoke the contract; or

He can affirm the contract and insist on the misrepresentation to be made good, if it is possible to do so; or

2) He can rely upon the misrepresentation as a defence to an action of the contract.

When the aggrieved party loses his rights?

The aggrieved party shall not be able to exercise any of the above rights in the following cases:-

(a) If he comes to know of mis-representation and even then, takes the benefit of the contract or approves the contract; or

(b) If the parties can not be brought back to their original position. Such situation arises where the subject matter of the contract has already been consumed or destroyed.

(c) If the contract cannot be rescinded in full, then it cannot be rescinded at all. Such decision has already been given in Sheffield Nickel Co. vs Dawin (1872, 2 Q.B.D. 215).

(d) If the aggrieved party has transferred the rights under the contract to the third party and the has acquired these rights in good faith and for consideration. (Phillips Vs Brroks, 1919, K.B. 243)

1.10.3 Distinction between Fraud and Misrepresentation

Fraud and Misrepresentation can be distinguished on the following basis:

(a) Intention: In Fraud the party's intention is to deceive the other party and got the benefit from him, while in Misrepresentation the party does not have any intention to deceive.

It makes a careless misstatement of facts of only.

(b) **Rights:** Fraud gives two rights to the aggrieved party, a right to action for damages and also to avoid the contract, i.e., while misrepresentation give only one right, i.e., to avoid the contract. It does not allow any damages.

(c) **Plea:** Fraud does not allow the defendant to take the place that the plaintiff had means to discover the truth but defendant is allowed to take this plea in case of misrepresentation.

(d) **Penalty:** The party defrauding the other can be prosecuted for cheating under I.P.C. also but such is not the case in misrepresentation.

IN-TEXT QUESTIONS

9. Gopi on a ship on the high sea threatens to kidnap Bipin, if the Bipin does not write a note in his favour, Gopi's act amounts to?
   a) Undue Influence b) Coercion
   c) Misrepresentation d) Fraud

10. When one of the two parties to the contract is in a position to dominate the will and mind of other, then it is an act of_____.
11. A promise made without any intention of performing it is an act of_____.

1.11 VOID AGREEMENT

Void agreements are those agreements which are not enforced by law courts. Section 2(g) of the Indian Contract Act 1872 defines a void agreement as, "an agreement not enforceable by law". Thus, the parties to the contract do not get any legal redress in the case of void agreements.

Void agreements arise due to the non-fulfillment of one or more conditions laid down by Section 10 of the Indian contract Act, 1872. This Section states as follows:

All agreements are contracts if they are made with free consent of parties competent to contract, for a lawful, consideration and with a lawful object, and are not hereby expressly

declared to be void.

Nothing herein contained shall affect any law in force in India, and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witness, or any law relating to the registration of documents.

From the above, it is quite clear that non-fulfillment of any of these conditions by one of the parties to a contract shall make an agreement void. These conditions being: -

1. Free consent of the parties.
2. Competency of the parties to contract.
3. Existence of a lawful consideration.
4. Existence of a lawful object.
5. Agreement being not included in the list of those specially declared to be void by the Indian Contract Act by its Section 26, 27, 28, 29, 30, and 56;

Completion of certain formalities required by any other law of the country like transfer of Property, Act, Company Act, etc.

1.11.1 Difference between a Void Agreement and a Void Contract

Most of the students do not make any distinction between the two terms. They treat them in one and the same sense. But this is wrong. Agreement shall be called a contract only when it fulfills all the conditions laid down by Section 10 of the Act.

The students can make a distinction between an agreement and a contract on the following basis: -

1. Definition: void agreement is defined by Section 2(g) viz., an agreement not enforceable by law is void agreement. Void contract is defined by Section 2(j) viz., a contract which ceases to be enforceable by law is a void contract since the time it ceases to be enforceable.

   Thus, it is very clear from the two definitions that a void agreement is void from the very beginning and does not create any legal effect, while a void contract is not void from the beginning, it becomes void at a subsequent stage due to the occurrence of an event or change in the original conditions. We may illustrate this with the help of an example. A, an Indian, enters into a contract with B, a Pakistani national, to supply woolen a carpet after three months. After some time, war breaks out between India and

Pakistan. The contract in between A & B shall become void at the outbreak of war.

2. Rights: A void agreement does not create any legal right or obligation upon the parties to the agreement. On the other hand, a void contract does create a right and an obligation upon the parties. A party to the void contract is within his rights to get back the benefit which he had given to the other party in terms of money, goods or services and the other party enjoying such benefit under a void contract is placed under an obligation to return that benefit to him. This is true in many cases but not in all cases e.g., a voidable contract being rescinded shall make, it obligatory on the aggrieved party to return the benefit which he has already derived from the contract. But if a contract becomes void due to supervening impossibility the benefit enjoyed by the promisor shall not be returned to the promisee by him.

3. Treatment: void agreements have been specifically stated in Chapter II of the act under Sections 11, 20, 23, to 30, and 56. But no such specific mention is made for void contract in any Chapter of the Act.

1.11.2 Difference between Illegal and opposed to Public Policy Agreements

All these three terms are the outcome of Section 23 of the Indian Contract Act which deals with lawful consideration and lawful object. The five cases stated in this section are: -

(a) it is forbidden by law; or

(b) is of such nature that, if permitted, it would defeat the provisions of laws; or

(c) is fraudulent; or

(d) involves or implies injury to the; person or property of another; or

(e) the court regards it as immoral or opposed to public policy.

The first four acts listed above i.e., from (a) to (d) form part of illegal acts, while the fifth act refers to immoral acts as well as those opposed to public policy. Let us know these acts before we distinguish them.

Illegal acts are not supported by Law. "Es turpi causa non oritur actio", which means that no right of action can spring out of an illegal contract, is an old and well-known legal maxim. It is founded on good sense and expresses a clear and well recognized legal principle.

Illegal acts may take any of the following forms: -

(a) Act which is prohibited by law. A is granted a license to ply a bus on a particular route. The license is to be used by him only and not to be transferred in somebody else's name.

He forms a partnership with B and transfers the license in the firm's name. The transfer is illegal since it is prohibited or forbidden by law.

(b) Any act which defeats the provisions of any law.

A agrees to lend B Rs. 1000 for six months provided B does not raise the plea of limitation under the Indian Limitations Act. The agreement is illegal since it defeats the provisions of Limitations Act.

(c) Any act which is Fraudulent.

A, B and C enter into an agreement for the division among them of gains acquired, to be acquired, by them by fraud.

The agreement is illegal since its object is fraudulent.

(d) Any act which involves an injury to the person or property of another.

A enters into an agreement with B, an editor of newspaper, to pay Rs. 500 if he (B) publishes a libelous matter in his paper against C. Here B cannot recover the money from A since the object of the agreement is to injure the person of C and thereby it is illegal.

Immoral: The word immoral is very comprehensive and concerns every aspect of personal life and conduct deviating from the standards and norms of the human life. Normally, acts contrary to sound and positive morality as recognised by law are immoral acts 'Ex dolo malo non oritur actio' is a maxim founded on general principles of policy and the courts are not prepared to help the persons whose action is based upon immoral act. Supreme Court of India in its decision confirmed in the case Cherulal Parekh V. Mahadee Das A.LR. 1959 has stated that judicial decisions have confirmed the operation of the doctrine to the cases of sexual morality.

On the above basis immoral acts can be divided into the following two categories: -

1. Where the consideration of the agreement forms an act of sexual immorality. This category includes case of illicit cohabitation or prostitution.
2. Where the object of the agreement promotes sexual immorality. Lending money to a prostitute to help her in the furtherance of her vocation forms part of such category.

Cases of immoral acts can be the following examples based on cases decided by the various courts, Indian as well as English.

(a) A made gift to a husband and a wife for the consideration that the wife shall maintain immoral relations with him (donor). Held the agreement is unlawful as it is immoral. Kandaswami V. Narayanswami, 1923, 45 Mad.L.J 551.

However, there has been a controversy about the past cohabitation. Allahabad and Madras. High Courts have treated an agreement to give woman sum of money in consideration of past cohabitation as good consideration as being a reward for past services under Sec. 25(2), but Bombay High Court and Mysore High Court have taken the view that gift made for past-co-habitation is void.

(b) A makes an agreement with B for hire of his house to be used by B for promoting prostitution. The agreement is void since the object is to promote immorality. All Baksh v. Chunia 1877 Punjab.

Hiring, sale of a house or property or giving ornaments for adopting vocation of prostitution or running a brothel declared immoral by the various Indian as well as English Courts. However, if money is borrowed by a dancing girl to teach singing or dancing to her own daughters, the agreement is not void because singing is not acquired with a view to practice prostitution. Khubchand v Beram (1889, 13 Bombay 150).

(c) A firm of coach-builder shared out a carriage to a prostitute, knowing that it was to be used by the prostitute to attract men. Held, the coach-builders could not recover the hire as the agreement was based on immorality. (Peace v Brooks 1866. L.R. 1 Ex. 213).

Opposed to Public Policy: agreement harmful to the public welfare said to be opposed to public policy. Lord Truro in Egerton v Brownlow (1953; 4 H...Cas. 1) has stated that Public Policy is that principal of law which holds that no subject can lawfully do that which has a tendency to be injurious to the public or against the public good-which may be termed the policy of the law, or public policy in relation to the law.

No precise definition can be given of term. Certain classes of acts are said to be against public policy or against the policy of the law when the law refuses to recognize it on the plea that they have a mischievous tendency and shall be injurious to the interests of the state or the Public. Agreements may not be in the interest of the Country and they are therefore not to be enforced. During the war, trading with enemies is one such example, pollution in the society or adversely affect the character of the youth. All such cases are to be dealt with under the head 'Opposed to Public Policy'. There is no limit to such acts which can be included under jurisdiction of this head, and therefore, Lord Halsbury in Nanson v Driefontein consolidated Mines (1902, A.C. 484,491) very rightly stated "no court can invest a new head of public

policy". Lord Davey in 1902 said in the House of Lord's that 'Public Policy is always an unsafe and treacherous ground for legal decision'. All those statements were made on account of reason that there is every scope of providing a judge with an excuse for invalidating any contract which is violently disliked. Burrough J. was excited to say that (public policy was a very unruly horse, and when you once get astride it you never know where it will carry you." (Richardson v Mallish, 1824, Bing 229,252).

However, the jurisdiction of the head 'agreements opposed to public policy' has been restricted by the Supreme Court's decision in Gherulal Prakh v Mahadeodas Mariya & Ors., (1959, S.C.A., 342) by the words, "it is advisable in the interest of stability of the society not to make any attempt to discover new heads in these days". It does not mean that the doors have been closed, but caution is given and the courts are permitted to evolve a new head but only under extraordinary circumstances which give rise to incontestable harm to the society.

The Indian Contract Act, 1872 has tried to restrict the scope of agreements opposed to public policy.

The following heads usually cover the agreements/opposed to public policy:

1. Agreements for trading with enemy countries;
2. Agreements for stifling prosecutions.
3. Agreements included under "Champerty and Maintenance" under the English Law. Such agreements relate to the promotion of litigation. However, these are not declared void in India.
4. Agreement creating interference with course of justice, e.g., agreements to use any kind of pressure of influence on judges or officers of justice shall be void.
5. Marriage brokerage contracts e.g., agreement to pay brokerage for getting a spouse shall be void.
6. Agreements tending to create interest against duty e.g., agreement by agents to deal in their own name instead in the name of their principals, without principal 's knowledge.
7. Agreements for sale of public offices e.g., agreement to pay some money in return of getting a job in an office, shall be declared void.
8. Agreements to create monopolies.
9. Agreements not to bid in an action sale.
10. Agreements in restraint of trades.

The above discussion, on agreements opposed to public policy, clearly states the grounds and explains that all such agreements which are contrary to the welfare of the state by interfering with the civil or judicial administration or with the individual freedom of the citizens shall be unlawful as opposed to public policy.

1.11.3 Agreements under Mistake of Law

Indian Contract Act has nowhere defined mistake. However, it can be defined as an erroneous belief about something. Mistake is of two broad types. (1) Mistake as to fact, and (2) Mistake as to Law.

Sec. 21 of the Act deals with the effect of Mistake as to Law but is silent over other issues relating to such types of mistakes.

A contract is not voidable because it was caused by a mistake as to any law in force in India but a mistake as to law not in force in India has the same effect as a mistake of fact.

Illustration

A and B make a contract grounded on the erroneous belief that a particular debt is barred by the Indian Law of Limitation. The Contract is not voidable.

A a widow, is entitled to certain occupancy rights. A remarries and believing that she has lost her occupancy rights by reason of her second marriage agrees to take the land from B, her Zamindar, on an increased rate of rent. Both A and B honestly believe that A has lost her occupancy rights. The contract is not voidable.

Now first of all we should see what a Mistake of Law pertains to ignorance of some Law of the land. It is expected from every citizen of a country to be conversant with the Law of the land. If he violates any law, he cannot be excused on the plea that he had no knowledge about the law, e.g., if a motorist crosses the road without carrying for the red-light signal is a punishable offence. He is to be prosecuted for the offence and is to be fined by the magistrate if challenged. Thus, the maxim. 'Ignorantia jusrisdon excusalt', meaning "Ignorance of Law is no excuse", holds good in every country.

It has been stated by many jurists without some arbitrary rule, imposing upon each citizen the duty of well considering and understanding the consequences of his own acts and contracts there would be no limit to the excuse of ignorance and there shall be no security in any contract. Of course, in some individual cases this maxim may put severe hardships, but it brings stability and certainty to the general transactions of Commerce. In the absence of such a rule such transaction shall become fluctuating and insecure.

However, Mistake of Law is again classified into two-

(1) Mistake as to Indian Law.

(2) Mistake as to Foreign Law.

Mistake as to Foreign Law is treated as Mistake as to Facts and therefore, an agreement based upon Mistake as to Foreign Law is declared void by the Indian Law Courts.

Mistake as to Indian Law does not universally or generally invalidate the transactions which are based upon it. It is due to the simple reason that the maxim Ignorantial juris non excusat is restricted in its operation to ignorance of the general law of the country. Sec. 21, as has been stated above, does not give any relief to the aggrieved party in respect of Mistake of Indian Law. It has been argued that when the mistake is so fundamental as to prevent any real agreement upon the same thing in the same sense for being formed, it is immaterial of what kind of mistake was and how it was brought about. Therefore Sec. 21, does not grant any validity to such apparent agreement which do not satisfy the conditions of Free and real Consent. These conditions have been stated by the provisions of sections 10-13 of the Indian Contract Act. Such a decision has been given in *Balaji Ganoba v Annapuranabai* (A.LR. Nag 1952) also. Thus, mistake of Indian Law does not vitiate the contract of the parties. They have to perform their part of promise otherwise shall face the consequences of the Breach of Contract.

You should remember one thing in this context. *Private rights of property are usually treated to be matter of facts.* If any party to the contract does not have knowledge of his private rights of property and enters into a contract which forms part of the same subject matter, certainly the contract shall be avoided as soon as the aggrieved party comes to realise mistake on his part. This shall all the more be clear from the following illustration.

A agrees to purchase a house from B who is distant relation of his father, never knowing that he is the actual owner of the house. After getting registration of transfer deed in his favour he comes to know of his ownership of the said house but could not get back the consideration money from B.

1.11.4 Agreements by Way of Wager

Agreements by way of wager are void and no suit be bought for recovering anything alleged to be won on any wager or entrusted to any person to abide by the result of any game or other uncertain event of which any wager is made.

This section shall not be deemed to render unlawful a subscription or contribution, or

agreement to subscribe or contribute, made or entered into for or towards any place, prize or sum of money of the value of amount of five hundred rupees or upwards, to be awarded to the inner or winners of any horse race.

Nothing in this section shall be deemed to legalize any transaction connected with horse racing to which the provisions or section 294-A of the Indian Penal Code apply. (sec.30).

Section 30 of the Indian Contract Act states "agreements by way of wager are *void quo no watt"* for the recovery of the amount won shall not be tenable. The section does not define Wager. What is Wager?

William Anson has defined Wager as a contract by A to pay money to B on the happening of a given event in consideration of B paying to him money on the event not happening. *(Hampden v Wash,* 1876 1 A.B.D. 189, 192). According to Justice Hawkins, a wagering contract is one by which two persons professing to hold opposite views touching the issue of a future uncertain event mutually agree that, dependent on the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake, neither or the contracting parties having any other interest in that contract then the sum of stake he will win or lose, there being no other real consideration for the making of such contract by either of the parties. It is essential to wagering contract that each party may under it either win or lose, whether he will win or lose being dependent on the issue of the event, and therefore remaining uncertain until that issue is known. If either of the parties win and cannot lose, or may lose but cannot win, it is not a wagering contract (*Carlil v Carbolic Smoke Bail Co.,* 1892, 2 Q.B. 484) Jenkins C.J. has stated in *Sasson v Tokersy* (1904, 28 Born. 616, 621). "It is of the essence of a wager that each side should stand to win or lose according to the uncertain or unascertained event, in reference to which the chance or risk is taken."

Characteristics

From the above, it can be stated that a wager must have the following characteristics:

a. It is a promise to pay money or money's worth.

b. The promise depends upon the happening or not happening of an event.

c. The event upon which the promise is to depend is uncertain, the parties do not know the occurrence of the event.

d. None of the parties has a control on the occurrence of the uncertain event.

None of the parties has an interest in the occurrence or non-occurrence of the event.

e. We can explain our point with the help of the following examples: -

1. On a cloudy day A bets Rs. 10 with B that it will rain, B being of the view that it shall not rain. A says to B, if it rains, he will receive Rs. 10 from B, but it is does not rain A shall pay Rs. 10 to B. It is a Wager.

A lottery is also a wager since it is a game of chance. An agreement to buy a ticket for a lottery is also a wagering agreement. When the lottery is authorised by the state, the person conducting the lottery is not punished, but that does not make the lottery a valid one, it remains a wagering transaction.

A wager may have all other requisites of a legal contract. It may have two or more parties consideration, subject matter and the identity of minds of the parties. But the peculiarity lies in its performance. Its performance is in the alternative, i.e., one party has to pay the amount to the other. Only one party is to gain and the other is to lose.

There is no difference between the expression 'gaming and wagering' used in the English Statute and repealed by Indian Contract Act XXI of 1848, and the expression 'by way of wager' used in this section. (Kong Yee Lone & Co. v Lowjee Nanjee 1901, 29 Cal 461, L.R. 28 I.A. 239).

Transactions which are not Wager

1. Prize competitions, according to the Prize Competition Act, 1955 in games of skill, if the prize does not exceed Rs. 100. Crossword puzzle is such an example, since it depends upon the skill.
2. Games of skill like athletic competition, wrestling bouts.
3. Subscription or contribution or an agreement to subscribe or contribute, towards any prize, plate or sum of money to be awarded to the winners of the horse race.
4. Tezi Mandir transactions or deals in shares and stocks, where the party's intention is to deliver the goods or securities.
5. Insurance contracts.

1.11.5 Distinction of wager with a conditional promise and a guarantee

The main distinction the wager and the valid conditional is that of intention and interest. In the wager either of the parties has no interest in the agreement except of again or loss. If the event goes in favour of one party he is to gain, if vice-versa he is to lose and one of the

parties is to lose, the other to gain. But in valid conditional contracts, both the parties have proprietary interest. This proprietary interest in the language of Insurance is called Insurable Interest. The insurable interest only makes a difference between a wager and the insurance, contracts, whether of life, fire or marine the parties having an insurance policy have an insurable interest which is a pecuniary interest. An insurance policy wherein the insured has no insurable interest shall be treated as Wager.

Secondly, in wager the parties bet. They depend upon the chance. The uncertain future event may be in their favour or against, they do not know. They have to gain or lose depending upon the result of the uncertain event. But in conditional contracts, like insurance contracts, the insured pays the consideration i.e., premium to the Insurance Company, whether there is loss or not. In the event of the loss sustained by the Insured (policy holder), the Insurance Company is to make good the loss. Thus, the party taking an insurance policy in no case is to bet or take an advantage of the position of the other party.

1.11.6 Wager and collateral Transaction

Section 30 of the Indian Contract 1872 has stated in clear terms that an agreement by way of wager is void. It does not speak that the agreement is illegal. Many cases arise in the law courts of such nature. The decision given by various courts in cases of such nature have proved that wager does not taint Collateral Transactions and therefore, the collateral transactions can be enforced. For example, a suit can be brought to recover a loan to help the payment of gambling debt (Beni Madho Das v Kaunsal, 1900, 22 All 452) or to enable a man to continue speculation or to recover brokerage.]

Wager is void but not forbidden by law. Except in Maharashtra Wager is neither immoral or opposed to public policy under section 23 of the Indian Contract Act. Therefore, the object of an agreement collateral to a wager is not unlawful (except in Maharashtra). A partnership to carry on wagering transactions with third parties has not been declared unlawful (*Gherulal Parakh v Mahadedoas,* A.LR. 1959, S.C. 781). The courts have decided similarly in many cases. In one case Bridgerv Savage (1885, Q.E.D. 363) (it was held) that an action would lie against commission agent who had recovered moneys on account of bets made for the plaintiff. Madras decision in *Muthuswami v Veeraswami* A.LR. 1936, and allahabad decision in *Bhola Nath v Mulchand* in 1903 also testify this rule. A betting agent or a broker, after the bets were lost, paid for the bets, could also recover the same from the defendant. (Read v Anderson).

To conclude, an agreement by way of wager though is void a contract collateral to it or in

respect of a wagering agreement is not void except in the Maharashtra State. To bring in uniformity the Contract act may be reviewed to incorporate the provisions of the Bombay Act. The Bombay Act (Act III of 1865) has declared wagering transactions as illegal and so is the rule in England. (Gaming Acts of 1835, 1845 and 1892). The collateral transactions, in Bombay as well as in England are also regarded illegal but in the rest of India (except Maharashtra) the collateral transactions to wagering agreements are valid ones, although wagering agreements are decided void.

1.11.7 Wager and a Contingent Contract

Before we distinguish a wager and a contingent contract, we must know what a contingent may be said a conditional contract. The performance of the Contract is dependent upon the happening or not happening of some event. Thus, certain contracts are dependent upon the occurrence of an event, while others are dependent upon the non-occurrence of the event.

Section 31 of the Indian Contract Act has defined a Contingent Contract, as a contract to do or not to do something if some event, collateral to such contract, does or does not happen.

Characteristics

A contingent contract has got the following characteristics:

a. A contingent contract is to be performed upon the happening or not happening of some event in future. On the basis of this characteristics this contract is distinguished from other types of contracts.

b. The future event is uncertain. Where the event is bound to happen, the contract is to be fulfilled and therefore, there does not remain any contingency.

The future event upon which the performance of the contract depends is incidental or collateral to the contract. It is not the main part of the Contract.

Examples of Contingent contracts can be found in the Contracts of Insurance, Indemnity and Guarantee.

Contingent Contracts are of two types: **1** those depending upon happenings of an event; and 2 those depending upon the non-happening of an event. Examples of such contracts are as follows:

A contract to pay B Rs. 10,000 if B's house is burnt. This is a contingent contract, here if B's is burnt A shall be liable to pay B Rs. 10,000. If B's house is not burnt, Ais discharged from his liability.

We may take another example. A promise to pay B Rs. 2,000 if B does not marry C. If B marries C, A discharged from his liability. But if B does not marry C but marries D, A is liable to pay Rs.2,000.

Rules regarding Continent Contracts are given in sections 32 to 36 of the Indian Contract Act.

Section 32 states about the enforcement of contracts contingent on an event happening e.g. A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced in law unless and until C dies in life time.

Section 33 states about the enforcement of contract contingent on an event not happening e.g. A agrees to pay B a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

Section 35 states about the performance of a contingent contract within a fixed period, otherwise it shall become void. This section states about both the types of the contracts. Example being.

(a) A promise to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt, within the year.

(b) A promise to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year or is burnt within the year.

Sec. 36 states that the agreement contingent on impossible events are void. Example relating to this are:

(i) A agrees to pay B 1,000 rupees if two straight lines should enclose a space. The agreement is void.

(ii) A agrees to pay B 1,000 rupees if B will marry A's daughter.

C was dead at the time of the agreement. The agreement is void

1.11.8 Distinction between a Wagering and a Contingent Contract

After knowing about a wager and a contingent contract we can easily distinguish between these two. The distinction can be made on the following basis.

1. **Definition:** The Indian Contract Act does not define a wager. Sec.30 of the act states the effect only i.e., wagering agreement is void. But the Act by Sec. 31 defines a

Contingent Contract as the very name suggests is a contract.

2. **Nature:** A wager is an agreement only but a contingent contract as the very name suggests is a contract.
3. **Promise:** In a wagering agreement both the parties of the agreement promise to each other i.e. A shall pay B if the event favours Band B shall pay A if the event favours A. But in a contingent contract the promisor only makes a promise and not the promisee.
4. **Result:** In wagering agreement the loss of one is gain for the other party and vice-versa. But in a contingent contract it is not necessary that one party must lose and the other must gain.
5. **Enforceability:** A wagering agreement is void. It is not enforceable by law. But a contingent contract is valid and can be enforced on the happening or not happening of a future uncertain event collateral to the contract.

So far, you have read that the Indian Contract Act has specifically declared certain agreements void. Till now you have known about the following void agreements:

(1) Agreements made by parties not possessing capacity to contract. —Sec.11
(2) Agreements made under Mistake ofFacts-Sec.23
(3) Agreements having unlawful objects and consideration-Sec.23
(4) Agreements having unlawful objects and consideration in part-Sec.24. Some other agreements declared void are:
(5) Agreement made without considered as Sec.25
(6) Agreement in restraint of marriage. Sec.26
(7) Agreement in restraint of trade. Sec.27
(8) Agreement in restraint of legal proceedings Sec.28.
(9) Agreements to do impossible acts. -Sec.56.

These four types of agreements are being discussed here.

I. Agreements in restraint of marriage-(Sec.26)

Agreements in restraint of marriage have been declared void u/s 26 of the Indian Contract Act since they are illegal. Sec. 26 states, "Every agreement in restraint of the marriage of any person, other than a minor, is void. This is because of the fact that every person has got a right as well as freedom of choice to marry. If an agreement is made interfering in this right,

that is unlawful.

Although a person is not bound by law to marry, but an agreement whereby a person is bound not to marry or whereby his freedom of choice is hindered, is opposed to public policy and illegal. This is the reason, why the act has specifically declared such agreements as void. In Rao Ram Vs Guiab, (A.LR., 1942, Alld. 351) the Allahabad High Court expressed doubt on the question whether partial or indirect restraint on marriage can be brought under the jurisdiction and purview of this section. Now it has also been decided that partial or Indirect restraint on marriage shall also be covered by this section. Indian law of contract differs with the English law over this point. Under English Law partial or Indirect restraint on marriage is not covered by this section. Such agreements shall not be declared void. Only agreements with total restraint shall be declared void.

However, agreement in restraint of marriage is not declared void under the following cases: -

1. Where a Hindu husband at the time of the marriage enters into an agreement with his first wife not to marry a second wife, till she (the first wife) is alive.
2. Where a husband under strained relations with his wife enters into an agreement with her to pay her maintenance allowance during separation.
3. Where an agreement is made to pay a woman certain annuity, until death or marriage or during widowhood.
4. Where a Muslim husband enters into an agreement with her first wife that she can divorce him if he marries a second wife. Under these circumstances the divorce shall be valid and the wife who divorces her husband shall be entitled to get maintenance allowances for the period of iddat. Babu v. Badaraumesa (1919 29 CIJ.230)

II. Agreements in Restraint of Trade: (Sec.27)

Every person has a lawful right to do or adopt any lawful profession, trade or business. If any agreement is made to put restriction over this right, that shall be an infringement of his fundamental right and shall also be against Public Policy. This is why the Indian Contract Act has specifically declared such agreements void.

Section 27 states:

Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Exception I-One who sells the goodwill of a business may agree with the buyer to refrain from carrying in a similar business, within specified local limits, so long as the buyer, or any

person deriving title to the goodwill from him, carries on a like business therein: Provided that such limits appear to the Court reasonable, regard being had to the nature of the business.

Exception 2. —Repealed

Exception 3. —Repealed

Exception 2 and 3 have been repealed by the Partnership Act. These exceptions have been included in the Act under the provisions of Secs. 11(2), 36 (2), 54 and 55 (3).

In India trade has been in its infancy and it is desirable to develop trade. Therefore, through the stringent provisions of Sec. 27 every agreement interfering with the right to trade has been specifically declared void. Public policy required that every citizen be allowed freedom to work for himself and should get the benefit of labour to himself or to the State. He should not enter into any agreement by which he may not be able to utilise his skill or talent for his benefit or to the benefit of his country. If he does so by an agreement, he shall not be allowed to do so. Jankins, C.J. has given such decision in Fraser & Co. V. The Bombay Ice Manufacturing Co. (1904, 29 Bombay 107 at P. 120). The objective of this section thus has been to protect trade. To cite Kindraley J. in Oakes & Co. V. Jackson (1976, 1, Madras, 134, 145), the legislature may have desired to make the smallest number of exceptions to the rule of agreements where trade may be restrained.

Indian law is very stringent on this point. It has invalidated many agreements on this around although they could have been allowed by the English Common Law. English Law has waivered from time to time with the changing conditions of the trade. Till some time Past it considered agreements in total restraint of trade to be valid, but in Nordenfalt V. Maxim Guns Co. it has been decided in 1894 that when restraint is reasonable it should be allowed and the agreement be not declared void on the plea of opposed to public Policy. In Madhub Chunder V. Raj Coomar, (14 Bengal L.R. 76), Couch, C J, has decided that, whether the restraint is general or partial, qualified or unqualified, if it is in the nature of a restraint of trade it is void and the fact that the restraint is limited in point of time or place is impartial. Thus, in India the courts have not been allowed to consider the degree of reasonableness or otherwise of the restraint.

The words, "To that extent", included in the provisions of Sec.27 are very important. These words clarify the position of a situation where the agreement can be broken up into parts. If the agreement can be broken into parts and some of these parts are not affected by the provisions of this section, i.e., are not vitiated as being in restraint of trade, the agreement

pertaining to these parts shall be held valid. However, where the agreement is not divisible, the whole of the agreement shall be declared void.

Let us now think over the cases where agreements in restraint of trade are not treated as void, by the courts in India also. The courts take the plea of reasonableness of limits as also their degree. The cases are covered under the head Exceptions.

Exception

The rule enunciated under section 27, i.e., agreement in restraint of trade is void, shall not hold good under the following cases:

1. *Trade Combinations:* Persons engaged in the same trade or Industry may from a combine to protect themselves from the uneconomic competition. If they enter into some agreement not to produce more than a certain quantity, or sell below a certain price, or to pay profits into a common fund, i.e., to pool the profits and divide it in certain proportion, then all such agreements shall be valid ones. They shall not be treated by the courts in India, also as against Public Policy. Sir Lawrence Jenkins, C.J. expressed a decided opinion in Fraser & Co. V. The Bombay Ice Manufacturing Co., (1904, Bombay) that a stipulation restraining the parties to a combination agreement from selling ice manufactured by them at a rate lower than the rate fixed in the agreement was not void under the provisions of this section. Can you foresee Why? The simple reason is, that such agreements do not restrain the parties from carrying out their business activities. They are simply to observe certain terms in carrying out business. In Kuber Nath V. Mahali Ram (1912, 34 Alld., 587) the Allahabad High Court has decided that such agreements, do neither restrain the trade not are opposed to public policy.

   The following two cases also serve as a good illustration under the above head, although they have been decided by the English Courts. In one case, Palmolive Co. V. Freedman (1928, Ch. 163, CA) a manufacturer of goods sold them to the wholesalers by a contract whereby the purchases (wholesalers) were not to sell these goods to the retailers below a certain price. The wholesalers sold some of the goods to the retailers without getting the required undertaking. It was decided that the wholesalers made a breach of the agreement.

   In the other case, Rawlings V. General Trading Co. (1921, **I.K.B.** 635 C-A.) two merchants entered into an agreement according to the terms of which one of them was to bid in an auction sale and the goods so purchased to be divided between them. This

agreement was entered into with the objective to avoid competition. Held the agreement was valid, and enforceable.

2. *Contracts of Service*: Where an agreement is entered into between the employer and the employee that during service contract, the employee shall not undertake any or the service, the agreement shall be valid one and be enforceable by the employer in case the employee makes a breach of the contract. In many cases the English and Indian Law Courts have decided likewise. An important case over the point is of Charelesworth V Macdonald (1899, 23, Bombay 103)

   However, where the employee is wrongfully dismissed by the employer then, he (employee) is within his rights to treat the dismissal as a repudiation of the contract by the employer and then shall be free from the terms imposing upon him such restrictions. The tests regarding validity of restraints between employees and employees or servants are fully discussed in the Gopal Paper Mills V. Surendra (A.LR., 1962 Calcutta, 61)

   But where the restriction included in the terms of service agreement seem to be unreasonable, the agreements shall be declared void. This point can be illustrated with the help of the following example:

   A medical assistant and two general practitioners entered into an agreement that the assistant shall not, during the service period, serve at any other place and for a period of five years after leaving the service shall not serve in any dispensary or department of medicine surgery or midwifery within a radius often miles from the dispensary of the medical practitioners. It was decided that the restrictions placed were unreasonable. Such decision was given in Routh v. J. Jones (1947, I Alld. E.R. 758). All agreements containing unreasonable restrictions or trade are declared void, unless there are special circumstances to justify them. In such circumstances the onus of proving such special circumstances lies on the party alleging them.

   An agreement by which a person is even partially restrained from competing with his former employer after the expiry of the period of his employment shall also be declared void.

3. *Sale of Goodwill*: Exception 1 to Section 27 states about the sale of Goodwill. Goodwill is the benefit or advantage which a business has in its connection with its customers. It is believed that old customers shall keep their contracts with the old firm and therefore the purchaser of the firm shall get the benefit of these customers. "Goodwill represents

business reputation which is a complex of personal reputation, local reputation and objective reputation and of the products of business. While one of these elements will predominate others will depend on the facts and circumstances of each case."

Thus, a person who purchases the goodwill of a firm can enter into an agreement with the seller not to carry on the same trade or business within a local limit and upto a certain period. But these restrictions of time and place should be reasonable. What is reasonable restriction is a question of fact and is to be decided on the merits of the individual cases. However, in Nordenfelt v Maxim etc. Co., (1894, A.C. 535) the meeting of the word reasonable was explained. The word reasonable means such as would afford a fair protection to the interests of the party concerned and not so large as to interfere with the interests of the public.

Thus, a seller of goodwill of a business may be asked to carry on (a) the same trade or business, within specified local limits (c) so long as the purchaser or his representative in the title carried on a like business, but such restrictions shall be reasonable as to time and space.

4. *Partners agreements*: Exceptions 2 and 3 of Section 27 have been repealed by the Partnership Act since they related to certain agreements between partners. The provisions of these exceptions have now been contained in Sections 11 (2), 36 (2), 54 and 55 (3) of the India Partnership Act.

Sec. 11 (2) states that a partner shall not carry on any other business other than the business of the firm.

Sec. 36 (2) states that a retiring partner may agree with the existing partner of the firm not to cany on a competing business within a specified period and specified local limits.

Sec. 54 states that in anticipation of a dissolution of the firm all partners may agree not to carry on a business carried by the firm within a specified area and a specified period.

Sec 55 (3) states that any partner of a firm upon the sale of a firm enter into an agreement with the buyer not to carry on a similar business upto a specified period and specified limits.

However, the restrictions concerning, and area limits should be reasonable, otherwise such agreements shall be declared void as per the provisions of Sec. 27.

III. Agreements in restraint of Legal Proceedings. (Sec. 28)

Every agreement by which any party thereto is restricted absolutely from enforcing his rights

under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent.

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

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

Section 28 of the Indian Contract Act, as is evident from the above, clearly states agreements retraining legal proceedings to be void. In India, as also in England, agreements perverting the course of justice are declared void, because their object is illegal. Neither the Law favours an agreement the object of which is to change the jurisdiction of a court of law nor it permits an agreement the object between the parties to invest a court which has no Jurisdiction, with authority to try the disputes arising out of a contract. But when two courts have jurisdiction to try a case, and the parties by an agreement limit the jurisdiction to one court only, then such an agreement shall not be declared as void.

Illustration

R of Ratlam sells out some good to M of Madras. R & M both agree that all disputes arising of transactions between them shall be settled only at Ratlam. Here the agreement limits the jurisdiction of Madras Court. Although Madras court can also try the case but the agreement between the parties has ousted the jurisdiction of Madras court as the parties have decided to go to Ratlam Court only and the Law does not take it bad, hence such an agreement is not declared void. By such an agreement none of the parties loses the right to go to the court of law to redress its grievances.

But when the rights of the parties to go to the court of law for getting their grievances redressed are lost or limited, then surely, the agreement shall be termed as an agreement in restraint of legal proceedings, and shall form the subject matter of Sec. 28. Where an agreement restricts the rights of the parties from going to the court of law but to refer all their disputes to arbitration, then too the agreement shall not be treated as an agreement in restraint of legal proceedings. Such an agreement is not intended to oust the jurisdiction of a court because an arbitrator himself acts as a Judge of a court and the award given by him can be

modified revised, remitted or set aside under certain circumstances.

The provisions of the above section were also held good in cases where an agreement provides that a suit should be brought for the breach of any terms of the agreement within a time shorter than the period of limitation, prescribed by the Law of Limitation. The agreement under such circumstances shall be declared void. This is so because the effect of such an agreement is absolutely to restrict the parties from enforcing their rights after the expiration of the stipulated period, though it may be within the period of limitation.

There are cases which do not limit the time within which the party is required to enforce his rights, but which provide for release or forfeiture of rights if no suit is brought within the stipulated period, stated in the agreement. Such cases do not fall under the purview of Sec. 28 cases are binding upon the parties. They are valid agreements. Usually, the Insurance Companies insert such clauses in their agreements with the insured. Let us take an example.

Suppose an insurance policy is taken by X Co., against fire for goods stored in the godown. The Insurance Company inserts a clause in the policy, which reads as follows:

"If the claim is made and rejected, and an action or suit be not commenced within three months after such rejection all benefits under this policy shall be forfeited."

The policy shall not be treated void, because the clause so inserted operates as a release or forfeiture of the rights of the assured if the condition be not complied with and the party shall not be able to maintain a suit after the expiry of three months from the date of rejection of the claim preferred by the insured. The High Court of Bombay gave such a decision in Baroda Spg & Wvg. Co. Ltd. v Satyanarayana Marine & Fire insurance Co. Ltd. (1914, 38 Born. 544).

Exception 1: This exception applies only to a clause of contracts, where as in Scott v Avery (1885, 5 H.L. 81l) the parties have agreed that no action shall be brought until some question has first been decided by a reference, as for instance, the amount of damage which the assured has sustained in a marine or fire policy. Such an agreement does not exclude the jurisdiction of the Court; it only stays the plaintiff's hand till some particular amount of money has been ascertained by reference." Such decision was given by Garh C.J. In Corings Oil Co. Ltd. v. Koegler (1876, **1** Cal. 466, 469).

Illustration

A conductor of a tramway company agreed to be bound by the manager of the company as regards a deposit and wage of the current month in case of any breach by him of the rules.

The agreement was held valid. Such decision was given in Aghore Nauth v Calcutta Tramway Company (1885 11, Calcutta 232).

Exception 2: This exception relates to those agreements which refrain the parties going to the Law Courts but in the event of disputes they shall refer them to the Arbitration. Such agreement shall not be declared void. The Courts shall recognize the agreements and give effect to them by staying proceedings in the Court. Mulji v Rans (1910, 34 Born. 13) is such case where the decision has been given on similar lines.

IV. An agreement to do an act impossible in itself is void (Sec.56)

Impossibility of performance of an act does not give or create any obligation upon the parties to a contract. Section 56 of the Act, declared such contract as void. This section states as follow:

An agreement to do an act impossible in itself is void.

A contract to do an act which, after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, becomes void when the act becomes impossible or unlawful.

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

Illustrations

(a) A agrees with B to discover treasure by magic. The agreement is void.

(b) A and b contract to marry each other. Before the time fixed for the marriage. A goes mad. The contract becomes void.

(c) A contract to marry B, being already married to C, and being forbidden by law to which he is subject to practice polygamy. A must make compensation to B for the loss. (d) A contract to take in cargo for Bat a foreign port. A's Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared. (e) A contracts to act a theater for six months in consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

After going through the provisions of Sec.56 as stated above, we find that impossibility is of

two types (1) Impossibility at the time of entering into a contract, and (2) Subsequent impossibility, i.e., after the contract has taken place. We should like to know in detail about these two types of impossibilities.

1. **Impossibility from the very beginning**, i.e., at the time of entering the contract. Agreements which are based upon acts the performance of which is impossible are declared void since the Law does not recognise impossible acts.

Impossible act from the very beginning may further be divided into two categories:

(a) WHERE SUCH ACTS ARE KNOWN TO THE PARTIES: - Such impossibility is termed as Absolute Impossibility and in such cases the agreement is declared void ab initio. If a tantric promises B to put life in the dead body of C for a consideration of Rs. 5,000 the promise forming this agreement shall be void ab initio, since it is a hard fact that life cannot be put in a dead body again.

(b) WHERE SUCH ACTS ARE NOT KNOWN TO THE PARTIES: - There may be cases where the parties to the contract do not know about the reality of the fact at the time of entering into contract but after a certain time, they come to know that the performance of such act is impossible. Soon the parties come to know about the impossibility of performance, the agreement becomes void. Such agreements are covered under the provisions of Sec.20 dealing with Mistake. In majority of cases such agreements relate to the non-existence of the subject matter of the contract at the time of entering into an agreement. Therefore, the agreement is vitiated by Mistake as to the existence of the subject matter of the contract. The following example will make the point all the clearer.

A agrees to sell out to B the timber lying in his Meerut godown for Rs. 2,000. He did not know that timber was already destroyed by fire. The contract is void under the provisions of Sec.20, i.e., Mistake as to the existence of subject matter of contract.

One important point in this connection is to be remembered. If one of the parties knows about the impossibility of performance, even then enters into an agreement with the other party, then the other party gets a right to be compensated for the loss or damage which he has suffered. Such an agreement tantamount to Fraud as discussed by Sec. 17 of the Act. For example, of A knew that the timber for which he is making an agreement to sell to B, has already been destroyed by fire, then his agreement with B shall not be covered by this section but by Sec.17 of the Act. Another good example is example

(c) of Sec.56 wherein A contracts to marry B being already married to C, and being

forbidden by the law to which he is subject to practice polygamy. A must make compensation to B for the loss caused to her by the non-performance of promise.

2. Impossibility which arises after the formation of the contract

A second category of impossibility relates to such contracts which are valid in the beginning but becomes void subsequently because of some act or happening beyond the control of the parties. Such Impossibility is termed as *Supervening Impossibility.* The effect of such impossibility is also to make a contract void. Paragraph 2 of Sec.56 has stated about such impossibility. The common Law of England fixes responsibility upon a person to perform his promise without any qualification. Where the parties to the contract feel that there may be any hindrance in the performance of the contract thus in order to limit their obligation or to qualify the agreement, they may impose such terms and condition which they deem fit. But a condition need not always be expressed in words. Conditions are implied also, which are to be fulfilled for a valid performance of the contract. If an event takes place which is beyond the control of the parties to the contract, and the performance of the contract is made impossible by such event, the parties shall be excused from performing their obligations. Many important decisions have been given in such cases by various English as well as Indian Court. *Krell v Henry* (1903, 2 K.B. 750 C.A.) and Taylor V. Caldwell (1863, 3 B, & S. 826), are important among the English decided *Satyabrata Ghose v* Mungeeram Bangur (1954, SCR 310: A.LR. 1954S.C. 44); *Sushi/a Devi v.* Harishing 1971, A.S.C. 1756; India/Pakistan Partition), are some important Indian cases relating to Supervening Impossibility.

A contract is declared void on the principle of Supervening Impossibility, if without promisor's fault, any one of the following positions has arisen:

(a) Performance is rendered impossible by Law. The Law of the land, after the agreement is entered into, may also take a change and thereby make the promisor helpless in meeting out his obligation. Under the circumstances he shall be excused for non-performance of his part of the promise.

A agrees to sell the product of his field to Bon 1st November 1977. On 1st October, 1977, the state government makes a Law to purchase all the crops from the producers. Here in spite of the desire to sell the producer to B, A is rendered helpless and performance is made impossible by law.

(b) A specific subject-matter assumed by the parties to exist or continue in existence is accidentally destroyed or fails to be produced, or an event or set of things assumed as the

foundation of the contract does not happen or fails to exist, although performance of the contract according to its terms may be literally possible.

In this second case, where the subject matter of the contract is destroyed by the act of God, the parties to the contract shall not be able to perform the promise. Therefore, they are excused for non- performance.

A music shall be taken on rent for several nights for arranging a series of concert. The hall is burnt down before the date of the first concert. The contract shall be declared void on the ground of supervening impossibility. A similar decision was given in Taylor Cadwell (1963, 3 B. & S. 826).

In the case of non-existence or non-occurrence of a particular state of things also the contract shall be discharged on the plea of supervening impossibility since the non-occurrence or non-existence of a particular state is on account of some act beyond the power of parties.

A agrees to marry B. Before the time fixed for such marriage B goes and mad. A shall not marry Band he shall be relieved of his obligation. Here B's mental state has made the contract void.

Similarly, where a room in a hotel is taken for witnessing a procession on a particular date, and the specific purpose, is made known the to the other party of the contract also, the change in the route of the procession shall make the contract void. Krell v. Henry is an interesting case over the point. Failure of the object of such nature is also termed as 'Frustration of the contract.'

c) The promise was to perform something in person and the promisor dies or is disabled by sickness or misadventure. Such cases are usually seen in the practical seen in the practical world. The contract is to be performed by the promisor only and not by his agent or any third party since the performance of the contract is based upon the personal skill or qualities. In such cases the contract shall be declared void, if the promisor becomes sick or is disabled or even dies. The case of *Robinson v Davision* (1871, L.R. 6 Ex. 269) is an important case over this point. A, an artist, entered into an agreement to paint a picture for B in 15 days time. A fell ill and could not paint the picture and deliver the same to B within the agreed time. Held A was discharged from his liability on account of Supervening Impossibility.

d) Outbreak of War. Alien enemy does not have capacity to contract and an enemy country during the war, it shall not be enforceable on the ground of trading with an enemy.

Where a contract is made with a country and after some time due to war the country is declared an enemy country, the contract shall be suspended till the war is over may be revived later on.

A, an Indian, entered into a contract with P of Lahore to supply some cloth. Before the performance of the contract war broke out with the Pakistan. The contract was suspended till the war was over.

Is impossibility of performance an excuse? This is a very important question. Ordinarily a person is expected to perform his obligation, unless its performance becomes absolutely impossible due to any of these causes stated above. To quote Scrutton L. "Impossibility of performance is, as a rule, not an excuse from performance."

A contract shall not be discharged on the ground of lmpossibility under the following cases-

1. The promisor feels difficulty in performing it, due to some unexpected events or delays. A entered into a contract with B to supply some goods to be brought by a ship via Suez Canal.

   The canal was closed for traffic and the shipowner refused to bring the goods through the route of Cape of Good Hope since it was a longer route. A took the plea of Supervening Impossibility to be exonerated from his liability. Held A had to compensate B for breach of the contract. This decision was given in Tsakiroglon & Co. Ltd. v. Noble Thorl G.M.B.H. (1962, A.C.93).

2. Commercial impossibility. Where a party is unable to perform his part of the promise due to the unfavorable market, then he can not escape his liabilities for breach of the contract.

   A agreed to supply 100 bales of Egyptain Cotton to B on 15th November, 1977. Due to lesser supply the price of the cotton rose in the market and A did not purchase it and delivered it to B. A shall not be allowed to take the plea of supervening impossibility.

3. Failure on account of third person's inability to do the work upon which the promisor relied upon, also shall not allow the promisor to plead supervening impossibility.

   A agreed to supply B 1000 pieces of shawls to be manufactured by Lal Imli Mills. The mills did not go for production due to lock out. A cannot be allowed to plead supervening impossibility. He has to pay damages to B.

4. Strikes, lock-outs and civil disturbances also do not exonerate the promisor from his responsibility of performance. If the parties want a relief from such events, they should specify in the terms of contract specifically.

   A agreed to supply 100 quintals of Burma rice to B upto 20th December, 1977. Due to Port strike the rice could not be loaded at Singapore and did not arrive in the market. A was not allowed to plead supervening impossibility. Jacobs v Credit Lyonnais (1884, 12 Q.B.D. 589) is a good case where a similar decision was given.

5. Failure of one object, where a contract is based on several objects, shall also not discharge the contract on this ground.

   A agreed to let out a boat to D for (i) viewing a naval review on the occasion of the Coronation of Edward VII and (ii) to sail round the fleet. The king fell ill and the naval review was abandoned but fleet was assembled. The boat therefore, could be used to sail round the fleet. Held the contract was not discharged. This decision was given in Heme Bay Steamboat Co., v Hutton (1903) 2 K.B. 683.

Effects of Supervening Impossibility

(1) The contract is declared void as per the provisions of Sec. 56 para 2.

(2) The promise is entitled for compensation, if the promisor knows about the impossibility of the performance at the time of entering into the contract, (Sec. 56, para 3).

(3) The parties receiving any benefit shall have to restore back or to make compensation to the other party in case the contract is declared void.

IN-TEXT QUESTIONS

12. Indian Contract Act defines a void agreement as, "an agreement not enforceable by law". **True/ False**
13. A agrees with B to discover treasure by magic. The agreement is void. **True/False**
14. Void agreement is defined by Section 2(j) viz.; Void contract is defined by Section 2(g). **True/False**

1.12 SUMMARY

Every man enters into contracts in the course of daily life. The power of man to make contracts grows as trade, commerce, and industry grew in modern civilization. People are able to negotiate the best deal for the purpose of making contracts because of law's protection and conferral of rights. These broad guidelines are spelled out in the Indian Contract Act of 1872. This promotes the lawful operation of contracts and offers redress to those who are harmed by them. As we discussed above, "a contract is an agreement between parties, creating mutual obligations that are enforceable by law" and an agreement is simply offer plus acceptance between the two parties. In this lesson we discussed about different essential elements of a valid contract which include offer and acceptance, intention to create legal relations, lawful consideration, capacity of parties and involvement of a lawful object.

"A proposal when accepted becomes a promise" and defines 'acceptance' as "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted." As a result, "acceptance" refers to the offere's indication of his consent to the offer's terms. Another concept that we discussed was 'Consideration' it is characterised as the sum paid to secure another's promise. Essentials of valid consideration include, consideration must move at the desire of the promisor, Consideration may be past, present or future and Consideration must be "something of value".

Another essential ingredient of a valid contract is that the contracting parties must be 'competent to contract'. Section 11 of the act lays down that every person is competent to contract, with some exceptions i.e., a minor, a person with unsound mind and if he/ she is disqualified from contracting by any law.

1.13 ANSWERS TO IN-TEXT QUESTIONS

1. 1st September 1872	9. Coercion
2. False	10. Undue Influence
3. Illegal objective	11. Fraud
4. True	12. True
5. Express and Implied contracts	13. True
6. True	14. False

7. a,b,c are correct 8. Implied offer	

1.14 SELF-ASSESSMENT QUESTIONS

1. How many types does contract can be classified into, on basis of formation? Explain.
2. What do you understand by the term 'Consideration'? Are there any circumstances under which a contract, under the provisions of the Indian Contract Act, 1872, without consideration is valid? Explain.
3. What do you understand by offer? What are its legal requirements.
4. Explain in brief the rules relating to 'Acceptance' of an offer under the provisions of the Indian Contract Act, 1872.
5. "An agreement enforceable by law is contract". Discuss the concept of valid contract and bring out the essentials of valid contract.
6. "All contracts are agreements, but all agreements are not contracts". Discuss the statement explaining the essential elements of a valid contract.
7. Distinguish between the following pairs:
   (a) Void and Voidable contracts
   (b) Void agreements and void contracts
   (c) Void and illegal agreements
8. Define offer and acceptance. What are essentials of a valid acceptance?
9. "An invitation to offer is not an offer". Justify and explain the statement.
10. "Insufficiency of consideration is immaterial; but an agreement without consideration is void". Explain the statement.
11. "Consideration need not to be adequate, but it must have some value in the eye of law". Explain the statement.
12. What do you understand by 'capacity to contract'.? What are the effects of agreements made by persons of unsound mind.
13. Discuss and explain in detail the provisions of law relating to minors' agreements.

14. What do you mean by consent given under coercion? How does coercion differ from undue influence.
15. Define the term 'misrepresentation'. What effect it has on the validity of a contract? Also distinguish it from fraud.
16. Distinguish between the following and give suitable illustrations:
    (a) Coercion and undue influence
    (b) Misrepresentation and Fraud
17. "An agreement is illegal and shall not be enforced if the court regards it as immoral". Comment.
18. Examine the validity of agreements with consideration and object unlawful in part.
19. What do you understand by an illegal agreement? What is the effect of illegal agreements?
20. Discuss briefly expressly declared void agreements under the Indian Contract act.
21. "An agreement in restraint of trade is void". Discuss the statement and give exceptions to it, if any.
22. Discuss with suitable examples the law relating to validity of contracts by minors.

1.15 SUGGESTED READINGS

- *Kuchhal, M. C., & Kuchhal, V. (2013). Business Laws. New Delhi. Vikas Publishing House.*
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- *Tulsian, P. C. (2000). Business Law. New Delhi. Tata McGraw Hill.*

1.16 ADDITIONAL READINGS

- *Arora, S. (2021) Business Laws. New Delhi. Taxmann.*
- *Das, & Roy, (2018). Business Laws. Oxford University Press*
- *The Indian Contract Act, 1872.*
- *https://legislative.gov.in/sites/default/files/A1872-09.pdf*
- *https://www.indiacode.nic.in/handle/123456789/2187?sam_handle=123456789/1362*

UNIT II

LESSON 2

DISCHARGE OF CONTRACTS

STRUCTURE

2.9 Additional Readings

2.1 LEARNING OBJECTIVES

- To help the students to understand modes of discharge of contracts.
- To make the students understand what is breach of contract and remedies against the breach.
- The objective of this course is to provide the students with legal knowledge of general business law and issues arising thereof.

2.2 INTRODUCTION

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

1. By agreement.
2. By performance of the contract.
3. By lapses of time.
4. By operation of law.
5. By material alteration.
6. By subsequent impossibility of the performance.
7. By breach

2.3 DISHCARGE OF CONTRACT

2.3.1 By Agreement Sec. (62-64)

The parties may agree to terminate the existence of the contract by any of the following ways:-

(a) **By Novation (Sec. 62):** Substitution of a new contract in place of the old existing one is known as 'innovation of contract'. New contract may be either between the same parties or between different parties, the consideration being mutually the discharge of the old contract.

(i) Substitution of a contract with new terms for an old contract between the same parties.

(ii) Substitution of a new party for an old one, the contract remaining the same. Promisee will now look to the third party for the performance of the contract. Original promisor is released of the obligations under the old contract.

Examples

(i) A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor, instead of A. The old debt of A to B is at an end and a new debt from C to B has been contracted.

(ii) A owes B Rs. 10,000 . A enters into an arrangement with B, and gives B a mortgage of his (A's) estate for Rs. 5,000 in place of the debt of Rs. 10,000. This is a new contract and extinguishes the old.

(iii) A owes B, Rs. 1,000 under a contract. B owes C Rs. 1,000. B orders A to credit C with Rs. 1,000 in his books but C does not assent to the arrangement. B still owes C Rs. 1,000, and no new contract has been entered into.

Novation can take place only with the consent of all the parties. It cannot be compulsory. (Appukuthan V Athapa, 1966).

As a result of novation, old contract is completely discharged, and law will not entertain any action based upon the terms of the old contract.

(b) **By rescission (Sec. 64)**: Rescission means cancellation of the contract. A contract can be rescinded by any of the following ways:-

(i) By mutual consent:- Parties may enter into a simple agreement to rescind the contract before it's breach.

(ii) By the aggrieved party :- Where a party has committed a breach of the contract, the aggrieved party can rescind the contract without in any way effecting his right of getting compensation for the breach of contract.

(iii) By the party whose consent is not free:- In case of a voidable contract, the party whose consent is not free can, if so decides, rescind the contract.

A contract may also be taken to be impliedly rescinded where none of the parties has performed his part till a long and no party has any complaint against the other.

(c) **By alteration:** Alteration means change in one or more of the conditions of the contract. Alteration made by the mutual consent of the parties will be perfectly valid. But any material alteration in terms of a written contract by the one party without the consent of other party will discharge such party from its obligations under the contract.

In case of novation a new contract replaces an old contract. The parties may also change. While in case of alteration only some of the terms of the contract are changed. Parties also continue to be the same.

(d) **By remission (Sec. 63)**: Remission means acceptance of a lesser performance than what was actually due under the contract. According to Sec. 63 a party may dispense with or remit, wholly or in part, the performance of the promise made to him. He can also extend the time of such performance or accept instead of any satisfaction which he deems fit. A promise to do so will be binding even though there is no consideration for it.

Example:

(i) A owes B Rs. 5,000. A pay to Band B accepts in satisfaction of whole debt Rs. 2,000 paid at the time and place where Rs. 5,000 were payable. The whole debt is discharged.

(ii) A owes B, under a contract, a sum of money., the amount of which has not been ascertained. A without ascertaining the amount gives to B, and B, in satisfaction, therefore, accepts the sum of Rs. 2,000. This is a discharge of the whole debt whatever may be its amount.

Accord and satisfaction: These two terms are used in English Law. In England, a promise to accept less than what is actually due under the contract is not enforceable, but if this promise has been actually carried out, it will give a valid discharge to the other partly.

Example: A is B's debtor for a sum, of Rs. 500. B agrees to accept Rs. 300 in full satisfaction of his claim. This promise is unenforceable. However, if A pays Rs. 300 and B accepts the payment, A will be discharged from his liability for the whole debt.

'Accord means promise to accept less than what is due under the contract. 'Satisfaction' implies the payment or the satisfaction of the lesser obligation. An

accord not followed by satisfaction will be unenforceable. Actual performance of the new promise and its acceptance by the other party is essential to discharge the old obligations by accord and satisfaction. The original cause of action is not discharged so long as the satisfaction, agreed upon, remains executory.

(e) **Owing to the occurrence of an event**, on the happening of which it was previously agreed that all rights and liabilities should cease.

(f) **By waiver (Sec. 63):** A contract may be discharged by agreement between the parties to waive their rights arising from the contract. Thus, in case of waiver, the person who is entitled to any right under the contract, intentionally relinquishes them without consideration and without a new agreement. Under English law waiver is possible only by agreement under seal.

Example: A promises to paint a picture for B.B afterwards forbids him to do so. A is no longer bound to perform the promise.

2.3.2 By performance of the contract (Sec. 37)

When parties fulfil their obligations and promises under a contract the contract is said to have been performed and discharged. Performance should be complete and according to the real intentions of the agreement. Offer of performance shall have the same effect as performance. A party to a contract shall become free from all obligations if it had offered to perform his part of the promise but it was not accepted by the other party.

2.3.3 By Lapse of time

Every contract must be performed either within the period fixed or within a reasonable time of the contract. Lapse of time may discharge the contract by barring the right to bring an action to enforce the contract under the Limitation Act.

2.3.4 By operation of law

A contract is discharged or terminated by operation of other laws in the following cases:

(a) **Merger.** Merger implies coinciding and meeting of an inferior and superior right on one and the same person. In such a case inferior right available to a party under an agreement will automatically vanish.

Example: A is holding a property under lease. He subsequently buys that property. A's right as a tenant is inferior to his right as an owner of the property. The right as a tenant and right as owner have coincided and met in one person i.e., A. Therefore, A's rights as a lessee will terminate.

(b) **Death:** In case a contract is of a personal nature, the death of the promisor will discharge the contract. In other case, the rights and liabilities of the deceased person shall pass to his legal representatives.

(c) **By complete loss of evidence** of the existence of the contract.

(d) **By insolvency**. An insolvent is released from performing his part of the contract by law. Order of discharge, however gives a new lease of life to the insolvent and he is discharged from all obligations arising from all his earlier contracts.

2.3.5 By material alteration

Any material alteration made intentionally in a written contract by the promisee or his agent without the consent of the promisor entitles the later to regard the contract as rescinded.

An alternation will be taken to be material if it directly or indirectly affects the nature or operation of the contract or the identity, validity or effect of the document.

IN-TEXT QUESTIONS

1. _____ means cancellation of the contract (Sec. 64).
2. Every contract must be performed either within the period fixed or within reasonable time, if not done so the contract is said to be discharged by_____.

   a) Lapse of Time b) Operation of Law
   c) Agreement d) Performance of contract.
3. An insolvent is released from performing his part of the contract by law. True/ False

2.3.6 By supervening impossibility of performance (Sec. 56)

Supervening impossibility arises due to the happening of certain events which were neither in the contemplation of the parties when they entered into the agreement nor either of the parties are responsible for causing the performance of the contract impossible. In such a case the contract will be void as soon as such events make the performance of the contract impossible. The impossibility must be either legal or physical but not commercial. This is called "Doctrine or Supervening Impossibility". Section 56 of the Indian Contract Act 1872 lays down:

"An agreement to do an impossible act is void".

A contract to do an act, which after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, becomes void when the act becomes impossible or unlawful. This is called "Supervening Impossibility", i.e., impossibility arising subsequent to the formation of the contract. The supervening impossibility may be due to any of the following causes:

(a) **By the destruction of the subject matter**. If the subject matter of the contract is destroyed subsequent to the formation of the contract, without any fault of either of the parties, the contract shall become void.

Examples:

(i) A music hall was let for a series of concerts on certain days. The hall was burnt down before the date of the first concert. The contract was held to be void.

(ii) A person contracted to deliver a part of a specific crop of potatoes. The potatoes were destroyed through no fault of the party. The contract was held to be discharged. (Howell V. Coupland, 1876).

(b) **Failure of ultimate purpose:** Where the ultimate purpose for which the contract was entered into fails, the contract is discharged, although there is no destruction of any property affected by the contract and the performance of the contract remains possible in literal sense.

Example:

(i) H hired a room from K for two days to witness the coronation procession of King Edward VII. K knew the object of the contract though the contract contained no reference to the coronation. Owing to King's illness the procession was cancelled. It was held that H was excused from paying rent for the room, as the existence of the procession as the basis of the contract and its abandonment discharged the contract. (Krell V. Henry 1903).

(ii) A and B contracted to marry each other. Before the time fixed for marriage, A goes mad. The contract becomes void.

(c) **Death or personal incapacity of the promisor**. Contracts involving personal skill of the promisor will stand discharged in the case of his death or personal incapacity.

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

(d) **Change of law**. On account of subsequent change in law, the performance of the contract may become impossible. The object of the contract may be declared to be unlawful.

Example: (i) A, who is governed by Muslim law and who already had a wife promises to marry B. Subsequent to this promise and before it is carried out, Special Marriage Act prohibiting polygamy is passed. The contract to marry becomes void.

Example: (ii) X sold to Y a specific parcel of wheat in a godown. Before delivery could be made, the godown was sealed by the Government and the entire quantity was requisitioned by the government under statutory power. The contract was held discharged (Re Shipp, Anderson & Co. V. Harrison Brs. and Co's Arbitration (1915).

(e) **Outbreak of War**. A contract entered into with an alien enemy during the war is unlawful and, therefore, void ab initio contracts made before the outbreak of war either suspended or declared void by the Government. If they are suspended, they may be performed after the termination of the war.

Example: A contracts to take in cargo for B at a foreign port. A's government afterwards declared war against the country in which port is situated. The contract becomes void when war is declared.

It is worthwhile to note that the word "impossible" under Section 56 has not been used in the physical or literal sense. A contract may not have become literally or physically impossible to perform but if an untoward event has happened which has totally upset the very foundations of the contract will be taken to be impossible to perform.

Cases not Covered by Supervening Impossibility

It may be stated that impossibility to perform arising subsequently to the agreement will not, as a rule, relieve the promisor from performing his part in all cases, because, "Where there is a positive contract to do a thing not in itself unlawful, the contractor must perform it or pay damages for not doing it, although in consequence of unforeseen accidents, the performance of his contract has become unexpectedly burdensome or even impossible (Tayler V. Caldwell (1863). Therefore, in the following cases the doctrine of supervening impossibility will not apply.

(a) **Difficulty in performance**. A contract can be avoided on the ground of supervening impossibility only when the events taking place make the performance of the contract physically or legally impossible as contemplated by the parties at the time of the making of the contract. Difficulty in performance will not discharge a contract on the ground of impossibility of performance.

Example:

(i) A sold to B a certain quality of Finland timber to be delivered between July and September1914. Before any timber was supplied, war brokeout in the month of August and transport was disorganised so that A could not bring any timber from Finland. It was held, B was not concerned with the way in which A was going to get timber, and, therefore, impossibility of getting timber from Finland did not excuse performances. Blakbum Bobbin Co. V.T.W. Allen & Sons, 1918).

(ii) X promised to send certain goods from Bombay to Antwerp in September. In August war brokeout and shipping space was not available except at very high rates. It was held that the increase of freight rates does not excuse performance.

(b) **Commercial impossibility:** A party cannot be discharged from performing his part of the contract simply on the ground that it will be now-profitable for him to perform the contract.

Example: A agrees to supply certain goods to B. Due to outbreak of war the price of goods suddenly shoots up. A is not discharged from his liability to supply goods to B.

(c) **Impossibility due to behaviour of a third person:** A contract, the performance of which depends on the behaviour of a third person, shall not become impossible of performance merely because the third party did not act in a particular manner agreed upon, on the ground that if a person chooses to answer for the voluntary act of third person, he must be held to warrant his ability to procure that act.

Example: X enters into a contract with Y for the sale of certain goods to be produced by Z a manufacturer of those goods. Z does not manufacture the goods. X is liable to Y for damages.

(d) **Strikes, lockouts and civil disturbances:** Strikes lock-outs and civil disturbances will not discharge a party from performing his part of the contract unless a specific provision to this effect has been made in the contract.

Example: X agreed to supply certain goods to Y. The goods were to be procured from Algeria. Due to riots and civil disturbances in that country goods could not be procured. It was held that there was no excuse for the non-performance of the contract. (Jacobs V. Credit Ilyonnais 1884).

(e) **Partial Impossibility:** Where there are several purposes for which a contract is made, failure of one of the objects will not terminate the contract.

Example: A company agreed to let a boat to H to view, (i) the naval review at the coronation; and (ii) to cruise round the fleet. Due to the illness of the King the naval review was cancelled, but the fleet was assembled. The boat, therefore, could sail round the fleet. Held, the contract was not discharged. (H.B. Steamboat Co. V. Hulton, 1903).

Effects of supervening Impossibility

1. The contract becomes void in case its performance becomes subsequently impossible, Parties to the contract will be released from further performance (Sec. 56 para 2).

2. The person, who has received any advantage under a contract which becomes subsequently void is bound to restore it or to make compensation for it to the person from whom he received it (Sec. 65).

3. Where one person has promised to do something which he knew or with reasonable diligence might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-- performance of the promise (Sec. 56 para 3).

   Example: A contracts to marry B being already married to C and being forbidden by the law to which he is subject to practice polygamy. A must make compensation to B for the loss caused to her by the non-performance of his promise.

2.3.7 By Breach

Breach means failure of a party to perform his or her obligation under a contract Breach of contract may arise in two ways.

1. Actual Breach.

2. Anticipatory Breach.

Actual Breach: Actual breach means breach committed either;

(i) at the time when the performance of the contract is due; or

(ii) during the performance of the contract.

Example:

(i) agrees to supply to B on the 1st February, 1975, 1000 bags of sugar. On 1st February 1975 he fails to supply. This is actual breach of contract at the time when the performance is due. The breach has been committed by A.

(ii) If on 1st February, 1975 A is prepared to supply the required number of bags of sugar and B without any valid reasons refuses to accept them, B is guilty of breach a contract.

Anticipatory Breach

Breach of a contract committed before the date of performance of the contract is called anticipatory breach of contract. (Sec. 39). The contract in this case is repudiated before the time fixed for its performance arrives and is so discharged.

Example:

(i) A agrees to employ B from 1st of March. On 1st February, he writes to B that he need not join the service, the contract has been expressly repudiated by A before the date of its performance.

(ii) A agrees to marry B. But before the date A marries C. The contract has been repudiated by A by his conduct before the due date of its performance.

Anticipatory breach of contract does not give rise to a right of action unless the promisee elects to treat it as equivalent to actual breach.

Remedies in the case of anticipatory breach

Two remedies are open to a promisee in the case of an anticipatory breach of contract. He may exercise any one of them:

1. To take the anticipatory breach as actual breach and sue for damages and other rights that may be available to him under the law. Thus, promisee may treat the contract as over without waiting for the arrival the due date of the performance of the contract.

   Example: K promised to marry F soon after the death of K's father. During the father's lifetime K absolutely refused to marry F. It was held that through the time of performance of the contract had not arrived. F was entitled to sue for the breach of promise to marry. (Frost V Knight (1872).

2. To wait till the due date of performance of the contract and then avail of legal remedies in case of breach of contract available against the party guilty of breach.

   If the promisee decides to enjoy the first remedy i.e., termination of the contract at the time when anticipatory breach of contract is communicated to him, the quantum of damages will be assessed by the difference of prices prevailing on the date of breach and the contract price. But if the party keeps the contract alive till the due of performance arrives, damages will be measured by the difference between the

contract price and the prices prevailing on the date fixed for the performance of the contract.

In a case when the promisee keeps the contract alive the contract will remain operative for the benefit of both the parties. If during the interval i.e., the date of breach and the due date for the performance of the contract, special circumstances intervene which operate for the benefit of the promisor, the promisor would also be legally entitled to take advantage of them. He may still perform the contract irrespective of his earlier repudiation (Phul Chand V. Jugal Kishore).

IN-TEXT QUESTIONS

4. X enters into a contract with Y for the sale of certain goods to be produced by Z a manufacturer of those goods. Z does not manufacture the goods. Will X be liable to Y for damages. True / False
5. Breach of a contract committed before the date of performance of the contract is called _____.
6. Which of the following case is not covered under discharge of contract by supervening impossibility of performance?
   a) Impossibility due to behaviour of a third person b) Strikes
   c) Difficulty in performance d) None of the above
7. If on 1st February 1975 A is prepared to supply the required number of bags of sugar and B without any valid reasons refuses to accept them, B is guilty of breach a contract under _____.

2.4 REMEDIES FOR BREACH OF CONTRACT

In the case of breach of contract on the part of one party, the aggrieved or injured party has the following remedies available: -

1. Rescission of the contract.
2. Damages.
3. Quantum meruit.

4. Specific Performance.
5. Injunction.

2.4.1 Rescission of the Contract

Rescission means the setting aside of the contract. The aggrieved party may be allowed by the court of treat the contract at an end and thereby, terminate all his liabilities under the contract. The court, however, will not allow recession of the contract in the following cases:

(i) Where the party wishing to set aside the contract has expressly or impliedly ratified the contract.

(ii) Where only a part of the contract is sought to be set aside and that part cannot be separated from the rest of the contract.

(iii) Where without fault of either party, there is a change in the circumstances since the making of the contract, on account of which the parties cannot be substantially restored to the position in which they were before the contract was made.

(iv) Where during the subsistence of the contract, third parties have acquired rights in the subject matter of the contract in good faith and for value.

The party rescinding the contract will have to restore all benefits received by him under the contract to the other party. Of course, he will be entitled to get compensation for the loss suffered by him on account of non-fulfilment of the contract.

2.4.2 Damages

Damages mean monetary compensation payable by the defaulting party to the aggrieved party in the event of the breach of a contract. The object of providing damages is to put the aggrieved party in the same position, so far as money can do, in which he would have been, had the contract been performed.

Types of Damages

Damages may be.

1. Ordinary damages.
2. Special damages.
3. Exemplary or vindictive damages.

4. Nominal damages.

1. **Ordinary damages:** Damages which arise in the ordinary course of events from the breach of contract are called ordinary damages. These damages constitute the direct loss suffered by the aggrieved party. They are estimated on the basis of circumstances prevailing on the date of the breach of the contract. Subsequent circumstances tending to change the quantum of damages are ignored.

2. **Special damages:** They are those which result from the breach of the contract under special circumstances. They constitute the indirect loss suffered by the aggrieved party on account of breach of the contract. They can be recovered only when the special circumstances responsible for the special losses were made known to the other party at the time of the making of the contract.

3. **Exemplary or vindictive damages:** They are quite heavy in amount and are awarded only in two cases:

   (i) Breach of a contract to marry.

   (ii) Dishonour of a customer's cheque by the bank without any proper reason.

   These damages are awarded with the intention of punishing the defaulting party. They are of a different nature and their object is to prevent the parties from committing breach. In the case of breach of contract to marry damages will include compensation for the loss of the feelings and the reputation of the aggrieved party. In the case of dishonour of a cheque, damages are awarded taking into consideration the loss to the prestige and goodwill of the customer and the general rule is that the smaller the cheque the greater is the amount of damages.

4. **Nominal Damages:** These damages are quite small in amount. They are never granted by way of compensation for the loss. In such usually actual loss is very negligible. They are awarded simply to recognize the right of the party of claim damages for breach of the contract.

Rules regarding the determination of damages (Sec. 73)

The rules regarding damages have been very explained in an English case of Hadley V Baxendale.

The case is discussed below:

"Hadley's mill was stopped on account of the breakage of a crankshaft Baxendale, a common carrier was entrusted with the delivery of this machine part for taking it to its makers at Green which as a pattern for a new one. Baxendale, did not have this information that delay in carrying the machine would result in loss of profits. The delivery was delayed beyond a reasonable time by some neglect on the part of Baxendale. Hadley claimed from Baxendale compensation for the wages of workers and depreciation charges which were incurred during the period the factory was idle for the delayed delivery and for loss of profit which might have been made if the factory was working the first two items were allowed because they were the natural consequences of breach but the loss of profit was disallowed as it was special or remote loss which could be recovered only when the party had information of it."

Alderson, J. Observed in the above case as follows.

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself or such as may reasonably be supposed to have been in the contemplation of the parties, at the time they made the contract as the probable result of the breach of it."

Rules regarding the ascertainment of the number of damages can be summarised as follows:

1. The principal upon which damages are to be assessed is that where a party sustains a loss by reason of breach of contract, he is, so far as money can do it, to be placed in the same situation with respect to damages if the contract had been performed. Aggrieved party shall be allowed compensation only for the actual loss suffered by him.

2. A party who sustains loss by the breach of a contract is entitled to recover from the party breaking it, compensation for any loss or damages caused to him.

3. Compensation can be claimed for damages: -

   (a) Which arise naturally in the usual course of things from breach of contract itself. (Hadley V. Baxendale, 1854) Damages are paid only for the proximate consequences of the breach of a contract; or

(b) As may reasonably be supposed to have been in the contemplation of both the parties, at the time they made the contract, as the probable result of the breach of it.

Claim for damages must be fair and reasonable.

4. Special or indirect loss can be recovered only when the special circumstances have been made known to the other party. Examples (1) A contracts to buy of B, at a stated price, 50 maunds of rice, no time being fixed for delivery. An afterwards informs B, that he will not accept the rice if tendered to him. B is entitled to receive from A, by way of compensation, the amount, if any, by which the contract price exceeds that which B can obtain for the rice at the time when A informs B that he will not accept it.

(ii) A contract with B to pay B Rs. 1,000 if he fails to pay B Rs. 500 on a given day. A fail to pay B Rs. 500 on that day. B is entitled to recover from A such compensation, not exceeding Rs. 1,000 as the court considers reasonable.

5. The party suffering from the breach is expected to take reasonable step to minimise the loss. He cannot claim as damages any loss which he has suffered due to his own negligence.

Example

A fires B's ship to go to Bombay, and agrees to take on board on the first of January, a cargo which A is to provide, and to bring it to Calcutta, the freight to be paid, when earned. B's ship does not go to Bombay, but A has opportunities of procuring suitable conveyance for the cargo upon terms as advantageous as those on which he had chartered the ship. A avail himself of those opportunities; but is put to trouble and expense in doing so. A is entitled to receive compensation from Bin respect of such trouble and expense.

6. Damages are given by way of restitution and compensation and not by way of punishment. Aggrieved party can recover only the actual pecuniary loss sustained by him and not exemplary damages, except in the circumstances already stated in the previous pages.

7. Nominal damages may be granted when breach of a contract is committed without any real loss.

8. In contracts of sale and purchase of goods the measure of damages will be the sum by which the contract price falls short of the price at which the purchaser might have obtained goods of life quality at the time and place that they should have been delivered. When no date has been fixed for the performance of the contract and the promisor commits a breach, the measure of damages will be the difference between the contract price and the market price at the date of the refusal to perform.

   It is to be noted that in case of such a contract if the promisor (seller) retains the goods after the breach of the contract by the promisee (buyer), he cannot recover from the buyer and further loss if the market fails, nor will be liable to have his damages reduced if the market rises, (Jamal V. Molla Dawood and Sons (1916).

   Example

   An agreed to sell certain shares to B to be delivered on 30th December. On account of heavy fall in the value of shares on the date B declined to accept the delivery of shares. Subsequently A sold the shares at a price higher than that prevailing on 30th December. Since his shares had picked up in the mean time. In a suit brought A it was held that he was entitled to recover from B the difference between the contract price of the shares and their market price on 31st December and B was not entitled to the benefits of the profits accrued after the breach.

9. As regards damages arising from the breach of contracts for the payment of money on a particular date, interest on the principal sum from the date on which the sum was agreed to be paid till the actual date of payment will be sufficient compensation to the aggrieved party.

10. If a sum is named in the contract as the amount to be paid in case of its breach if the contract contains any other stipulation by way of penalty for failure to perform his part of the obligation under a contract, court will allow reasonable compensation not exceeding the amount so named in the contract, (Kemble V. Farren 1829).

11. Damages for breach of services contracts by the employers will be determined with reference to the usual terms of wages for the employment contracted for and the time that would be lost before similar employment can be obtained.

12. A carrier of goods can be held responsible for damages arising from deterioration caused by delay even without any prior notice. deterioration in the value of goods

includes both physical damage to the goods as well as damages arising from the loss of special opportunity for sale. (Wilson V. Luncashire and Yorkshire Rly. Co.)

2.4.3 Quantum Meruit

Literally speaking the words "Quantum Meruit" mean "as much as merited" or "as much as earned". It is principle which provides for payment of compensation under certain circumstances, to a person who has rendered goods or services to another person under a contract which could not or has not been fully performed.

Example (i): A person renders some service to a company under contract of employment which is duly approved by the Board of Directors of that company. Subsequently the constitution of Board of Director's found to be illegal and, therefore, the contract of employment becomes void. The employee who has rendered some service to the company shall be entitled to claim remuneration for his service under the doctrine of quantum meruit.

(ii) X forgets certain goods at Y's house. He had no intention to have them with him gratuitously uses those goods for his personal benefit. X can compel Y to pay for those goods.

Doctrine of Quantum meruit is however, subject to the following limitation:

(a) In a contract which is not divisible in to parts and a lumpsum of money is promised to be paid for the complete work, past performance will not entitle the party to claim any payment.

Example: A mate was engaged on the term that he would be paid in a lumpsum for a complete voyage. He died before that voyage was completed. It was held that his representatives could not recover the lumpsum neither could they sue for payment for the services rendered by the deceased. (Cutter V. Powel, 6: TR.320).

(b) A person, who himself is guilty of breach of contract, cannot be allowed claim any payment under the doctrine of quantum meruit.

Example: A, a builder, undertakes to build a house on the land of X for a lumpsum. After A has done part of the work, he refuses to finish it, and X completes the building using some of the materials left on the premises by A Can A recover compensation for the work he has done and for the materials used by X?

A contract being a complete entity no action lies against X, either on the original contract or on a quantum meruit respecting the work done. The fact that X completes the work is no evidence of an undertaking to pay for what he has been following the rule in Sumpter V. Hedges (1878).

If in completing the premises X uses the materials belonging to A, A will have a good claim in respect of the value of the materials used.

But the above rule is subject to the following exception: -

(i) In case of a divisible contract, part performance will also entitle the defaulting party to claim compensation the basis of quantum meruit if the other party has taken the benefit of what has been done.

(ii) If a lumpsum is to be paid for the compensation of an entire work and the work has been completed in full though, badly the defaulting party can recover the lumpsum less a deduction for bad workmanship.

(c) Any claim based upon the doctrine of quantum meruit cannot be entertained unless there is evidence of express or implied promise to pay for the work which has already been done.

Following two remedies are available to the aggrieved party under equity for breach of a contract.

2.4.4 Specific performance

Specific performance: Law courts can at their discretion, order for the specific performance of a contract according to the provisions of the Specific Relief Act in those cases where compensation will not be an adequate remedy or actual damages cannot accurately be assessed.

Specific performance means the actual carrying out by the parties to contract, and in proper cases the court will insist on the parties carrying out their agreement. Specific performance of agreement will not be granted in the following cases: -

(1) Where the agreement has been made without consideration.

(2) Where the court cannot supervise the execution of the contract e.g., a building contract.

(3) Where the contract is of a personal nature.

(4) Where one of the parties is a minor.

Specific performance is usually granted in contracts connected with land or sale of rare articles.

It is, however, to be noted that the plaintiff who seeks specific performance must, in his term perform all the terms of the contract which he ought to have performed at the date of the action (Pudi Lazarus V. Rev. Johnson Edard. 1976 AP. 243).

2.4.5 Injunction:

Where a contract is of a negative character, i.e., a party has promised not to do come thing and he does it, and thereby commits a breach of the contract, the aggrieved party may under certain circumstances, seek the protection of the court and obtain an injunction forbidding the party from committing breach. An injunction is an order of the court instructing a person to refrain from doing some act which has been the subject matter of a contract, Courts, at their discretion, may grant a temporary or a perpetual injunction for an indefinite period.

For example: A agreed to sing at B's theatre and to sing nowhere else for a certain period. Afterwards A made a contract with E to sing at E's theatre and refused to sing at B's theatre. The court refused to order specific performance as the contract was of a personal nature but granted an injunction to restrain the breach of A's promise not to sing elsewhere.

Equitable rights of specific performance or injunction may be lost by laches. Equity is for the benefit of the diligent and not for the sleepy.

IN-TEXT QUESTIONS

8. _____are those which result from the breach of the contract under special circumstances. They constitute the indirect loss suffered by the aggrieved party on account of breach of the contract.
9. X forgets certain goods at Y's house. He had no intention to have them with him gratuitously. Y uses those goods for his personal benefit. X can compel Y to pay for those goods under_____.

IN-TEXT QUESTIONS

10. Alteration means change in one or more of the conditions of the contract. Alteration made by the mutual consent of the parties will not be valid. **True/ False**
11. A person, who himself is guilty of breach of contract, cannot be allowed claim any payment under the doctrine of quantum meruit. **True/ False**
12. A party can claim damages if any loss has been suffered due to its own negligence. **True/ False**

2.5 SUMMARY

When the responsibilities of the contract between the contract's parties are fulfilled, the contract is discharged. This also renders the contract's legal validity null and void. The contract is sometimes referred to as being discharged or being terminated. A contract can be discharged by performance, mutual agreement, supervening impossibility, lapse of time, operation of law or even breach of contract. Whenever any breach of contract occurs, the injured party becomes entitled to many remedies against the guilty party. Remedies like suit for damages, rescission of contract, suit for injunction, quantum meruit and suit for specific performance of contract is provided to the injured party.

2.6 ANSWER TO IN-TEXT QUESTIONS

1. Rescission	9. Doctrine of Quantum meruit
2. Lapse of Time	10. False
3. True	11. True
4. True	12. False
5. Anticipatory Breach	
6. None of the above	
7. Actual Breach	
8. Special Damage	

2.7 SELF-ASSESSMENT QUESTIONS

1. Explain briefly the various modes in which a contract can be discharged.
2. What do you understand by 'anticipatory breach of contract?' Discuss consequences of such breach on the rights and liabilities of the parties.
3. "Impossibility of performance is, as a rule, not an excuse for non-performance of a contract." Discuss.
4. What do you mean by suing on *quantum meruit*? Under which circumstances a claim on a *quantum meruit arise*?
5. When can an aggrieved party file a suit for 'specific performance' and 'injunction'? Explain and give examples.

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2.9 ADDITIONAL READINGS

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LESSON 3

CONTINGENT CONTRACT AND QUASI CONTRACT

STRUCTURE

3.1 LEARNING OBJECTIVES

- To help the students to understand what contingent and quasi contracts are.
- To make the students understand different acts under law
- The objective of this lesson is to provide the students with practical legal knowledge of general business law and issues arising thereof.

- To help students understand and learn the basics of Laws governing commercial contracts.

3.2 INTRODUCTION

A contingent contract is defined as "A contract to perform or not to do something if some event, collateral to such contract, does or does not happen" in Section 31 of the Indian Contract Act, 1872. Therefore, it may be described as a conditional contract also. On the other hand, Quasi contract is created in the absence of an agreement. A contract is something in which parties enter intentionally but a quasi-contract is created by law not by intention. Moreover, there is no intension of the parties to enter into the contract. These are referred to as quasi contracts because, despite the fact that there isn't a written agreement or contract between the parties, they are made to operate as though there is. It is based on the maxim of "Nomo debet locuplatari ex liena justua" that means no man must grow rich out of another person's costs. To put it another way, no one should be allowed to benefit themselves at the expense of others.

3.3 CONTINGENT CONTRACTS

3.3.1 Introduction

According to the Indian Contract Act, 1872, a contingent contract is one whose performance is uncertain. The performance of the contract which comes under this category depends on the happening or non-- happening of certain uncertain-events. On the other hand, an ordinary or absolute contract is such where performance is certain or absolute in itself and not dependent on the happening or non-happening of an event. A contingent contract is defined as a contract to do or not to do something, if some event, collateral to such contract, does or does not happen (sec. 31).

Example- (A) A contracts to pay Rs. 50,000 if B's house is destroyed by fire. This is a contingent contract as the performance depends on the happening of an event.

(B) A asks B to give loan to M and promises that he (A) will repay the loan if M does not return it in time.

3.3.2 Characteristics of a Contingent Contract:

A Contingent Contract must have three essential characteristics. There are:

(1) The performance of the contract depends on the happening or non-happening of a certain event in future. This dependence on a probable future event distinguishes a contingent contract from an ordinary contract.

(2) This event must be uncertain, that means happening or non-happening of the future event is not certain, i.e., it may or may not happen. If the event is hundred percent sure to happen, and the contract in that case has to be performed any way, such a contract is not called a contingent contract.

(3) The event must be collateral or incident to the contract.

Therefore, contracts of indemnity, guarantee and insurance are the most common instances of a contingent contract.

3.3.3 Rules regarding contingent contracts

To enforce the performance of a contingent contract the following rules have to be followed:

1. Where the performance of a contingent depends on the happening of an uncertain future event, it cannot be enforced till the event takes place. And if the happening of the event becomes impossible, such contracts become void (sec. 32).

   Example- A contracts to sell B a piece of land if he (A) wins the legal case involving that piece of land. A loses the case. The contract becomes void.

2. Where the performance of a contingent contract depends on the non-happening of a future event, the contract can be enforced if the happening becomes impossible (sec. 33).

   Example- A agrees to sell his house to B if Y dies. This contract cannot be enforced till Y is alive.

3. If the contract is dependent on the manner in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which makes it impossible that he should so act within any definite time or otherwise than under further contingencies (sec. 34).

4. Contingent contract to do or not to do anything, if a specified uncertain event happens within a fixed time, becomes void if the event does not happen and the time expires or it is happening becomes impossible before the time expires [sec. 35(1)].

5. Contingent contract to do or not to do anything, if a specific event does not happen within a specified time, may be enforced when the time so specified expires and such event does not happen, or before the time so specified it becomes certain that such event will not happen [sec. 35(1)].

6. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether or not the fact is known to the parties at the time when it is made (sec. 36).

IN-TEXT QUESTIONS

1. A contract of life insurance is a _____.
2. A contingent contract depending on the happening of the impossible event is valid. **True / False**
3. Ram agrees to pay Rs 5000 to Shyam if Shyam's car is burnt. It is a?

   a) Void
   b) Voidable agreement
   c) Wagering agreement
   d) Contingent contract

4. A contract to pay Rs 50,000 to X if Y marries Z. But Z dies before marriage. The contract between X and Y:

   a) cannot be enforced
   b) can be enforced at the option of X
   c) can be enforced if Y marry Z
   d) can be enforced at the option of Y

3.4 QUASI CONTRACTS

3.4.1 Introduction

The name **'Quasi Contracts'** is given by the English Law to such transactions in which there is in fact no contract between the parties, but the rights and obligations are created similar to those created by a 'contract'.

For a contract there must be offer and acceptance, free consent, lawful consideration and object and such other elements described under Sec. 10 of the Indian Contract Act 1872. But Quasi Contracts do not have such essential elements of a contract and, therefore, Indian Contract Act has now here used the term 'Quasi or Implied' Contracts'. Instead, it has referred to "certain relations resembling those created by Contract" under Chapter V of the Indian Contract Act, 1872. Such relations are dealt with in the Indian Contract Act 1872 under Sections 68-72.

You may raise a question here. When the essential conditions are not fulfilled an agreement remains unenforceable at Law, this is a rule. Then why these relations dealt with under Sections 68- 72 are recognised by the Indian Contract Act, 1872. The answer to your question is based upon the law of Equity. Where you have received an advantage or got a benefit from some other party which you were not entitled to receive it becomes your duty to compensate fully the other party. Therefore, the Contract Act also, by its Sections 68-72, has given recognition to these relations. These five sections are based upon equitable considerations that such obligations should be fairly compensated. A person who has received the benefit is under an obligation to compensate the person giving the benefit.

Param and Karan enter a contract under which Param agrees to deliver a basket of fruits at Karan's residence and Karan promises to pay Rs 1,500 after consuming all the fruits. However, Param erroneously delivers a basket of fruits at Jay's residence instead of Karan. When Jay gets home, he assumes that the fruit basket is a birthday gift and consumes them.

Although there is no contract between Param and Jay, the Court treats this as a Quasi-contract and orders Jay to either return the basket of fruits or pay Param.

3.4.2 The types of relations dealt here in the Indian Contract Act, 1872 in these sections are stated as below:

1. Supplier of necessaries to minors. Lunatics, married women etc. (Sec. 68).
2. Person paying moneys due by another (Sec.69).
3. Person enjoying benefit to non-gratuitous act or Quantum Meruit. (Sec. 70).
4. Finder of goods (Sec.71).
5. Person receiving money or goods belonging to another under mistake or under coercion (Sec.72). Let us now take these cases one by one

1. Claim for necessaries suppled to a person incapable of contracting (Section 68)

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

Illustration

(a) A supplies B, a lunatic, with necessaries suitable to his conditions in life. A is entitled to be reimbursed from B's property.

(b) A supplied the wife and children of B, a lunatic, with accessories suitable to their conditions in life, A is entitled to be reimbursed from B's property.

The situation discussed by the above section is covered by Section 11 of the Act also, which deals with agreements with persons incompetent to contract. The two illustrations given above here also state the same position. However, the situation arises only in dealing with the incapable persons. Two points here are to be kept in mind.

(1) The amount is recoverable from the property and not from the person. Such person is not personally liable. If he has got any property, then only the creditors shall be able to get their re- imbursement. If no property belongs to such person or persons, the creditors shall not be left with any right

(2) The object supplied must be necessities of life. The word necessities of life is used here in its technical sense, and has a wide scope. It does not only concern with food, and clothes but with everything which the circumstances permit. In England, in one case an engagement ring for one's Finance has been treated as a necessity, but vanity bag has not been included, under this term. (Elkington & Co. V. Amery 1936).

In India, the term necessities, has also included in its purview the costs of defending a suit on behalf of a minor, in respect of his property (Watkins V. Dhunoo,) moneys lent for marriage expenses of a minor and others, say his sisters (Nardan Prasad V. Ajhudhia Prasad) and also a loan to the minor to save his property from execution. (Kedarnath V. Ajhudhia, 1883). Thus, the term 'necessities' is to be viewed in its proper perspective.

The following conditions are to be satisfied for the use of the term 'necessaries'

(a) Things supplied must be suited to the minor's conditions in life.

(b) These must be necessary for minor's requirements, when actually sold or delivered; and

(c) The minor must be having such things in sufficient quantity at the time of such supply. Non-fulfilment of any of these above stated conditions shall effect adversely the rights of the other party.

Nature of Remedy: Remember, a supplier of necessaries has been granted a remedy under this

section against the property of the person and not the person himself.

2. Reimbursement to person paying money due by another in payment of which he is interested (Section 69).

A person who is interested in the payment of money another is bound by law to pay and who, therefore, pay it, is entitled to be reimbursed by the other.

Illustration:

B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being an 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 to prevent the sale and the consequent annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid.

The above illustration is based on the decision given in Faiyazunissa V Bajrang Bahadur Singh (1927).

The above case taken up under Sec. 69 is an exception to the rule regarding consideration Sec. 2 (d) of the Act defining the term 'Consideration', starts with "When at the desire of the promisor, the promisee or any other person has done.....", If there is no desire of the promisor, the act or abstinence of the stranger or even the promiser shall not amount to consideration and in the absence of lawful consideration, there shall not be any contract. It is clear from the above illustration, that the payment of the revenue by B to the Government has not been made with the concurrence of A. Yet, Principles of Equity has created an obligation upon A to reimburse B, the payment made by him to the Government.

Section 69, lays down three important conditions for its operation:

(a) The person who is interested in the payment of money, should have paid for the protection of his own interest. If the payment is not bonafide for the protection of his own interest, but is made without any such notice, then he shall be having no right for reimbursement.

Let us make our point more clear with the help of the following examples:

(i) A purchases property from B, and the sale is fictitious. A cannot recover from B money paid by him to save the property from being sold in execution of a decree against B. (Janki Prasad Singh v. Baldeo Prasad (1908). But where the sale is bonafide, he shall be entitled to recover the amount from B.

(ii) A's goods are wrongfully attached in order to release arrears of Government revenue due by B, and A pays the amount of save the goods from sale, A is entitled to recover the amount from B. (Tulsa Kunwar V Jageshwar Prasad (1906). Another case on the point is Abid Hussain V Ganga Sahai (1928).

It is sufficient to show that the person claiming the benefit had an interest in paying the money at the time of the payment. In a case decided by Madras High Court, a similar decision is given. Sarni Pillai VB. Naidu (1972) a mortgagee of a tenant's crop paid the amount due to Government in respect of a loan given to the tenant (Mortgagor) and raised the attachment. The mortgagee being interested in payment at the time of payment and therefore, was entitled to recover from the mortgagor (tenant) the amount so paid to the Government. Remember, this section does not require from the person interested in payment to have legal proprietary interest in the property in respect of which the payment has been so made. Decision in Govindram v. State of Gandal (1950), Bombay bears in testimony to this point.

(b) The payment should be a voluntary one. If the payment is made voluntarily, the other party then is not under an obligation to make the payment back. While deciding in Ram Tuhul Singh V Biseswar Lal the judicial Committee, observed," It is not in every case in which a man has benefitted by the money of another that an obligation to repay that money arises. The question is not to be determined by nice considerations of what may be fair or proper according to the highest morality. To support such a suit there must be an obligation in the case of a voluntary payment by A of B's debt.

Example

A canal company owned a canal and was under a statutory duty to keep the bridge on the canal under repair. The bridge fall into disrepair and the plaintiffs, the highway authority called upon the canal company to repair it. When the canal company failed to do so, the plaintiff's themselves repaired the bridge and brought an action to recover the money paid. Held, the plaintiff could not recover as they act as mere volunteers. (Macclesfiled Corporation V Great Central Rly. 1911).

The payment made by such as the other party was bound by law to pay. The liability for which payment may be made under this section need not be statutory. Contractual liability is not a necessary element. Let us make the point clear with the help of the following examples: -

(i) W was the owner of a warehouse. G imported certain goods and kept them in the ware house. The goods were stolen without any negligence on the part of W. The authorities made a demand on W for the payment of the custom duties which W paid. Held W could recover the amount from G. (Brook's Wharf Ltd. V Goodman Bros. 1937).

(ii) The goods belonging to A are wrongfully attached in order to realise areas of Government revenue due by G. A pays the amount to save the goods from sale. A is entitled to recover the amount from G. (Abid Hussain V Ganga Sahai, 1928).

3. Obligation of a person enjoying benefit of non-gratuitous act (Sec.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 thereof, the latter is bound to make compensation to the former in respect of, or to restore the thing so done or delivered.

Illustrations:

(i) A, tradesmen, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them.

(ii) A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously. A manages the estate of his wife and sisters-in-law and is under the impression that he will receive remuneration for his services. He is entitled to get reasonable remuneration.

(iii) The right of action this section arises only after the fulfilment of the following three conditions:-

(a) The thing must be done lawfully.

(b) The thing must be done by a person not intending to act gratuitously; and

(c) The person for whom the act is done must enjoy the benefit of it.

The explanation of the above points is given below:

(a) The thing must be done lawfully. Here the word 'lawfully' is quite significant. It indicates that after something is done or delivered to one person by another and the thing is accented and enjoyed by the former, a lawful relationship occurs between the two. Such decision has been given in Chaturbhuj Vzlthaldas V Moreshwar (1954). However, it should be noted that the thing done or delivered must not have been delivered or done with fraud or dishonesty.

(b) The thing should not be done or delivered gratuitously. If the benefit to the other person has been done by a person gratuitously i.e., without any intention to get a reward, he shall not be able to give any right under this section. The section requires other person to use his right of rejecting the thing, if he so likes. The section is applicable for those acts only which are done with the intention of being paid for. Services freely rendered, without any co-operation of a reward for them do not lie under the preview of this section.

A saves B's property from fire. He does the act on the basis of humanity and fellow-feeling. Here A cannot get any reward from B under section 70. On the other hand, if the Salvage Crops of an Insurance Co. with which the property is insured renders its services for saving the house property from fire, from the objective is for getting the payment of the services so rendered, although no such agreement has taken place.

(c) The person for whom the act is done must enjoy the benefit of it. If such person has not enjoyed such benefit, he shall not be liable to pay for it.

Examples

(i) A village was irrigated by a tank. The Government effected certain repairs to the tank for its preservation and had no intention to do so gratuitously for the zamindars. The zamindars enjoyed the benefit thereof. Held, they were liable to contribute. (Damodar Mudaliar V Secretary of State for India, 1894).

(ii) A Railway Company had constructed a culvert near Madura, which in 1938 it widened at considerable expense, on a requisition in that behalf being made by the Provincial Government. The company had done the work under protest, alleging that the order was illegal and that they would claim to recover the expenditure, from the government or the Madura municipality, or both. These two latter, however, had repudiated their liability. In a subsequent suit on behalf of the Railway Company against the Madura municipality, it was held by P.C. that Sec. 70 could not be invoked to assist the Railway, for through the work was done lawfully and without intending to do it gratuitously, the defendants could not made liable, therefore, as it was not done for the defendants, nor had the defendants enjoyed benefit of it (Pallonji Edulji & Sons V Lonavla Municipality)

Remember Section 70 does not apply to persons who are incompetent to contract. In Simohaj Khan V. Bangi Khan (1931) it has been made clear that Section 70 refers to circumstances in which the law implies a Promise to pay, and where there could not have been a legally binding contract, a promise to pay cannot be implied.

Quantum Meruit

It is a phrase which means, "payment in proportion to the amount of work done". Quantum meruit literally means, "as much as earned" or as much as merited. "Under English Law a party who for some reason cannot claim under the contract, may under certain circumstances claim way of Quantum merit i.e., reasonable remuneration for work done. Thus, Quantum is a remedy and not any alternate to the form of damages. When the party injured by the breach, has at the time of breach done part, but not all of that which he is bound to do under a contract, and is seeking to be compensated for the value of the work done, he can get a remedy under this concept, for example when the contract provides that payment is to be made on completion of the work, the party cannot demand any remuneration under the contract as the work has not been completed. But he can claim on the basis of quantum meruit for the work done by him.

Lord Atkin has explained this concept in very simple words with the help of an example in the case of Steven V. Bromby & Son (1919). To quote him, "Ifl order from a wine merchant 12 bottles of whisky at so much a bottle, and he sends me ten bottles of whisky and two of brandy, and I accept them, I must pay a reasonable price for the brandy".

Let us take on more example: -

The defendant proposed to erect and let seats to view the funeral of the Duke of Wellington. It agreed that the plaintiff should advertise the seats outside England and sell tickets, and that he should receive a commission on all the tickets thus sold. The plaintiff prepared advertisements and paid printers, but, before he had sold any tickets, the defendant wrongfully revoked his authority.

It was held in De Bernardy V. Harding (1853) be Alderson B. that the plaintiff could one in quantum meruit for the work already done.

Alderson B. said, "Where one party has absolutely refused to perform or has rendered himself incapable of performing, his part of the contract, he puts it in the power of the other party either to sue for a breach of it or to rescind the contract and sue on a quantum meruit for the work actually done."

The objective of Quantum meruit is different from that of awarding damages. Damages are awarded to put the party in the same position as if the contract as if the contract was performed by the other side and to compensate the injured party for the injury suffered by the breach. On the other hand, remedy under quantum meruit is to compensate a party for the work he had done and to place him in the same position as if there was no contract between the parties.

The right of claiming Quantum Meruit, like damages does not arise out of contract. It is a right conferred by law. It is a Quasi-Contractual right and not a contractual right.

Claims on Quantum Meruit

Claim on Quantum Meruit arises under the following cases:

(1) Work done under void contracts (Sec. 65): Where a person renders services under an agreement which later on is being discovered as void or has rendered services on pursuance of a transaction, supposed by him to be a contract, but the contract in truth, is without legal validity, he gets a right to be compensated for the advantage received by the other party from him.

(2) Work done with on non-gratuitous basis (Sec. 70): When a person does some work or renders some service, with an intention not to do so gratuitously and the other person takes the benefit of such work or service, the person rendering such service or doing such work can claim compensation from the person enjoying such benefits, or get the goods so delivered back from him.

Example

A, a trader, leaves some goods at B's house by mistake. B. Treating the goods as his own uses them. He is bound to pay A for them.

(3) Abandonment or refusal of performance of a contract: When one of the parties abandons the work or refuses to perform the contract, the other party can get compensation for the work done by him. Decision given by C.J. Tindal in the case of Planche V Colbut (1831) is a good example to illustrate this point. The facts of the case are: -

The plaintiff had agreed to writer for "The Juvenile Library", a series published by the defendants, a book on Costume and Ancient Armour. He was to receive £100 on the completion of the book He collected material and wrote part of the book, and then the defendants abandoned the series. There were negotiations for the publication of the books as a separate work, but these fell through, apparently as the plaintiffed that he had written especially for children and that to publish his work as a magnum opus would injure his reputation. He claimed alternatively on the original contract and on a quantum meruit.

(4) Divisible Contract: Where a contract is divisible and the party not in default has received the advantage out of it, the defaulting party can get compensation under quantum Meruit. But remember, the party in default cannot get this right in case of indivisible contract on the basis of this principle.

The case of Sumpter V. Hedges (1898) provides a good example on this point.

S undertook to build a house for H for Rs. 50,000. After completing half of the work, S abandoned the construction work He afterwards got the house constructed by someone else. It was decided, S could not recover the remuneration for the construction work done by him since the payment was to be made only after the completion of the building.

(5) Badly performed indivisible contracts: Where an indivisible contract has been performed the work is badly done, the performance can get the remuneration, but the other party also gets a right to make deduction for the bad work

The case of Hoemig V. Isaacs (195) serves a good example to illustrate the point.

A, a decorator undertook to decorate B's flat for a lumpsum of Rs. 10,000. B. laid down certain requirements. A completed the work but B pointed out certain defects in

the work done A. B got those defects removed from Cat a cost of Rs. 500/- Held A could recover (10,000-500=)9,500/- from B.

4. Responsibility of a finder of goods (Section 71)

A person who finds goods belonging to another, and takes them into his custody, is subject to the same responsibility as bailee.

Hollins V Fowler is a good case over the point. The facts of the case are:

H picked up a diamond on the floor of K's shop and handed it to K to keep it till the owner appeared. In spite of wide advertisement in the newspapers no one appeared to claim it. After the lapse of some weeks, A tendered to K the cost of advertisement and an identity bond and requested him to return the diamond to H.K. refused. K is liable for damages. His entitled to retain the goods as against everyone except the true owner, so if after wide advertisement the real owner does not tum up and if H is prepared to given indemnity to K, K must deliver the diamond to H.

The position of finder of Good is s akin to that of a Bailee. Section 71 charges the finder of goods with certain obligations. But Sec. 168 and 169 strengthen him with certain rights.

Obligations:

The finder of goods must take all reasonable measures to find out the true owner and take all reasonable care for the protection of the goods. If he does not make reasonable efforts for finding out the true owner, he shall be liable of wrongful conversion of property.

Rights:

The finder of goods has a right to retain the goods so found till he finds out the true owner, has got a right to claim for the reward if any from the true owner. He has got a right to claim for the reasonable expenditures incurred by him. He can also sell out such goods under the following circumstances.

(a) Where the goods are perishing.

(b) Where the owner has not been found out even after great diligence.

(c) Where the owner is found out, but he refused to pay the reasonable expenses incurred by the finder of goods, for finding out the owner, as well as for preserving the goods.

(d) Where the reasonable charges so incurred by him, amount to more than two thirds of the value of the thing found.

5. Liability of person to whom money has been paid or anything delivered, by mistake or under correction (Seeton 72): A person to whom money has been paid, or anything delivered by mistake or under coercion must repay or return it.

Illustrations.

(a) A and B jointly owe to 100 Rs. to C. A alone pays the amount to C, and B not knowing this fact, pays 100 Rs. over again to C.C is bound to repay the amount to B.

(b) A railway refused to deliver certain goods to the consignee, except upon the payment of illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charges as was illegally excessive.

(c) K paid sales tax on his forward transactions of bullion. Subsequently this tax was declared ultra vires. Held K. could recover the amount of Sales Tax and that Section 72 is wide enough to cover not only a mistake of fact but also a mistake of law. (Sales Tax Officer, Benaras V Kanakiya of Saraf 1959).

The above examples clearly state the scope of Section 72. The principle involved in this Section is applicable regardless of the fact whether a privity of contract does or does not exist between the parties. The principles are based on equity.

The person enjoying the benefit is made liable to compensate the aggrieved party, not on the basis of any contract between the concerned parties but on the basis of advantage taken by him due to mistake of or coercion on another. The mistake may relate to facts or even of law (See Example 'c' above).

The liability to repay money under this Section can be enforced either by the person who has paid the money or by the person who becomes aggrieved due to non-discharge of such liability. Many cases have been decided over these issues by the various High Courts of India.

IN-TEXT QUESTIONS

5. Quasi contractual relations are based upon the intensions of the parties. **True/ False**
6. Quasi contracts are enforceable even if the essential elements of the contract are not present. **True / False**
7. About Quasi obligation, which of the following is correct:
   a) There is no real contract in existence b) No intention to make contract
   c) There is no offer and acceptance. d) all of these
8. Aman supplies to Bipin, a lunatic, the necessaries suitable to his conditions in life. In this case:
   a) Bipin is personally liable to pay b) Bipin's property is liable.
   c) Bipin's parents are personally liable d) None of these
9. A quasi contract is a:
   a) A contract b) A Legal Obligation
   c) An agreement d) Contingent contract
10. A quasi contract is not an enforceable contract. **True/ False**

3.5 SUMMARY

In this chapter we have already discussed about contingent contracts that are clearly defined under section 31 of contract act and quasi contracts which are special obligations that make a contract happen. Although these are both considered under the heading 'contracts' but both are very different from each other. Contingent contracts are conditional contracts which are based on occurrence of some act, it means that the contingent contract's performance depends upon the happening or non-happening of a certain or an uncertain event. It has different features like it cannot be enforced if the event does not take place, if event becomes impossible the contract will be termed void and performance of contract is futuristic. When there is no initial agreement between the parties, the court may enter into a quasi-contract to impose the obligation of the contract to prevent one party from unfairly benefiting at the expense of the other parties. Types of quasi contracts include supply of necessities contract, payment by an interested party, finder of goods, Obligation to Pay for a Non-Gratuitous Act and a mistake under coercion.

3.6 ANSWERS TO IN-TEXT QUESTIONS

1. contingent contract 2. False 3. Contingent contract 4. Cannot be enforced 5. False 6. True 7. all of these 8. Bipin's property is liable	9. A Legal Obligation 10. False (A quasi contract is enforceable as per the rules contained in sections 68 to 72)

3.7 SELF-ASSESSMENT QUESTIONS

1. Define the term 'contingent contracts. Discuss the rules relating to the performance of contingent contracts.
2. Abhay agrees to sell land to Vinay at a price to be fixed by Karan. Karan refuses to fix the price. Is the contract enforceable? Give reasons for your answer.
3. 'A quasi contract is not a contract at all! It is an obligation that law creates'. Explain this statement and define quasi contracts.
4. Discuss the different rights and duties of finder of goods?
5. What are quasi contracts? Discuss different quasi contracts dealt under Indian Contract act.

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UNIT III

LESSON 4

CONTRACTS OF INDEMNITY AND GUARANTEE, BAILMENT AND PLEDGE & AGENCY

STRUCTURE

4.1 LEARNING OBJECTIVES

- To help the students to know and understand the nuance of Contract of Indemnity & Guarantee.
- To help students use the concepts of Contract of Bailment and Contract of Pledge.
- To help students understand what is contract of Agency and who are different types of agents.

- To let students, know rules regarding special contracts of indemnity and guarantee, bailment and pledge.

4.2 INTRODUCTION

Although there are many different sorts of contracts, Indian law has recognised several particular and special types of contracts in order to give them a certain level of formality. Five categories of special contracts are recognised by the Indian Contract Act of 1872: indemnity, guarantee, bailment, pledge, and agency. A contract of indemnification is entered into to safeguard the promisee from unforeseen losses. Contract of Guarantee refers to an agreement to uphold commitments made or release a third party from liability in the event when the latter fails to do so. Next special contract comes From the French word "ballier," which meaning "to deliver," comes the word "bailment." It involves two parties namely bailor and bailee. The person to whom goods are delivered is called the “bailee”. Pledge is also a variety or specie of bailment. And the last special contract is related to a person who is hired to perform any act for another or to represent another in interactions with third parties is referred to as a "Agent" under Section 182 of the Contract Act. The "principal" is the person on whose behalf this act is carried out or who is being represented by the agent. Let us discuss all these contracts in detail.

4.3 CONTRACTS OF INDEMNITY

A contract of indemnity is "a contract by which one party promises to save the other from the loss caused to him by the conduct of the promisor himself, or by the conduct of a third party" (Sec. 123).

Example: A contracts to indemnify B against consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity. A will be termed as "indemnifier" and B as the "indemnity-holder".

Definition is not very exhaustive:

According to the definition given by Sec. 124 of the Indian Contract Act, 1872, contract of indemnity includes (i) only express promise to idemnify and (ii) cases where loss is caused by the conduct of the promisor himself or by the conduct of any other person. It does not include (a) implied promise to indemnify and (b) cases where the loss is caused by accident or by the conduct of the promises.

According to English law, a contract of indemnity is "a promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor". It thus, includes the loss caused by events or accidents also. The definition of a contract of indemnity as per Indian Law is thus very restrictive. If it is strictly applied, even the contracts of insurance would fall outside the purview of contract of indemnity. But Indian Courts apply the English definition to contracts of indemnity. As was observed by Justice Chagla, "Sections 124 and 125 of the Indian Contract Act, 1872 are not exhaustive of the law of indemnity and the courts here would apply the same principles that the courts in England do". (Gajanan Moreshwar V. Moreshwar Madras, 1942 Bomb. 302).

Indian courts, in a large number of cases, have also observed that contracts of indemnity also include implied promise to indemnify.

Example: A is the owner of an article. It is lost and found by B. B sends it to an auctioneer for selling it. The auctioneer sells the article. A recovers damages from the auctioneer for selling away his article. The auctioneer can recover the loss from B. There is an implied promise by B to save the auctioneer from any loss that may be caused to him on account of any defect in B's authority to let the article sold.

4.3.1 Commencement of Indemnifier's Liability

High Courts have differed in their judgements regarding commencement of indemnifier's liability. According to High Courts of Calcutta, Madras, Allahabad and Patna indemnity holders when asked to meet a liability, can compel the indemnifiers to put him (indemnity-holder) in a position to meet the liability without waiting until he (indemnity-holder) has actually discharged it. High Courts of Bombay, Lahore and Nagpur have, however, held that indemnifier can be made liable only when indemnity-holder has incurred an actual loss, i.e., discharged the liability. The former view seems to be more correct and is also in consonance with the English view "to indemnity does not merely mean to reimburse in respect of moneys paid, but to save from loss in respect of liability against which the indemnity has been given...if it be held that payment is a condition precedent to recovery, the contract may be of little value to the person to be indemnified, who may be unable to meet the claim in the first instance." (Kennedy L.J.) in Liverpool Insurance Co. case.

Thus, we can conclude that if the indemnity holder had incurred an absolute liability, he has the right to call upon the indemnifier to save him from that liability and pay it off.

4.3.2 Rights of the indemnity-holder when sued

The indemnify holder is entitled to the following rights:

1. Indemnity-holder is entitled to recover all damages which he might have compelled to pay in any suit in respect of a matter covered by the contract.

2. Indemnity holder is entitled to recover all costs incidental to the institution or defending of the suit. But the party indemnified cannot recover costs when he has not acted as a prudent man in defending the action against him or has not been authorised by the indemnifier to defend the suit or where the costs incurred have been unreasonable in amount.

3. Indemnity holder is entitled to recover all sums paid under any compromise of any such suit, provided the compromise was not contrary to the directions of the promisor and it has been made on the best available terms. Promisee must have acted prudently in making such a promise. (Sec. 125).

It is to be noted that a contract of indemnity being a specie of the general contract and therefore, must satisfy all essentials of a valid contract such as competent parties, free consent, lawful object etc., otherwise it will not be valid.

Example: A agrees to indemnity B for all consequences which may arise as a result of his (B) giving a good beating to C. The object being unlawful the agreement is also void.

IN-TEXT QUESTIONS

1. Contract of life insurance is not a contract of indemnity. **True / False**
2. In contract of indemnity, there must be:
   a) Lawful consideration and object b) six parties
   c) implied consideration d) agreement without consideration
3. Which section defines a contract of indemnity? _____.
4. If a contract does not have free consent, will it be considered as a valid contract of indemnity? **Yes/No**

4.4 CONTRACTS OF GUARANTEE

4.4.1 Definition

A 'Contract of Guarantee" is a contract to perform the promise or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called 'the principal debtor 'and the person to whom the guarantee is given is called the 'creditor'. The contract of guarantee may be either written or oral (Sec. 126).

Purpose: Contracts of guarantee are usually entered into

(a) to secure the performance of something which may be immediately related to a mercantile agent, or

(b) to secure the honesty and fidelity of someone who is to be appointed to some office, or

(c) to secure someone from injury arising out of some wrong committed by another.

4.4.2 Essentials of a valid contract must be present

A contract of guarantee like other ordinary contrary must satisfy all the essentials of a contract but it has two distinctive features.

(a) Something done or any promise made for the benefit of the principal debtor is presumed by law to be a sufficient consideration for the contract of guarantee. It is not necessary that the surety himself must be benefited.

Example: A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

(b) In a contract of guarantee, the creditor and surety must be competent to enter into a contract, but principal debtor may be a minor or a person incapable of entering into a contract. In such a case the surety will be taken as the principal debtor and will be liable to pay.

(c) In a contract of guarantee, the liability of the surety is condition. It arises only when the principal debtor makes a default. A liability which arises independently of a

'default' is not within the definition of guarantee. (Punjab National Bank V. Sri Vikram Cotton Mills, (1970) ISCC 60).

4.4.3 Invalid Guarantee

Following is a few of those cases when the guarantee given by the surety will be invalid and cannot be enforced against him:

(i) Guarantee obtained by misrepresentation (Sec. 142): Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

(ii) Guarantee obtained by concealment (Sec. 143): Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

(iii) In case co-surety does not join (Sec. 144): Where a person gives a guarantee upon a contract that the creditor shall not act upon until another person has joined in it as co-surety, the guarantee will be invalid if that other person does not join.

Example (i) A agrees with B to stand as a surety for C for a loan of Rs. 1000 provided D also joins him as surety. D refuses to join. A is not liable as a surety.

(ii) A guarantee to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

4.4.4 Distinction between a Contract of indemnity and a contract of guarantee:

BASIS	CONTRACT OF IDEMNITY	CONTRACT OF GUARANTEE
Parties	Only two parties- 'indemnifier & indemnified.	There are three parties-- 'Creditor' 'principal debtor' and 'surety'.
Liability	The liability of the indemnifier is 'primary'	The liability of the surety is secondary, i.e., the surety's is liable only if the principal debtor fails. The liability of the principal debtor

		is primary.
Contingency	The liability of the indemnifier arises only on the happening of a contingency.	There is an existing debt or duty the performance of which is guaranteed by the surety.
Contract	There is only one contract between the indemnifier and the indemnified.	Three contracts; one between the creditor and principal debtor; second, between the surety and the creditor, and third, between the surety and the principal debtor.
Object	The indemnity contract is for reimbursement of loss. It provides 'security'.	The contract of guarantee provides 'surety' to the creditor.
Right to sue	Indemnifier cannot sue a third party for the loss suffered.	Surety can sue the principal debtor.

4.4.5 Kinds of Guarantee

Contracts of guarantee may be

(1) Specific, or

(2) Continuing.

1. **Specific guarantee:** Specific guarantee means a guarantee given for one specific transaction. In this case the liability of the surely extends only to a single transaction.

   Example: A guarantee payment to B of the price of 5 sacks of flour to be delivered by B to C and to be paid in a month. B delivers sacks to C and receives payment from C. Afterwards B delivers four sacks to C, for which C does not pay. The guarantee given by A was only a specific guarantee and accordingly he is not liable for the price of the four sacks.

2. **Continuing guarantee (Sec. 129):** A continuing guarantee is that which extends to a series of transactions (Sec. 129). It is not confined to a single transaction. Surety can

fix up a limit on this liability as to time or amount of guarantee, when the guarantee is a continuing one. The fact that the guarantee is continuing can also be ascertained from the intentions of the parties and the surrounding circumstances.

Example: (i) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of 5,000 rupees, for the due collection any payment by C of those rents. This is continuing guarantee.

(ii) A guarantees payment to B, a tea/dealer to the amount of £ 100, for tea he may from time-to-time supply to C.B supplies C with tea to the extent of the agreed value i.e., £ 100 and C pays B for it. Afterwards B supplies C with tea to the value of£ 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of£ 100.

4.4.6 Revocation of continuing guarantee

A continuing guarantee is revoked by any of the following ways.

l. By notice (Sec. 130). A continuing guarantee may at any time be revoked by the surety as to future transactions, by giving a distinct notice to the creditor.

Example: A in consideration of B's discounting at Ns request, bills of exchange, for C guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees, B discounts bills for C to be extent of 2,000 rupees. Afterwards at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for 3,000 rupees, on the default of C.

2. By Death (Sec. 131): Death of the surety will operate as a revocation of the continuing guarantee with regard to the future transactions unless the contract provides otherwise. No notice of death need be given to the creditor. Heirs of the surety will not be liable for any fresh transactions entered into by the creditor with the principal debtor after the death of the surety without knowledge of such death.

4.4.7 Nature of surety's liability

Where the parties do not specifically agree as to the extent of the liability or the surety does not put up any limit on his ability at the time of entering into the contract, the liability of the surety will be co-extensive with that of the principal debtor. In other words, whatever amount

of money a creditor can legally realise from the principal debtor including interest, cost of litigation, damages etc., the same amount he can recover from the surety.

Example: A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A will be liable not only for the amount of the bill also for any interest and charges which have become due on it.

The liability of the surety arises immediately on the default of the principal debtor, but the creditor is not bound to give any notice of the default of the principal debtor to the surety or it exhaust all the remedies open to him as against the debtor before proceeding against the surety. Besides that, creditor is free to release the debt when it becomes due to either from the debtor or the surety. It is not necessary for him to proceed against the debtor first. He may sue the surety without suing the principal debtor. It is surety's duty to see that the principal debtor pays or performs his obligation.

4.4.8 Rights of the Surety

Rights of the surety can be classified under three heads:

(i) Against the principal debtor.

(ii) Against the creditor.

(iii) Against the co-sureties

1. **Rights of the surety against the principal debtor**

(a) Rights to be subrogated: When the principal debtor had committed the default and the surety pays the debt to the creditor, surety will stand in the shoes of the creditor and will be invested with all the rights which the creditor had against the debtor (Sec. 140).

(b) Right to claim indemnity: In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety and the surety is to recover from the principal debtor whatever sum he has rightfully paid under the guarantee but no sums which he has paid wrongfully, e.g., cost of fruitless litigation (Sec. 145).

Examples: (i) B is indebted to C, and A is surety for the debt. C demands payments from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with

costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

(ii) A guarantees to C, to the extent of 2000 rupees, payment for rice to be supplied by C to B. C supplies rice to a less amount than 2000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

2. **Rights of the surety against the creditor**

A surety is entitled to the benefit of every security which the creditor has against the debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not and if the creditor loses or without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security (Sec. 141). But a surety, however, cannot claim the benefit of the securities only on the payment of a part of the debt.

3. **Right against co-sureties**

When two or more persons stand as sureties for the same debt or obligation they are termed as co-sureties. The position of co-sureties is as follows.

Co-sureties liable to contribute equally (Sec. 146): Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contract, and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

Example: A, B and C are sureties to D for the sum of 3,000 rupees lent to E.E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

4.4.9 Liability of co-sureties bound in different sums (Sec. 147)

Co-sureties who are bound in different sums are liable to pay equally as far as the limits to their respective obligations permit.

Example: (i) A, Band C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of

40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and care each liable to pay 10,000 rupees.

(ii) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that 20,000 rupees and C in that of 40,000 rupees, conditioned for D's duly accounting to E, D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

4.4.10 Discharge of surety

Surety will be discharged from his liability in the following cases:

1. By notice or death (Secs. 130 & 131): A contract of continuing guarantee may be terminated at any time by notice to the creditor. The death of the surety brings an end to continuing guarantee. No notice of death needs to given to the creditor. The surety will not be responsible for acts done after his death.

2. Variations in terms of the original contract between the principal debtor and the creditor (Sec. 133): If the contract between the creditor and the principal debtor is materially altered without the consent of the surety, the surety is discharged as to transactions subsequent for the alteration.

   Example (i): A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts B. allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without the consent and is not liable to make good this loss.

   (ii) C contracts to lend B Rs. 5,000 on first March. A guarantees repayment. C pays the amount to B on first January. A is discharged from the liability, as the contract has been varied in as much as C might sue B for the money before the 1st March.

3. By release or discharge of the principal debtor (Sec. 134). The surety is discharged by any contract between in creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of a surety on one agreement will not release the other surety bound for the same debtor by a separate agreement from his engagement, unless the effect of such release is to adversely affect the others right to contribution.

Example (i) : A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(ii) A contracts with B to grow crop of indigo on his (A's) land and to deliver it to Bat a fixed rate. C guarantees Ns performance of his contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

4. Compounding by creditor with the principal debtor (Sec. 135). A contract between the creditor and the principal debtor by which the creditor makes a composition with, or promise to give time to, or not sue to the principal debtor discharges the surety unless the surety assents to such contract.

But where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged (Sec. 136).

Example: C, the holder of an overdue bill of exchange drawn by as surety for & and accepted by B, contracts with A to give time to B, is not discharged.

Similarly, mere forbearance on the part of the creditor to sue the principal debtor within the limitation period or to enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary discharge the surety (Sec. 137).

Example: B, owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from the suretyship.

Where there are co-sureties a release by the creditor of one of them does not discharge the other; neither does it free the surety so released from his responsibility to other sureties (Sec. 138).

5. Creditor's act or omission impairing surety's eventual remedy (Sec. 139). If the creditor does any act which is inconsistent with the rights of the surety or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the

surety himself against the principal debtor is thereby impaired, the security is discharged.

Example: (i) B contracts to build a ship for C for a given sum to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's performance of the contract. C without the knowledge of A, prepays to B the last two instalments. A is discharged by his pre-payments.

(ii) A puts Mas apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see M to make up the cash. B omits to see M as promised, and M embezzles. A is not liable to B on his guarantee.

6. Loss of security (Sec. 141). If the creditor losses on, without the consent of the surety, parts with any security given to him at the time of the contract of guarantee, the surety is discharged from liability to the extent of the value of security.

Example: C advances to B, his tenant Rs. 2,000 on the guarantee of A. C has also further a security of Rs. 2,000 by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from his liability to the amount of the value of the furniture.

6. By invalidation of the contract of guarantee (Secs. 142, 143 and 144). A contract of guarantee becomes invalid if guarantee was obtained by fraud or concealment etc. about material facts as discussed before. Surety in such a case will be discharged from his liability.

IN-TEXT QUESTIONS

5. How many parties are there in contract of guarantee? _____.

6. Whose consent is necessary in the contract of guarantee?

a) surety b) creditor
c) debtor d) All of the above

7. Who is protected under the contract of guarantee?

a) guarantor b) creditor
c) third person d) debtor

IN-TEXT QUESTIONS

8. A contract of guarantee is not required to be made in writing, but it is required to be evidenced in writing. **True/ False**
9. A continuing guarantee cannot be revoked by giving notice. **True/ False**

4.5 CONTRACTS OF BAILMENT AND PLEDGE

4.5.1 Definition

Bailment is "the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them. The person delivering the goods is called the 'bailor'. The person to whom they are delivered is called the 'bailee'.

Examples: -

(i) A lends his motor cycle to B for his use.

(ii) A gives a piece of cloth to a tailor to make it into a coat.

(iii) A gives his radio set to a mechanic for repairs.

4.5.2 Essential characteristics

The essential elements of the definition of bailment can be summed up as under: -

(a) Bailment is always based upon a contract. In exceptional cases it can also be implied by law, e.g., finder of goods.

(b) There can be a bailment of movable properties only but money is not included in the category of movable goods.

(c) In Bailment the possession of goods must change. It thus requires temporary delivery of goods. Mere custody of goods without possession will not be sufficient to constitute bailment. A servant or a guest using his master's or host's goods will not be a bailee.

In bailment the delivery of goods may be actual or constructive.

Example:

(i) A delivers his radio set to B for repair. This s a case of actual delivery of goods by A to B. A is the bailor and B is the bailee.

(ii) A employed a goldsmith to melt old jewellery and prepare new jewels. Everyday she used to receive half-made jewels from the goldsmith and put them in a box and leave the box in the goldsmith's room. She kept the key of the room with her. On one night-the jewels were stolen. It was held that there was redelivery of jewels to the lady and the goldsmith could not be regarded as bailee. The lady herself must bear the loss (Kaliapurimal v. Visalakshmi).

(d) In bailment, ownership is not transferred. The bailor continues to be the owner of the goods.

(e) Goods are delivered upon a condition that they are to be returned in specie.

Deposit of money in a bank is not a case of bailment since the return of money will not be of the identical coins deposited. Moreover, the money handed over to the bank is not for safe custody but to be credited to some kind of account. The relation between the bank and the depositor of money is that of a borrower and the lender and not that of a bailor and bailee.

4.5.3 Rights and Duties of The Bailor

Rights of the bailor

(1) Right of termination. Bailor has the right to terminate the bailment and claim damages, if any, if the conditions of bailment are disobeyed by the bailee, e.g., bailee uses the goods bailed in a manner inconsistent with the conditions of bailment.

Example: -

A let, B for hire, a horse for his own riding, B drives the horse in his carriage. A can terminate the contract of bailment.

(2) Rights to demand return of goods any time in case of gratuitous bailment. In the case of a gratuitous bailment, the bailor can demand back the goods bailed at any time he chooses in spite of the fact that he had lent them for a fixed period or for a specified purpose. But if the bailee had, in this case, acted in such a manner that the return of the goods before the stipulated time would cause loss greater than the benefit which he has derived, the bailor shall be asked to indemnify him for the loss if he compels immediate return of the specified object.

(3) Enforcement of rights: The duties of the bailee are the rights of the bailor and he can sue bailee for their enforcement.

Duties of the bailor

1. To disclose faults in the goods bailed (Sec. 150): The bailor is bound to disclose to the bailee faults in the goods bailed of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks, and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

   If the goods are bailed for hire the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

   Example: -

   (i) A hire a carriage of B. The carriage is unsafe, though B is not aware of it and A is injured, B is responsible to A for the injury.

   (ii) R hired a motor launch from B for a holiday on River Thames. The launch caught fire and R could not extinguish the fire as the fire-fighting equipment was out of order. R was injured Held D was liable to pay him damages (Reed V. Dean, 1949).

2. Responsibility for title to the goods (Sec. 164). The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment or to receive back the goods or to give directions respecting them.

3. To bear necessary expenses of bailment (Sec. 158). When by the conditions of the bailment the goods are to be kept or to be carried or to have work done upon them by the bailee for the bailor and the bailee is to receive no remuneration (bailment is gratuitous), the bailor shall repay the bailee the necessary expenses incurred by him for the purpose of the bailment.

4. To indemnity gratuitous bailee (Sec. 159). Where the bailor has lent the goods gratuitously for a specified time or purpose and if he requires the return of the goods before the time agreed upon or before the purpose is accomplished, he shall indemnify the bailee if he puts the bailee to any loss caused by earlier demand.

5. To bear risk for loss etc. Bailor is to bear the risk of loss, destruction or deterioration of the thing bailed if the bailee has taken as much care as a man of ordinary would

under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

4.5.4 Rights and Duties of The Bailee

l. Rights to interplead (Sec. 165). If a person, other than the bailor, claims the goods bailed, bailee may apply to the court to stop the delivery of the goods to the bailor and to decide the title to the goods.

2. Rights against third person (Sec. 180). If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or causes them any injury, the bailee is entitled to use such remedies as the owner might have used in a like case if no bailment has been made. Bailee can thus bring a suit against a third person for such deprivation or injury.

3. Right of particular lien for payment for services (Sec. 170). Where the bailee has (a) in accordance with the purpose of bailment, (b) rendered any service involving the exercise of labour of skill, (c) in respect of the goods, he shall have (d) in the absence of a contract to the contrary, right to retain such goods, until he receives due remuneration for the services, he has rendered in respect of them. Bailee has, however, only a right to retain the article and not to sell it. The service must have entirely been formed within the time agreed or a reasonable time and the remuneration must have become due.

   This right of particular lien shall be available only against the property in respect of which skill and labour has been used.

   Examples

   (i) A delivers a rough diamond to jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

   (ii) A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, to give A three month's credit for the price. B is not entitled to retain the coat until he is paid.

4. Right of general lien (Sec. 171). Bankers, factors, wharfingers, attorneys of a High Court and policy brokers will be entitled to retain, as a security for a general balance

of amount, any goods bailed to them in the absence of a contract to the contrary. By agreement other types of bailees excepting the above given five may also be given five may also be given this right of general lien.

5. Right to indemnity (Sec. 166). Bailee is entitled to be indemnified by the bailor for any loss arising to him by reasons that the bailor was not entitled to make the bailment or to receive back the goods or to give a direction respecting them. If the bailor has not title to the goods, and the bailee in good faith, delivers them back to, or according to the directions of the bailor, the bailee shall not be responsible to the owner in respect of such delivery. Bailee can also claim all the necessary expenses incurred by him for the purpose of gratuitous bailment.

6. Right to claim compensation in case of faulty goods (Sec. 150): A bailee is entitled to receive compensation from the bailor or any loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him. If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults.

7. Right to claim extraordinary expenses (Sec. 158): A bailee is expected to take reasonable care of the gods bailed. In case he is required to incur any extraordinary expenses, he can hold the bailor liable for such expenses.

8. Right of delivery of goods to any one of the several joint bailors of goods. Delivery of goods to any one of the several joint bailors of goods will amount to delivery of goods to all of them in the absence of any contract to the contrary.

Duties of the bailee

l. To take reasonable care (Sec. 151 & 152): Bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the good bailed. It will not make any difference whether the bailment is gratuitous for reward. If any loss is caused to the goods, in spite of such reasonable care by the bailee, he shall not be liable for the loss. Bailee shall be held liable for losses arising due to his negligence.

Example

(i) A delivered to B certain gold ornaments for safe custody. B kept the ornaments in a locked safe and kept the key in the case box in the same room. The room was on the ground and was locked from outside, and therefore, was easily accessible to burglars. The ornaments were stolen. It was held that the bailee did not take reasonable care, and therefore, was liable for the loss (Rampal V. Gauri Shanker, 1952).

(ii) A deposited his goods in B's godown. On account of unprecedented floods, a part of the goods were damaged. Held, B is not liable for the loss (Shanti Lal V. Takechand).

A bailee is liable to compensate the bailor for any damages done to the thing bailed by the negligence of his servants acting in the course of the employment.

2. To return the goods. Bailee must return or deliver the goods bailed according to the direction of the bailor, on the expiry of the time of bailment or on the accomplishment of the purpose of bailment (Sec. 160).

Bailee shall be responsible to the bailor for any loss, destruction or deterioration of the goods from of the date of the expiry of the contract of bailment, if he fails to return deliver or tender the goods at the proper time (Sec. 161).

3. To return any increase or profit from the goods (Sec. 163). Bailee is bound to deliver to the bailor any increase or profit which might have come from the goods bailed, provided the contract does not provide otherwise.

Example: A leaves a cow in the custody of B. The cow gives birth a calf. B is bound to deliver the calf as well as the cow to A.

4. To use goods according to the conditions of bailment (Sec. 154). Bailee must use the goods according to the conditions of the contract of bailment or the directions of the bailor. He shall be held liable for compensation to the bailor if any damage is caused to the goods because of his unauthorised use. Bailee must not do any act with regard to the goods bailed which is inconsistent with the terms of the bailment, otherwise the contract shall become voidable at the option of the bailor and bailee shall be held liable to compensate and damages caused to the goods.

Example: A lends his horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C, rides with care but the horse accidently falls and is injured. What remedy has A against B?

A can claim damages from B for the injury caused to the horse from an unauthorised use. B in this case has failed to use the horse according to the conditions of bailment, and therefore, he shall be liable to pay compensation to the bailor for the damages caused to the horse because of his unauthorised use.

5. Must not mix up the goods with his own goods (Sec. 155 & 156-157). Bailee is not entitled to mix up the goods bailed with his own goods except with the consent of the bailor. If he, with the consent of the bailor, mixes the goods bailed with his own goods, both the parties shall have an interest in proportion to their respective shares in the mixture thus produced (Sec. 155).

   If the bailee, without the consent of the bailor, mixes the goods bailed with his own goods and the goods can be separated or divided, the property in the goods remains in the parties respectively bailee is bound to bear the expenses of separation and division and any damage arising from the mixture (Sec. 156).

   If the bailee, without the consent of the bailor mixes the goods of the bailor with his own goods in such a manner that it is impossible to separate the goods bailed from the other goods and to deliver them back, the bailor is entitled to compensation by the bailee for loss of the goods (Sec. 157).

   Examples: (i) A bails two bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales of his own, bearing a different mark. A is entitled to have his 100 bales returned, and B is bound to bear all the expenses in the separation of the bales and any other incidental damages.

   (ii) A bail a barrel of cape flour worth Rs. 45 to B. B without A's consent, mixed the flour with country flour with country flour of his own, worth only Rs. 25 a barrel. B must compensate A for his flour.

6. Must not set up an adverse title. Bailee must not set up a title adverse to that of the bailor. He must hold the goods on behalf of and for the bailor. He cannot deny the title of the bailor.

4.5.5 Rights of Bailor and Bailee against Third Parties

1. Suit by bailor or bailee against a wrong-doer (Sec. 180). If a third person wrongfully deprives the bailee of the use of possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have in a like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

2. Appointment of compensation obtained by such suits (Sec. 181). Whatever is obtained by way of relief or compensation in any such suit shall as between the bailor and bailee, be dealt with according to their respective interests.

4.5.6 Rights and liabilities of the finder of goods

One who finds goods belonging to another and takes them in his possession is called the finder of the goods. He rights and liabilities have been discussed in Secs. 168 and 169 of the Contract Act as follows:

(i) A finder of the goods is free to take or not to take the goods found out under his custody. A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee.

(ii) Finder of goods is not entitled to bring a suit for the realisation of compensation for the trouble and expenses voluntarily incurred by him in preserving the goods and in finding out the real owner. However, he can exercise his right of particular lien on the goods found out and may refuse to deliver them to the real owner until he receives the compensation for his trouble and expenses.

(iii) In case where the real owner of the goods has offered a specific reward for their return of goods lost, the finder of the goods may sue for the realization of such rewards and may also retain his possession ever the goods until he received the reward with all other necessary costs.

(iv) Finder of the goods has no right to sell the goods found out except when all the following conditions are satisfied.

(a) When the thing found out is commonly the subject of sale.

(b) When the owner cannot be found out with reasonable diligence or when the owner refuses to pay the lawful charges of the finder.

(c) When the thing is in danger of perishing or losing the greater part of its value or when the lawful charges of the finder in respect of thing found out exceed two-thirds of the value of the goods.

4.5.7 Lien

Lien is a right of person to retain that which is in his possession and which belongs to another, until the demands of the person in possession are satisfied.

Kinds of Lien

There are two kinds of liens: (a) particular lien, (b) general lien.

(A) Particular Lien:

It is a right to retain possession over those particular goods in connection with which the debt arose. It is restricted to those goods which are subject matter of the contract and are liable for certain demands of the person in possession of those goods.

According to Section 170 where the bailee has, in accordance with the purpose of the contract of bailment, rendered any service involving the exercise of labour and skill in respect of the goods bailed, he has, in the absence of a contract to contrary, a right to retain such goods in his possession until he receives due remuneration for the services, he had rendered in respect of them.

Besides the bailee, other persons who are entitled to exercise particular lien are unpaid seller of goods, finder of goods, pawnee, agents, etc.

(B) General Lien:

It entitles a person in possession of the goods to retain them until all claims of the person in possession against the owner of the goods are satisfied. It is not necessary that the demands should arise only out of the articles detained under possession. General lien is a kind of a special privilege which the law has granted only to few persons (i) bankers, (ii) factors (iii) wharfingers, (iv) attorney of the High Courts, (v) policy brokers, and (vi) others by agreement. These parties, can exercise general lien against any goods under their possession and for any sum legally due on a general balance of account. But where the goods are deposited for some special purposes, e.g., safe custody, they will not come under the spell of

general lien. This is because acceptance of goods for, special purpose implied by excludes general lien.

Example (i) K deposited certain jewels with the Madras Bank to secure certain debt. after payment of this debt, he demanded the return of these jewels from the bank. He was still indebted to the bank for certain other debts. On the bank's refusal to return, it was held that he was not entitled to recover unless he proved that the bank had agreed to give up its general lien (Kunhan V. Bank of Madras, 1895).

(ii) A solicitor has a general lien on all the papers of the client in his possession in his professional capacity as solicitor. He can claim a lien for all costs due to him from the client but not for money loans (Re. Taylor).

IN-TEXT QUESTIONS

10. In the contract of bailment, the person delivering the goods is known as_____.
11. The bailor is bound to disclose all the faults in goods to the bailee. **True/ False**
12. A finder of goods is subject to the same responsibility as that of a bailor. **True / False**
13. Right to claim all expenses incurred in keeping and protecting goods, is an important right of bailee. **True/ False**
14. Which of the following is a necessity in bailment:

a) transfer of ownership
b) transfer of property
c) transfer of possession
d) None of the above

4.6 PLEDGE

4.6.1 Definition

Pledge is the bailment of goods as security for payment of a debt or performance of promise.

Bailor in this case is called the 'pawnor' and the bailee is called the 'pawnee' (Sec. 172).

Pledge by non-owners

Ordinarily only a person who is the real owner of the goods can make a valid pledge, but in the following cases pledge made by non-owners will also be valid.

l. Pledge by a mercantile agent (Sec. 178). Where a mercantile agent is, with the consent of the owner, a possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same, provided that the pawnee act in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge.

2. Pledge by person in possession under voidable contract (Sec. 178 A). When the pawnor has obtained possession of the goods pledged by him under a contract voidable under Section 19 or Section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquired a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

3. Pledge where pawnor has only a limited interest (Sec. 179). Where a person pledges goods in which he had only a limited interest, the pledge is valid to the extent of that interest.

   Example: A finds a watch on the road and spends Rs. 25 on its repairs. He pledges it with B for Rs. 50/-. The real owner can get the watch by paying Rs. 25 to the pledge.

4. Pledge by a co-owner in possession. If there are several joint owners of goods and goods are in the sole possession of one of the co-owners with the consent of other co-owners, such a co- owner can make a valid pledge of goods.

5. Pledge by seller or buyer in possession after sale: A seller who has got possession of goods even after sale, can make a valid-pledge, provided the pawnees act in good faith.

   Example: X buys goods from Y, pays for them, but leaves them in the possession of Y, and Y then pledges the goods with Z who does not know of sale to X, the pledge is valid.

   Similarly, if the buyer obtains possession of goods with the consent of the seller before payment of price and pledges them, the pawnee will get a good title provided he does not have the notice of seller's right of lien or any other right.

4.6.2 Rights and duties of the pawner

Right to receive goods till sole (Sec. 177). If a time is stipulated for the payment of the debt or performance of the promise, for which the pledge is made, and the pawnor makes default in the payment of the debt or the performance of the promise at the stipulated time he may redeem the goods pledged at any subsequent time, before their actual sale of them, but he must in that case pay, in addition, any expenses which might have arisen from his default.

4.6.3 Rights and duties of the pawnee

l. Right to receive payment of the debt or to obtain the performance of promise with interest and expense (Sec. 173). Pawnee has a right to retain possession on the goods pledged till he obtains payment of his debt interest on that debt and all other necessary expenses which he might have incurred for the preservation of the goods pledged or in respect, of his possession.

2. Right of Particular lien (Sec. 174). Pawnee has no right to retain his possession over the goods pledged for any debt or promise other than the debt or promise for which they were pledged unless otherwise provided for, by a contract.

3. Right to receive extraordinary expenses (Sec. 175). Pawnee is also entitled to receive from the pawnor any extraordinary expenses which he might have incurred for the preservation of the goods pledged.

4. Pawnees right in case of default of the pawnor (Sec. 176). In the case of default by the pawnor in the payment of debt or the performance of promise at the stipulated time or on demand or within reasonable time, the pawnee can exercise the following two rights:

   (a) He has a right to bring a suit on the debt or promise and can retain the goods pledged as a collateral security.

   (b) He has also a right to sell the goods pledged after giving reasonable notice of sale to the pawnor.

   He has a right to claim any deficit arising from the sale of the goods pledged from the pawnor. He will have to return to the pawnor any excess obtained by the sale of goods pledged beyond the amount necessary to pay the debt and other expenses due.

5. Pawnee must not use the goods pledged. He must not use goods pledge unless they are such as will not deteriorate by wear.

   Besides the above rights and duties, all other rights and duties of the bailor and bailee apply equally to pawnor and the pawnee.

4.6.4 Termination of Bailment

A contract of bailment shall terminate in the following circumstances:

l. On expiry of stipulated period: If the goods were given for a stipulated period, the contract of bailment shall terminate after the expiry of such period.

2. On fulfilment of the purpose: If the goods were delivered for a specific purpose, a bailment shall terminate on the fulfilment of that purpose.

3. By Notice: (a) Where the bailee acts in a manner which is inconsistent with the terms of the bailment, the bailor can always terminate the contract of bailment by giving a notice to the bailee.

   (b) A gratuitous bailment can be terminated by the bailor at any time by giving a notice to the bailee.

4. By death: A gratuitous bailment terminates upon the death of either the bailor or the bailee.

IN-TEXT QUESTIONS

15. The bailment of goods as security for payment of a debt or performance of a promise is called _____.
16. In pledge contract a bailor is known as a pawnee. **True / False**
17. X and Y go to a shop, Y says to shopkeeper Z, let X have the goods and if he does not pay you, I will. This is which type of contract?

    a) Contract of guaranteed
    b) Contract of indemnity
    c) Quasi contract
    d) Wagering agreement

4.7 CONTRACT OF AGENCY

4.7.1 Definition

When a person employs another person to do any act for himself or to represent him in dealing with third persons, it is called a 'Contract of Agency'. The person who is so represented is called the 'principal' and the representative so employed is called the 'agent (Sec. 182). The duty of the agent is to enter into legal relations on behalf of the principal with third parties. But, by doing so he himself does not become a party to the contract to the contract not does he incur any liability under that contract. Principal shall be responsible for all the acts of his agent provided they are not outside the scope of his authority.

Competence of the parties to enter into a contract of agency

The person employing the agent must himself have the legal capacity or be competent to do the act for which he employs the agent. A minor or a person with unsound mind cannot appoint an agent so as to be legally represented by him (Sec. 183). But an agent so appointed need not necessarily be competent to contact (Sec: 184) and hence minor or an insane can be appointed as an agent he can bring about legal relations between the principal and the third party but such an incompetent agent cannot personally be held liable to the principal.

Consideration not required: Contract of agency requires no consideration. It comes under the category of those contracts which law has declared to be valid without consideration (Sec. 185).

4.7.2 Creation of Agency

Agency may be created by any of the following ways:

1. **Expressly (Sec. 187)**

When an agent is appointed by words spoken or written, his authority is said to be express.

2. **Impliedly (Sec. 187)**

When agency arises from the conduct of the parties or inferred from the circumstances of the case, it is called implied agency.

Example: A of Calcutta has a shop in Delhi. B, the manager of the shop, has been ordering and purchasing goods from C for the purpose of the shop. The goods purchased were being

regularly paid for but of the funds provided by A. B shall be considered to be an agent of A by his conduct.

Partners, servants and wives are usually regarded as agents by implications because of their relationship.

Wife as an implied agent to her husband

(a) Where the husband and wife are living together in a domestic establishment of their own, the wife shall have an implied authority to pledge the credit of her husband for necessaries. The implied authority can be challenged by the husband only in the following circumstances.

(1) The husband has expressly forbidden the wife from borrowing money or buying goods on credit (Debenham V. Mellon (1880) 6 A.C. 24).

(2) The articles purchased did not constitute necessities.

(3) Husband had given sufficient funds to the wife for purchasing the articles she needed to the knowledge of the seller (Miss Gray Ltd. V. Cathcort (1922) 38 T.L.R. 562).

(4) The creditor had been expressly told not to give credit to the wife (Etherington V. Parrot (1703) Salia 118).

(b) Where the wife lives apart from husband without any of her fault, she shall have an implied authority to bind the husband for necessaries, if he does not provide for her maintenance.

3. **Agency by necessity**

Under certain circumstances, a person may be compelled to act as an agent to the other, e.g., master of the ship can borrow money at a port where the owner of the ship has not agent, to carry out necessary repairs to the ship in order to complete the voyage. In such a case of necessity, person acting as an agent need not necessarily have the authority of the principal. However, the agent must act under pressing conditions and for the benefit of the principal.

Example: The master of the ship on finding that the cargo is rapidly perishing is entitled to dispose it of at the best price available so as to bind the consignor as an agent by necessity.

4. **Agency by estoppel (Sec. 237)**

When an agent has without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts and obligations if he has by his words or conduct induced such third person to believe that such acts and obligations were within the scope of the agent's authority.

Example: A says to B in the presence of and within the hearing of C that he is C's agent. C remains mum. B supplies goods of Rs. 10,000/- to A taking him as C's agent. C's responsible for the payment of price of these goods.

5. **Agency by ratification (Sec. 196 to 200)**

Ratification means subsequent acceptance and adoption of an act by the principal originally done by the agent without authority. According to section 196. "Where acts are done by one person on behalf of another but without his knowledge or authority, he may check to ratify or to disown such act. If he ratifies them, the same effects will follow as if they had been performed by his previous authority."

Example: The manager of a company purporting to act as an agent on the company's behalf but without its authority, accepted an offer by L, the defendant L subsequently withdrew the offer, but the company ratified the manager's acceptance. L was held to be bound by the acceptance. His revocation of the offer was held to be invalid. Ratification relates back to the due when the agent had first acted and, therefore, subsequent revocation shall have no effect. *

In order that ratification may be legal and valid, it must satisfy the following essentials.

(1) The act must be done in the name of the principal.

(2) Principal must have been in existence and competent to contract at the time when agent acted on his behalf as well as on the date of ratification.

(3) The act must be legal which the principal must be competent to do.

(4) Ratification must be with full knowledge of all the material facts (Sec. 198).

(5) Ratification must relate to the whole act and not to a part of it. Ratification of a part of the act will not be valid (Sec. 199).

(6) There can be no valid ratification of an act which is to the prejudice of a third person (Sec. 200).

Example: A holds a lease from B, terminable on three months' notice, C, an unauthorised person gives notice to termination to A. The notice cannot be ratified by B, so as to be binding on A.

(7) Ratification of an act must be made, either within the time fixed for this purpose or within a reasonable time after the contract was entered into by the agent.

4.7.3 Extent of agent's authority (Sec. 186 to 189)

Principal is responsible for the acts of the agent done by him within the scope of his authority. The authority of an agent may be express or implied. An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case (Sec. 186 to 187).

Example: A owns a shop in Serampur, living himself in Calcutta, and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purpose of the shop end of paying for them out of A's funds with A's knowledge. B had an implied authority from A to order goods from C in the name of A for the purposes of the shop.

The authority of an agent extends to the performance of every lawful thing necessary to do an act for which he is appointed. When he is appointed to carry on business, he can do every lawful thing necessary for the purpose or as is usually done in the course of conducting such business (Sec. 188).

An agent has authority in an emergency to do all such acts for the purpose of protecting the principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances, the emergency must be real not permitting the agent of communicate with the principal (Sec. 189).

Example: A consigns provisions to B at Calcutta, with directions to send them immediately to C at Cuttack. B may sell the provisions at Calcutta, if they will not bear journey to Cuttack without spoiling.

4.7.4 Delegation of agent's authority (Secs. 191 to 195)

The general principal is "A delegate cannot further delegate". (Delegatus non-protest delegate). An agent, himself being the delegate of his principal, cannot further delegate his

powers. However, under certain circumstances the agent may delegate some or all of his powers to another person. Such person may be either a sub-agent or a substituted agent.

Sub-agent

A 'sub-agent" is a person employed by and acting under the control of the original agent in the business of agency (Sec. 191). In the following cases an agent can appoint a sub-agent unless he is expressly forbidden to do so: -

(i) When the ordinary custom of trade permits the appointment of a sub-agent.

(ii) When the nature of the agency business requires the appointment to a sub-agent.

(iii) When the act to be done is purely ministerial and involves no exercise of discretion or confidence, e.g., routine clerks and assistants.

(iv) When the principal agrees to the appointment of such a sub-agent expressly or impliedly.

(v) When some unforeseen emergency has arisen.

The relations of the sub-agent to the principal depend on the question whether the agent had an authority to appoint the sub-agent and whether sub-agent is properly appointed.

Where the sub-agent is properly employed the principal is, so far as regard third persons, represented by the sub-agent and is bound by and is responsible for his acts as if he was an agent originally appointed by the principal, therefore, will be responsible for the acts of a properly appointed sub-agent.

Where an agent, without having authority to do so, has appointed a person to act as a sub-agent, i.e., a sub-agent is improperly appointed, the principal is not represented by or responsible for the acts of the sub-agent as between himself and the third parties. The sub-agent is also not responsible to the principal for anything. The agent is responsible for the acts of the sub-agent both to the principal and to the third persons (Sec. 193).

Substituted agent

Where an agent holding an express or implied authority to name another person to act in the business of the agency, has accordingly, named another person such person is not a sub-agent but a substituted agent. The substituted agent shall be taken as the agent of principal for such part of the work as is entrusted to him (Sec. 194).

Example: A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer to conduct the sale. C is not a sub-agent, but is A's agent for the conduct of the sale.

In selecting substituted agent for his principal an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case, and if he does this, he is not responsible to the principal for acts or negligence of the substituted agent.

Example: A instructs B, a merchant, to buy a ship for him. B employed a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligence and the ship turns to be unseaworthy and is lost. B is not, but the surveyor is responsible to A.

4.7.5 Effect of agency on contracts made with third persons

The consequences of agents' acts, done in the course of his employment, in relation to third parties can be studied under the following three heads:

1. When the agent expressly contracts as an agent for a named principal.
2. When the agent expressly contracts as an agent for an unnamed principal.
3. When the agent acts for an undisclosed principal.

1. **When the agent contracts for a named principal**

   (i) Acts within authority of agent. The principal is bound by the acts done by the agent within his actual authority. He will also be liable to the third parties for the acts of the agent which may be beyond his actual authority but which come within his ostensible or apparent authority unless the third party knows of the limitations of the agent's apparent authority.

   Example: A leaves a watch with B, an auctioneer, with the instruction that it is not to be sold below Rs. 100. B sells the watch to C for Rs. 80, who does not know about the special instruction. A cannot set aside the contract.

   (ii) Acts beyond agent's authority (Sec. 27) "When an agent does more than he is authorised to do and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and his principal."

Example: A being an owner of a ship and cargo, authorises B to procure an insurance for 4,000 rupees on the ship. B procures a policy of Rs. 4,000 on the ship and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

Where an agent does more than he is authorised to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognise the transaction (Sec. 228).

Example: A authorises B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of Rs. 6,000. A may repudiate the whole transaction.

(iii) Liability of principal inducing belief that agents unauthorised acts were authorised. When agent has, without authority, done acts or incurred obligations to a third person on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority (Sec. 37).

Example: A consigns goods to B for sale, and give him instruction, not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

(iv) Notice to the agent. "Any notice given to or information obtained by the agent, provided it be given or obtained in the course of business transacted by him for the principal shall be between the principal and the third parties, have the same legal consequences as if it had been given to or obtained by the principal." (Sec. 29).

Example: A is employed by B to buy from C certain goods of which C is the apparent owner and buys them accordingly. In the course of the treaty for the sale a learns that goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods.

(v) Misrepresentation or fraud by an agent: The principal is liable for misrepresentation or fraud of the agent committed in the course of the

employment or within the scope of employment or within the scope of agent's apparent authority (Sec. 38). It is immaterial for whose benefits such fraud or misrepresentation has been done.

Of course, the principal is not liable for misrepresentation made or fraud committed by his agent in matters which do not fall in agent's authority.

(vi) Admission made by an agent: The law considers the principal and agent as one person and, therefore, any admission made by the agent in the course of agency business will be taken to have been made by the principal and the principal will be bound by that admission. In a case where the station master reported to the police that one of the porters had run away with the parcel, it was held that admission made by the station master was admission made by the railway company itself and, therefore, it was responsible to compensate for the loss.

2. When the agent contracts for an unnamed principal

An agent is not personally liable to third parties when he has disclosed the fact that he is an agent but has not disclosed the name of his principal to them. The third parties can proceed only against the principal and not against the agent. However, if the agent declines to disclose the identity of his principal, then asked by the third parties, they can sue him personally also.

3. When the agent contracts for an undisclosed principal

When an agent makes a contract with a person who neither knows, nor has reason to suspect that he is an agent, his principal is termed as an undisclosed principal. The position of the third party, the principal and the agent in such a case is as follows:

(i) If the, third party comes to know the existence of the principal before obtaining judgement against the agent, he may sue either the principal or the agent or both. If he decides to sue to the principal, he must allow the principal the benefit of all payments received by him (third party) from the agent (Sec. 231).

Example: A enters into a contract with B to sell him 100 bales of cotton and receive Rs. 500 in advance from B afterwards he (A) discovers that B was acting as agent for C.A may sue but he must give credit to C for Rs. 500 paid by his agent, B to him.

(ii) The principal, if he likes, may intervene and sue the third party. In such a case he can obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract. (Sec. 232).

Example: A who owes 500 rupees, to B, sells 1000 Rupee's worth of rice to B. A is acting as agent for C in the transaction. but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A' debt.

(iii) Para 2 of Sec. 231 states that the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract if he can show that, ifhe had known who the principal in the contract was, or if he had known that agent was not a principal, he would not have entered into the contract.

(iv) When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, she cannot afterwards, hold liable the agent or principal respectively (Sec. 234).

G authorised L & Co. to buy goods for him from A. later on G himself approached A for purchasing them. A knew that L & Co. were buying goods for G but preferred to treat L & Co. as principal and debited their account L & Co. failed to pay the money and A sued G for payments. It was held that A was not entitled to recover payment from G because he (a) had shown a clear intention from the beginning that he had given credit to the agent alone, and he also knew of the principal (Addison v. Gandaseqni (812).

(v) A person untruly representing himself to be the authorised agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing (Sec. 235).

Example: A and B, directors of a company borrowed money from D on its behalf. The company had no powere to borrow money under its memorandum of association. D was unable to recover the amount of the loan from the

company, and he therefore, sued the directors. They were held liable (Collen V. Wright, 1857).

4.7.6 Personal Liability, Rights and Duties of an Agent

Personal liability of the agent

Generally, an agent is not personally responsible for the contracts made by him on behalf of his principal. But he incurs personal liability in the following cases:

l. Foreign principle: When the contract is made by the sale or purchase of goods for a merchant resident abroad, in case of breach of contract the third party can make the agent personally liable.

2. Undisclosed principal: When the agent does not disclose the name of the principal the third party can make the agent personally liable if he has relied upon the responsibility of the agent.

3. Principal cannot be sued: Where the principal though disclosed cannot be sued, e.g. foreign sovereign, ambassador, etc., or the principal is disqualified from contracting though otherwise competent to contrast and this inability of the principal was not communicated to the third party at the time of contracting, he can hold the agent personally liable.

4. Personal liability by agreement: When the agent expressly by agreement or impliedly by conduct undertakes personal liability of the contract.

5. Agent's liability for breach of warranty: When the agent acts without or beyond his authority and in this was commits a breach of warranty of authority, he can be hold personally liable.

   If the agent knows that he is exceeding his authority, the breach of warranty will amount to deceit (Polhill V. Walter (1832) 3 B & Ad. 114).

6. Agent signs the contract in his own name: An agent who signs a Negotiable Instrument e.g., Bills of Exchange, Promissory Notes etc., his own name without making it clear that he is signing as an agent, will be held, personally liable.

7. Agency coupled with interest: Where the contract of agency relates to a subject matter in which the agent has a special interest, agent shall be personally liable to the extent of his interest since he shall be a principal for that interest.

8. Non-existent principal: If an agent acts for a non-existent principal, he shall be held personally liable as if he had contracted on his own account, e.g., promoters entering into contracts on behalf of a company yet to come into existence.

Rights of an Agent

l. Right to claim reimbursement for expenses: Agent has the right to retain, out of the money received on behalf of the principal, money advanced or expenses properly incurred in conducting the agency business (Sec. 217). The agent may have paid the money at the request of the principal, or on account of the understanding implied by the terms of the agency or through mercantile usage.

2. Right to receive remuneration: He has also a right to claim remuneration as may be payable to him for acting as an agent. In the absence of any contract to the contrary, this right to claim remuneration will arise only when he has carried out the object of the agency in full without being guilty of misconduct (Sec. 219).

An agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of the part of that business which had been misconducted (Sec. 220).

Example: A employs B to recover 1,00,000 rupees from C, and to lay it out on good security. B recovers, 1,00,000 rupees and lays out 90,000 rupees on good security, but lays out 10,000 rupees on security which he ought to have known to be had, whereby A losses 2,000 rupees. B is entitled to remuneration for recovering the 1,00,000 rupees and for investing the 90,000 rupees. He is not entitled to any remuneration for investing the 10,000 rupees and the he must make good the 2,000 rupees to A.

3. Right to indemnification against consequences of all lawful acts: An agent has a right to be indemnified by the principal against the consequences of all lawful acts done in exercise of his authority. (Sec. 222).

Example: B, a broker at Calcutta, by the orders of A, merchant there, contracts with C for the purchase of 10 casks of oil for A. Afterwards A refuses to receive the oil and C sues B. B informs A, who repudiates the contract altogether. B defends, but unsuccessfully, and has to pay damages and incurs expenses. A is liable to B for such damages, costs and expenses.

4. Rights of indemnification against consequences of acts done in good faith: An agent has a right to be indemnified by the principal for any compensation which he may be required to pay to the third parties for injuries caused to them by his wrongful acts within the scope of his actual authority done in his good faith, i.e., without any wrong or dishonest intentions (Sec. 223).

   Example: B at the request of A, sells goods in the possession of A, but which A had no right to dispose of B does not know his, and hands over the proceeds of the sale to A. Afterwards C, the true owner of the goods sues B and recover the value of the goods and cost. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses.

   But where one person employs another to do an act, which is criminal, the employer is not liable to the agent either upon an express or an implied promise, to indemnify him against the consequences of the act (Sec. 224).

   Example: A employs to B to beat C, and agrees to indemnify him against all consequences of the act. B thereupon beats C, and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.,

5. Right of indemnification for injuries caused by Principals neglect: An agent has a right to claim compensation from the principal for injuries caused to him by the negligence or want to skill on the part of the principal (Sec. 225).

   Example: A employs Bas a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B.

6. Right of particular lien: An agent is entitled to retain under the possession both movable and immovable of the property of the principal received by him until the amount due to him for commission, disbursements and services has been paid or accounted for him, provided the contract does not provide otherwise (Sec. 221).

Duties of an Agent

l. To follow the instructions of his principal: The agent must conduct the business of the principal according to the directions of the latter. In the absence of any such directions, he must follow the custom of the business prevailing in the locality where the agent is conducting such business. If the agent acts otherwise and the principal

sustains a loss, the former must compensate the latter for it. He will have to account for the profits to the principal if there are any. He will also lose his remuneration (Sec. 211).

Example: A, an engaged in carrying on for B a business in which it is the custom to invest from time to time, at interest, the money which may be in hand omits to make such investment. A must take good to B the interest usually obtained by such investment.

2. Duty to act, with skills and diligence (Sec. 212): The agent must conduct the business of agency with as much skill as is generally possessed by persons engaged in similar business unless the principal has notice of his want of skill.

   Example: A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit without, making the proper and usual enquires as to the solvency of B. B. at the time of such sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

3. Duty to render accounts: An agent is bound to render proper accounts to his principal on demand. He must explain those accounts to the principal and produce the vouchers in support of the entries (Sec. 213).

4. Duty to communicate with the principal: In cases of difficulty, it is the duty of the agent to use all reasonable diligence in communicating with the principal and in seeking to obtain the instructions. It is only in an emergency where there is no time to communicate that he may act bonafide without consulting the principal (214).

5. Duty not to deal on his own account: The relationship of principal and agent is of a fiduciary character. An agent, therefore, should not deal on his own account and should not do anything which may indicate a clash between his interest and duties. An agent shall have to pay all the benefits to the principal, which may have resulted to him from his dealings on his own account in the business of the agency without the knowledge of the principal (Secs. 215 & 216).

   Example: A directs B, his agent, to buy a certain house for him. B tells A that it cannot be bought, any buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

6. Duty not to delegate his authority: An agent cannot delegate his authority to another person unless authorised or warranted by the usage of trade or nature of the agency. A work entrusted to the agent must be done by him.

7. Duty to protect the interest of principal or his legal representative in the event of principal's unsoundness of mind or his death: When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him (Sec. 209).

8. Duty to pay sums received for principal: The agent is bound to pay to his principal all sums received on his account after deducting for his own claim (Sec. 218).

Rights and Duties of the Principal

The agent's duties are principal's right and agent's rights are principal's duties.

4.7.7 Termination of Agency

Agency may be terminated by any of the following ways.

By Act of Parties

1. By agreement between the principal and agent: In some cases, contract of agency itself may contain provisions as regard the termination of agency. They may be express or implied, which may be inferred from the circumstances of the case and terms of the contract.

2. By revocation of agency by the principal: Principal may either expressly or impliedly, after giving reasonable notice, revoke the authority of the agent before it has been exercised by the latter so as to bind the former (Sec. 207).

   Example: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

   Principal shall have to pay compensation to the agent for any earlier revocation of his authority without sufficient cause before the period for which it was given to him.

   Irrevocable agency: However, the principal will not be entitled to revoke the authority of the agent in the following circumstances:

(i) Where the agency is coupled with interest: An agency where the agent himself has an interest in the property which form the subject matter of agency is said to be agency coupled with interest. Such an agency cannot be revoked.

Example: A gives authority to C to sell A's land and to pay himself out of the proceeds the debt due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

(ii) Where authority has been partly exercised by the gent: If the authority has partly been exercised by the agent, the principal cannot revoke the authority of the agent so far as regards such acts and obligations as arise from acts already done in the agency (Sec. 204).

Example: A asks B, his agent, to pay out of A's funds a sum of Rs. 1,000 to C in two equal instalments. By a subsequent letter A revokes B's authority. Before this revocation B had already paid a sum of Rs. 500 to C. A is bound by this payment.

(iii) Where agent has incurred personal liability: Where the agent has purchased bounds in his personal name for the principal has thereby made himself personally liable, the principal cannot revoke agent's authority.

Example: A authorised B to buy 1,000 bales of cotton on account of A and to pay for it but of A's money remaining in B's hands B buys, 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

3. By renunciation of business by the agent: Agent, after giving reasonable notice to the principal, may renounce the business of agency. In case the contract of agency is entered into for a fixed period, agent shall have to pay compensation to the principal for his earlier renunciation of the business of agency.

By Operation of Law

1. By insolvency of the principal: The contract of agency will come to an end when the principal becomes insolvent and the fact of his insolvency comes to the knowledge of the agent. As against third persons, the agency will terminate when it comes to their knowledge. Insolvency of an agent will not lead to the termination of the contract of agency.

2. Destruction of the subject matter of the contract of agency: The contract of agency will come to an end when the subject matter of the agency will come to an end or when it ceases to exist or when the principal is deprived of his powers on the subject matter of the contract of agency.

3. By the completion of the agency - For which an agency is constituted may be terminated once the agency's task has been completed.

4. Insanity or Death of principle or agent- Section 209 of the Indian Contract Act deals with situations where the principal or agent is deceased or insane. The firm's business or agency may be dissolved in the event of the death of the principle or agent.

5. Principal becoming an alien enemy: Breaking out of war between two countries in one of which resides principal and in the other resides the agent, shall cause the termination of the authority of an agent.

When termination of agent's authority takes effect as to agent, and as to third person: The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or so for as regards third persons, before it becomes known to them. (Sec. 208).

Agent's duty on termination of agency by principal's death or insanity when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him (Sec. 209).

Termination of sub-agents' authority: The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent's authority) of the authority of all sub-agents appointed by him (Sec. 210).

IN-TEXT QUESTIONS

18. An agent is a special employee who is employed to do any act for another or to represent someone else in dealing with any of the third person. **True / False**

19. Who appoints sub agent?

    a) Servant b) Owner
    c) Main agent d) Principal

20. On Principal's insolvency agency is terminated. **Yes/No**

4.8 SUMMARY

Finally, we may state that the term "bailment" refers to a type of relationship in which one person temporarily gives another person possession of another person's personal property. One person is the owner and another has the possession of the items or products. On the other hand, the primary point of differentiation between a pledge and a bailment, is the nature of the contract's purpose. It is regarded a pledge when the delivery of goods has the purpose of serving as security for a loan or the performance of an obligation. Under section 124 of Indian Contract act a special contract named as contract of indemnity is also defined, here one party promises to protect the other from a loss brought on by the promisor's contract or by another party's actions.

Contracts of guarantee are agreements to carry out promises made by third parties or release them from obligations in the event of their breach. The individual providing the guarantee is referred to as the "surety," and the party against whose default it is provided is referred to as the "principal debtor." The "creditor" is the party to whom the assurance is given. A promise may be expressed in writing or verbally.

The last type of special contract was contract of agency. A legal arrangement or contract is known as an agency contract it occurs when one person selects another to carry out transactions on his behalf. The principle is the individual who designates the other to handle his business. While the agent is the one who oversees the principal's transaction.

4.9 ANSWERS TO IN-TEXT QUESTIONS

1. True	11. True
2. Lawful consideration and object	12. False, it should be bailee
3. Section 124	13. True
4. No	14. transfer of possession
5. Three	15. Pledge
6. All of the above	16. False
7. creditor	17. Contract of guarantee

8. True 9. False 10. Bailor	18. True 19. Main Agent 20. Yes

4.10 SELF-ASSESSMENT QUESTIONS

1. Explain contract of guarantee and its special features? Also distinguish between a contract of guarantee and contract of indemnity.
2. State the rights of surety against: (i) creditors (ii) the principal debtor and (iii) co-surety. Also give examples.
3. State and explain the cases or circumstances under which a surety is discharged from his/her liability.
4. Define contract of bailment and briefly discuss the rights and duties of bailor and bailee.
5. What are rights and obligations of 'finder of goods. Explain.
6. Define pledge and distinguish between contract of pledge and bailment.
7. Define the terms agent and principal. Discuss the general rules of agency.
8. Who is an agent? How does he differ from a servant? Can a minor appoint an agent or be appointed as an agent? Explain.
9. Briefly explain the duties of an agent towards his principal. What are his rights against the principal?
10. What is agency by ratification? What are requisites of a valid ratification?
11. Describe briefly various modes by which an agency can be terminated. When is agency irrevocable?
12. Who is a sub-agent? What are the consequences of the appointment of a sub-agent? Distinguish between a substituted agent and a sub-agent.

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UNIT IV

LESSON 5

THE SALE OF GOODS ACT 1930

STRUCTURE

5.1 LEARNING OBJECTIVES

- To make the students understand the object and significance of the Sale of Goods Act, 1930.
- To help the students know about Doctrine of Caveat Emptor.

5.2 INTRODUCTION

To clarify and modify the law governing the sale of goods or movables, the Sale of Goods Act, 1930, was established. The first day of July 1930 saw the implementation of the Act. This Act establishes certain rules for contracts for the sale of goods. Contracts for the sale of products are also subject to the general law of contracts, unless they expressly conflict with the terms of the Sale of Goods Act, 1930. Under this act, A person who purchases products or agrees to do so is referred to as a "buyer," while a person who sells or agrees to sell goods is referred to as a "seller." This Act has seen several amendments and adaptation orders in due course. Let's discuss the act in detail.

5.3 FUNDAMENTAL CONCEPTS

5.3.1 Goods

1. **Goods**: Goods have been defined by Section 2, sub-section 7 of the Sale of Goods Act 1930 as "every kind of movable property, other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of land which are agreed to be served before sale or under a contract of sale.

Therefore, goods as defined by this act has the following characteristics:

1. Every movable property is goods.
2. Money and actionable claims are not considered as goods. Money is defined as the current coin of realm. But those coins which are no longer in circulation can become the subject matter of a contract of sale as an article of curiosity.
3. Goods include stocks and share although in English raw stocks and shares are not covered by the definition.
4. Goods also include growing crops and grass.

5. Anything which is attached to or forming part of the land (immovable property) can become goods if it is separated from the immovable property. Therefore, unless something is separate from immovable property, it cannot be called goods. But if separate valuation is put on immovable property on the one hand, and the fixtures and fittings on the other, it is taken as a proof that the intention of the parties was to separate the two. Similarly, where two parties enter into an agreement under which one of them was to cut certain trees in the garden of the other party when their growth exceeded a certain specified limit, it was held that the portion of the trees cut are goods but not the trees themselves. In same way mineral beneath the surface of the earth are not goods but as soon as they are brought to the surface, they become goods.

5.3.2 Kinds of Goods

KINDS OF GOODS:

Broadly speaking goods are of the following three kinds.

(i) **Existing goods:** They are those goods which have actual existence at the time when the contract of sale is made. Existing goods are again of the following kinds: -

(a) Unascertained goods: They are those goods which are not actually identified by the seller but are described by description alone.

(b) Ascertained goods: Unascertained goods become ascertained when the seller decides which particular goods he is going to sell. This word is used as synonymous with specific goods but the difference between the two is that the ascertained goods may become identified only after a contract of sale has been made.

(c) Specific goods: They have been defined by Section 2, Sub-section 14 as those goods which are actually identified and agreed upon at the time a contract of sale is made.

Illustration: A person is the owner of a number of cars and enters into an agreement with the other to sell any of them. This is a contract for unascertained goods which would become ascertained when the seller decides as to which particular car he wants to sell and it will become a contract for specific goods when the car to be sold by the seller is actually pointed out to the buyer and he agrees to the same.

(ii) **Future Goods:** A person may enter into an agreement to seal something to the other which may have no actual existence but which he is to acquire, produce or manufacture in future. For example, a cultivator may agree to sell the crop that he has sown.

(iii) **Contingent goods:** Are those the acquisition of which by the seller depends on a contingency which may or may not happen.

For example, an importer in Bombay agrees to sell the consignment of goods which is on its way from America. This consignment is an instance of contingent goods because the acquisition of goods by the importer in Bombay depends upon a contingency whether it arrives safe at its destination or not. Therefore, contingent goods are also a special class of future goods.

5.3.3 Effect of Perishing of Goods

According to sections 7 and 8 then word 'perishing' means not only physical destruction of the goods but it also covers:

(a) damage to goods so that the goods have ceased to exist in the commercial sense, i.e., their merchantable character as a such has been lost (although they are not physically destroyed) e.g., where cement is spoiled by water and becomes stone.

(b) Loss of goods by theft.

(c) where the goods have been lawfully requisitioned by the government.

It may also be mentioned that it is only the perishing of specific and ascertained goods that affects a contract of sale where, therefore, unascertained goods from the subject-matter of a contract of sale, their perishing does not affect the contract and the seller is bound to supply the goods from wherever he likes, otherwise be liable for breach of contract.

The effect of perishing of goods may be discussed under the following heads:

1. Perishing of goods at or before making of the contract this may again be divided into the following sub-heads:

   (i) In case of perishing of the 'whole' of the goods where specific goods from the subject- matter of a contract of sale (both actual sale and agreement to sell) and they, without the knowledge of the seller, perish, at or before the time of

contract, the contract is void. This provision is based either on the ground of mutual mistake as to a matter of fact essential to the agreement, or on the ground of impossibility of performance, both of which render an agreement void ab-initio.

(ii) In case of perishing of only 'a part' of the goods. Where in a contract for the sale of specific goods, only part of the goods is destroyed or damaged, the effect of perishing will depend on whether the contract is entire or divisible. If it is entire or indivisible and only part of the goods has perished, it is void. If the contract is divisible, it will not be void and the part available in good condition must be accepted by the buyer.

2. Perishing of goods before sale but after agreement to sell. Where there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is thereby avoided i.e., the contract of sale becomes void and both parties are excused from performance of the contract. This provision is based on the ground of supervening impossibility of performance which makes a contract void (section 8).

If only part of the goods agreed to be sold perish, the contract becomes void if it is indivisible, but if it is divisible then the parties are absolved from their obligations only to the extent of the perishing of the goods.

Further, if fault of either party causes the destruction of the goods, then the party in default is liable for non-delivery or to pay for the goods, though undelivered.

Effect of perishing of future goods. A present sale of future goods always operates as an agreement to sell. As such there arises a question as to whether Section applies to a contract of sale of future goods as well. The case of Howell Vs. Coupland provides the answer. In this case it has been held that future goods, if sufficiently identified, are treated to be as specific goods, the destruction of which makes the contract void.

The facts of the case are as follows:

C agreed to sell to H 200 tons of potatoes to be grown on C's land. C sowed sufficient land to grow the required quantity of potatoes, but without any facility on his part, disease attacked the crop, and he could deliver only about 10 tons. The contract was held to have become void.

Document of Title to goods: A document of title to goods is one that is produced as a proof of the possession or control of goods when such goods are subjected to any transaction in a business. In a business deal such a document authorizes, either by endorsement, or delivery, its possessor to transfer or receive goods. It gives a right to the purchaser to receive the goods or to deal further with the goods.

Conditions of a document of title to the goods:

1. The document of title to the goods must be used in the ordinary course of business.
2. The unconditional undertaking to deliver the goods to the possessor of the document.
3. The unconditional entitlement to receive the goods to the possessor of the document.

IN-TEXT QUESTIONS

1. The sales of Goods Act, 1930 came into force on _____.
2. 'Sale' and 'agreement to sell' are same. **True / False**
3. Which of the following are essential characteristics of a contract of sale?
   a) Two parties b) Transfer of property
   c) Goods d) All of the above
4. Goods, the acquisition of which by the seller depends upon an uncertain contingency are called _____.
5. Perishing does not cover loss to goods by theft. **True / False**

5.4 CONTRACT OF SALE

Under Section 4 of the Sale of Goods Act, a contract of sale has been defined as "whereby the seller transfers or agrees to transfer the property in goods to the buyer for a period.

A contract of sale is of two kinds: A sale and an agreement to sell. According to Section 4 sub- section 3 a sale has been defined as where the seller transfers the property in the goods to the buyer at the time when a contract of sale is made and an agreement to sell has been defined as where the seller agrees to transfer the property in the goods to the buyer after the expiration of a certain period of time or the fulfilment of certain conditions.

For example, a cash transaction in which goods are immediately purchased and sold is an instance of a sale while forward contracts on a stock exchange in which goods are agreed to be purchased on a future date ate instances of agreement to sell.

Therefore, according to section 4 sub-section 4, an agreement to sell becomes a sale after the expiration of a stipulated time or the fulfilment of the conditions laid down in a contract of sale.

A sale and an agreement to sell differ from each other on the following points.

(1) A sale is an executed contract while an agreement to sell is an executory contract.

(2) In the case of a sale there is an immediate transfer of property or ownership in the goods but in an agreement to sell such a transfer of property or ownership is to take place at a future date either on the expiration of the fixed time or the fulfilment of certain conditions.

These two points of distinction create different legal implications in the case of a sale and an agreement to sell.

(a) In the case of agreement to sell as the property in the goods has not passed to the buyer.

The purchaser has the right of recovering damages only from the seller of goods that are sold to a third party but in the case of a sale the seller can be held guilty of either conversion or misappropriation if the goods are sold by him to a third party because the property in the goods has passed to the buyer.

(b) In the case of an agreement to self if the buyer fails to pay the price of the goods the seller has only the right to recover damages from the buyer because buyer has yet not become the owner of the goods but in the case of a sale seller shall have the right to file a suit against the buyer for the price of the goods if the purchaser commits a breach of the contract, by refusing to purchase the goods because he has become the owner thereof.

(c) Where in the case of a sale the buyer becomes insolvent without the payment of price, the seller shall have to hand over the goods, if they are in his possession (except in the case of disputed ownership) to the official assignee of the buyer but in an agreement to sell he can refuse to deliver the goods till the payment of price because seller is still the owner of the goods.

(d) In an agreement to sell, if the seller becomes insolvent and the goods are still in his possession the buyer cannot recover the goods but can file a petition against the seller in insolvency preceding for damages due to the breach of the contract but in the case of a sale the buyer can take the goods from the seller who has become insolvent (except in the case of reputed ownership).

Therefore, it can be said that a sale creates a "right in rem" while an agreement to sell creates a "right in personam ".

5.5 SALE DISTINGUISHED FROM OTHER TRANSACTIONS

5.5.1 Sale distinguished from Hire Purchase

Contracts of sale resemble contracts of hire purchase very closely, and indeed the real object of a contract of hire purchase is the sale of the goods ultimately. Nonetheless a sale has to be distinguished from a hire purchase as their legal incidents are quite different. Under hire purchase agreement the owner of the goods agrees to transfer the property in the goods to the hire-purchaser when a certain fixed number of instalments of price are said by the hirer. Till that time, the hirer remains the bails and the instalments paid by him are regarded as the hire charges for the use of the goods. If there is default by the hire purchaser in paying an instalment, the owner has a right to resume the possession of the goods immediately without refunding the amount till the, because the ownership still rests with him. Thus, the essence of hire-purchase agreement is that there is no agreement to buy, but there is only a bailment of the goods coupled with an option to purchase them which may or may not be exercised.

But mere payment of price by instalments under an agreement does not necessarily make it a hire- purchase, but it may be a sale.

The main points of distinction between the 'sale' and 'hire-purchase' are as follows:

1. In a sale, property in the goods is transferred to the buyer immediately at the time of contract, whereas in hire-purchase the property in the goods passes to the hirer upon payment of the last instalment.

2. In a sale the position of the buyer is that of the owner of the goods but in hire purchase the position of the hirer is that of a bailee till he pays the last instalment.

3. In the case of a sale, the buyer cannot terminate the contract and is bound to pay the price of the goods. On the other hand, in the case of hire-purchase the hirer may, if he so terminates the contract by returning the goods to its owner without any liability to pay the remaining instalment.

4. In the case of a sale, the seller takes the risk of any loss resulting from the insolvency of the buyer. In the case of hire purchase, the owner takes no such risk, for if the hirer fails to pay on instalment the owner has the right to take back the goods.

5. In the case of a sale, the buyer can pass a good title to a bonafide purchaser from him but in a hire-purchase, the hirer cannot pass any title even to a bonafide purchaser.

6. In a sale, sales tax is levied at the time of the contract whereas in a hire-purchase sales tax is not liveable until it eventually ripens into a sale.

5.5.2 Sale Distinguished from Contract for Work and Labour

A distinction has to be made between a contract of sale and a contract for work and labour mainly because of taxation purpose, sales tax is levied only in the case of a contract of sale when the property in the goods intended to be transferred and goods are ultimately to be delivered to the buyer, it is a contract of sale even though some labour on the part of seller of the goods may be necessary. Where, however, the essence of the contract is rendering of service and exercise of skill and no goods are delivered as such, it is a contract of work and not of sale.

Sale and Barter or Exchange

Where transfer in the property of the goods takes place for a price, it is called sale. But where goods are exchanged for goods, the deal is called a barter and not a sale similarly, when money is exchanged for money, it is not a sale. It is called exchange. But when consideration of a transaction is partly in money and partly in goods, it is a sale.

5.5.3 Conditions and Warranties

Sometimes in a contract of sale certain representations are made by the seller to the buyer and such representations are also made a part of the contract of sale itself. They either rank as conditions or warranties. According to Section 12, "a condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated." [Section 12 (2)].

A Warranty has been defined as "a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated". [Section 12 (3)].

Whether a particular stipulation in a contract of sale is a condition or warranty depends upon the particular fact of the case or the intention of the parties at the time of making the contract. A stipulation may be a condition though called a warranty in the contract. [Section 12 (4)].

Example: (i) A goes to B a horse dealer, and says, "I want a horse which can run at a speed of 40 m.p.h. The horse dealer points out a particular horse and says, "this will suit you". A buy the horse. Later on, A finds that the horse can run only at the speed of 30 m.p.h.

This is a breach of condition because the stipulation made by the seller forms the very basis of the contract.

(ii) A goes to B, a horse dealer, and says, "I want a good horse". The horse dealer shows him a horse and says, it can run at a speed of 40 mph'. A buy the horse. Later on, A finds that the horse can run only at a speed of 30 m.p.h.

There is a breach of warranty because the stipulation made by the seller was a collateral one.

Stipulation as to time

Unless a different intention appears from the terms of the subject, stipulations as to time of payment are not deemed to be essence in a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract (Section 11). But in mercantile contracts, time for delivery of goods is always taken as of essence unless otherwise agreed.

Example: There was a contract of sale of goods, c.i.f. Antwerp to be shipped in October. The buyer was not to reject delivery even if there was any difference in the type or value or grade specified. The goods could not be shipped till November on account of strike at the port. It was held that the buyer could refuse to take delivery of the goods. (Aron & Co. V/s Comptoir Wegmont (1921).

When Conditions to be Treated as Warranty

(1) **Voluntary Waiver**: According to Section 13(1) where a contract of sale has a stipulation to be fulfilled by the seller which is in the nature of a condition the buyer has a right to treat the breach of such condition as a breach of warranty and to file a

suit for damages only. This is called the right of waiver. But a buyer who has once treated the breach of a conditions as a breach of a warranty and therefore has not repudiated the contract can later on import the same condition into the contract and can repudiate the same.

Illustration: A person made an agreement with the owner of a garage to build the body of a car on the chassis to be furnished by him and the car was to be delivered up to the 20th of May. The car was not delivered on that date and the purchaser of the card did not repudiate the contract but kept on pressing for delivery and on 29th of June he gave a notice to the garage owner that the car must positively be delivered on 25th July. The car was not delivered on that date but was delivered later on. The buyer refused to pay the price. The court decided that the buyer has a right to repudiate the contract.

(2) **Compulsory waiver of a condition:** Where a contract of sale is not severable and the buyer has accepted the goods either completely or in parts the buyer can treat the breach of condition as a breach of warranty and cannot repudiate the contract, unless there is an express or implied terms to that effect [Section 13 (2)].

IN-TEXT QUESTIONS

6. Where goods are exchanged for goods, the deal is called_____.
7. In a sale the position of the buyer is that of the 'owner' of the goods but in hire purchase the position of the 'hirer' is that of a bailee till he pays the last instalment. **True/ False**
8. Sale creates a "right in rem" while an agreement to sell creates a "right in personam ". Is the statement **True or False**?
9. A agrees to supply B, 10 bags of first quality wheat @ Rs. 1000 per bag but he supplies second quality wheat @ Rs 900 per bag. There is a breach of condition, and the buyer can reject the goods. But if the buyer elects, he may treat it as a breach of warranty, accept the second quality wheat and claim damages @ Rs 100 per bag. This is a case of?

5.6 IMPLIED CONDITIONS AND WARRANTIES

5.6.1 Implied Warranties (Section 14)

(1) **The buyer must get quiet possession:** In a contract of sale of goods there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods [Sec. 14 (b)].

Example: A had given his bicycle on hire for a period of ten days to B. Soon after A sold it to C without disclosing to him that B was entitled to use the bicycle on account of hire agreement. B claims the bicycle from C. C's possession is disturbed. He is entitled to get damages from A.

(2) **The goods must be free from encumbrance:** That the goods shall be free from any charge or encumbrance (Legal burden) in favour of any third party which are not declared or known to the buyer before or at the time when the contract is made. [Section 16 (3)].

Example: A pledge his bicycle with C for a loan of Rs. 100 and promises him to give its possession the next day. Soon after he sells the bicycle to B, an innocent buyer, who does not know about the fact of bicycle being pledged. B may either ask A to clear the loan or may himself pay the money and then file a suit against A to recover the money with interest.

(3) **By usage of trade:** An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade. [Section 16(3)].

Implied Conditions (Sections 14 to 17)

(1) **Conditions as to title:** In a contract of sale of goods there is an implied conditional that the sellers shall have the right to sell the goods in the case of a sale and in an agreement to sell he shall have such a right at the time when the property is to pass. [Section 14 (a)]. For example, where a buyer of a car was deprived of the same due to the defective title of the seller, the court decided that the buyer can recover the full price of the car even though he has used the same for a few months. The above implied warranties, in fact, depend upon this condition because a buyer can only enjoy those goods which the seller has right to sell. [Section 14 14].

(2) **Condition as to description:** Where there is a sale of goods by description the goods shall correspond with the description and if the sale is by description as well as by sample it is not sufficient if the bulk of the goods corresponds with the sample alone and not with the description. [Section 15].

Illustration (1): A Building Co., sold to a buyer a copper fastened ship and the ship was sold under the condition that is to be taken by the buyer subject to all the defects. Later on, the ship was found not to be copper fastened in the language of the ship trade. The court, decided that there has been a breach of condition because the ship did not correspond to the description and the buyer was allowed to repudiate the contract.

Illustration (2): There was a contract between a buyer and a seller for the sale of 'Foreign Refined Rape Seed Oil' warranted equal to the sample shown to the buyer. On when supplied was equal to the sample shown but was not refined rape seed oil. The court decided that the buyer had the right to repudiate the contract because the goods supplied did not correspond to the description as well as the sample, although they were similar to the sample exhibited to the buyer.

(3) **Condition as to quality of fitness for a particular purpose**: As a general rule the rule of caveat Empter applies when a purchaser purchases the goods for satisfying needs but there are cases when the buyer makes known to the seller the particular purpose for which the goods are required and relief upon seller's skill and judgement for supplying the goods of his requirement and the goods are of such a nature that they are sold by the seller in the course of his business, (whether he is the manufacturer or producer or not), there would be a breach of condition as regards quality fitness if the goods supplied are not fit for the purpose for which they have been purchased.

Illustration: The GI.P. Railway Company purchased some timber from a seller especially for the purpose of being used as Railway sleepers and when supplied the timber was found unsuitable for the purpose. It was decided that the Railway Company, has a right to reject the goods because the timber was purchased for a particular purpose which was made known to the seller.

If the goods supplied by the seller to buyer are of such a nature that they can be put to several use but they are unfit to be used for any particular purpose for which they may have been purchased, there can be no breach of this condition if the buyer's purpose is

not served. For example, a buyer agreed to purchase from the seller jute bags for the purpose of packing food articles but when supplied jute bags had a peculiar smell which rendered them unfit for packing food stuff. The court decided that there is not breach of the condition relating to fitness for any particular purpose because the particular purpose for which bags were to be used was not make known to the seller and so although bags might have been purchased must be unfit for packing food articles, they were fit for other purposes.

Therefore, in such a case the particular purpose for which the goods are to be specified must be specified by the buyer to the seller. But if goods are purchased under a patent or trade name there is no implied condition regarding their fitness for a particular purpose for which they might have been purchased. For example, a cultivator purchases Ruston Oil Engine to be fitted in his well for irrigation his field but when put to use it was found unable to cope with the requirements of irrigation, the court decided that there is no breach of such a condition, because the buyer has exposed more confidence in the trade name rather than in the skill of the seller.

(4) **Implied condition of merchantability:** According to section 16 sub-section 2 where goods are purchased by description from a person who usually sells them (although he may be a manufacturer or producer or not) there is an implied condition that the goods supplied shall be of merchantable quality. For example: (Pir Mohammed V/s Dallo Ram) where black woollen yam was supplied by the seller to the buyer and the same was found moth-eaten, it was decided that there was a breach of this condition.

The work merchantable has not been defined anywhere in the Act but it has been taken by the courts to mean the quality of the goods of which, if properly tendered to the buyer will compel him to accept their delivery but this does not imply that the seller is guaranteeing the goods to be easily saleable.

Illustration: A manufacturer of tonic water in England agreed to sell the same to a buyer in Argentina. The tonic water contained a particular acid and according to the law of Argentina the sale of any liquid article containing that particular acid was banned. The goods arrived in Argentina and were condemned by the Port authorities. The court decided that there is no breach of condition regarding merchantability as the tonic water was prepared according to the prescribed chemical formula and merchantability does not imply that the seller would provide an article for which there would be ready and willing buyer.

But if the buyer has examined the goods there is no implied condition regarding their merchantability in respect of those defects which any examination ought to have revealed. For example, where a buyer purchased vegetable Ghee packed in the casks and the buyer inspected the containers from outside alone and agreed to purchase the goods but later on when the ghee was found to be adulterated, the court decided that there was no breach of condition as buyer has examined the goods and if he has not properly examined them, seller cannot be held liable.

5. **Implied condition in a contract of sale by sample:** (i) In the case of sale by sample the bulk of the goods must correspond with the sample in quality because in such cases it is the sample alone which has been held to be representative of the quality of goods to be supplied by the seller and therefore it is but natural that the goods must conform to the sample.

(ii) The buyer should get reasonable opportunity of comparing the bulk with the sample. There is some conflict of legal opinion as to whether the whole of the goods conform to the sample. The courts have laid down a rule that goods supplied shall be considered according to the sample if so, much of the quantity out of the entire lot is equal to the sample as any standard of fair play and equity prescribes. In other words, it is the discretion of the court to decide whether the goods conform to the sample or not.

(iii) In the case of sale by sample there is an implied condition that the goods shall be merchantable and free from defects which could not be disclosed by an ordinary examination. For example, a manufacturer agrees to sell 2500 pieces of grey shirting's each weighing 7 pounds the price of which was to be 18s. 6 d. per piece. The sample of the cloth was shown and approved by the buyer. When rendered it unfit to be made into dresses, because some China clay has used in the preparation of the cloth to increase its weight. The court decided that although the sample was shown and approved by the buyer yet it was of such a nature that the defect could not be detected so that goods are un-merchantable even though they conform to the sample.

5.6.2 Doctrine of Caveat Emptor

The maxim of caveat Emptor means "let the buyer beware". According to the doctrine of caveat emptor it is the duty of the buyer to be careful while purchasing goods of his requirement and, in the absence of any from the buyer, the seller is not bound to disclose

every defect in goods of which he may be cognisant. The buyer must examine the goods thoroughly and must see that the goods he buyers are suitable for the purpose for which he wants them. If the goods turn out to be defective or do not suit his purpose, the buyer can not hold the seller liable for the same, as there is no implied undertaking by the seller that he shall supply such goods as suits the buyer's purpose. If, therefore, while making purchases of goods the buyer depends on his own skill and makes a bad choice, he must curse himself for his own folly, in the absence of any misrepresentation or fraud or guarantee by seller.

Exceptions: The doctrine of caveat emptor is subject to the following exceptions:

1. Where the seller makes a misrepresentation and the buyer relies on it, the doctrine of caveat emptor does not apply. Such a contract being voidable at the option of the innocent party, the buyer has a right to rescind the contract.

2. Where the seller makes a false representation amounting to fraud and the buyer relies on it, or when the seller actively conceals a defect in the goods so that the same could not be discovered on a reasonable examination, the doctrine of caveat emptor does not apply. Such a contract is also voidable at the option of the buyer and the buyer is entitled to avoid the contract and also claim damages for fraud.

3. Where the goods are purchased by description and they do not correspond with the description.

4. Where the goods purchased by description from a seller who deals in such class of goods and they are not of 'merchantable quality', the doctrine of caveat does not apply. But the doctrine applies, if the buyer has examined the goods, as regards defects which such examination ought to have revealed.

5. Where the goods are bought by sample, the doctrine of caveat emptor does not apply if the bulk does not correspond with the sample, or if the buyer is not provided an opportunity to compare the bulk with the sample, or if there is any hidden or latent defect in the goods.

6. Where the goods are bought by sample as well as by description and the bulk of the goods does not correspond both the sample and the description, the buyer is entitled to reject the goods.

7. Where the buyer makes brown to the seller the purpose for which he requires the goods and relies upon the seller's skill and judgement but the goods supplied are unfit

for the specified purpose, the principle of caveat emptor does not protect the seller and he is liable in damages.

8. Where the trade usage attaches an implied condition or warranty as to quality or fitness and the seller deviates from that the doctrine of caveat does not apply and the seller is liable in damages.

5.7 ESSENTIALS OF A CONTRACT OF SALE OF GOODS

These are various essential elements which must be present in a contract of sale of goods these are:

(1) **At least two parties:** To make a contract of sale there must be at least two parties. These parties must be distinct, that is, a buyer and a seller. These parties should be also competent to make a contact. In this context the word 'buyer' means any person who buys or agrees to buy the goods and the word 'seller'" means any person who sells or agrees to sell the goods.

(2) **Goods:** the subject-matter of the contract of sale of goods, must be some goods the purpose of this contract is to transfer the property in these goods from the seller to the buyer. And the goods forming the subject-matter of contract should be movable. The regulation of transfer of immovable property does not come within the purview of sale of Goods act.

(3) **Price-the consideration:** In a contract of sale the consideration is price. The price must be money when the goods are sold in exchange for goods, this is not sale but only a barter. But price or consideration may by partly in money and partly in goods.

(4) **General property:** In a contract of sale the object is to transfer general property, from the seller to the buyer, in the goods. General property in the goods is different from special property in the goods. If a person has the ownership of the goods, it means, he has the general property in the goods. If the owners of the goods pledge these goods with a money-lender, the moneylender has special property in the goods.

(5) In a contract of sale all the essential elements of a valid contract must be present, namely, agreement, intention to create legal relationship, capacity to make contract, free consent, lawful consideration, lawful object, etc.

IN-TEXT QUESTIONS

10. According to the doctrine of caveat emptor it is the duty of the seller to disclose all facts about the goods when the buyer is buying it. **True/ False**
11. In a contract of sale all the essential elements of a valid contract must be present, namely, agreement, intention to create legal relationship, capacity to make contract, free consent, lawful consideration, lawful object, etc. **True / False**
12. Section 13 of the sales of Goods Act, 1930 deals with:

    a) Sale by sample b) Existing or future goods

    c) When condition to be treated as warranty d) Duties of seller
13. (Pir Mohammed V/s Dallo Ram) where black woollen yam was supplied by the seller to the buyer and the same was found moth-eaten, it was decided that there was a breach of _____.

5.8 SUMMARY

Chapter VII of the Indian Contract Act of 1872 originally contained the law governing the sale of goods and moveable property. The Sale of Goods Act of 1930's Section 4 states that a contract for the sale of goods is one in which the seller transfers or agrees to transfer the buyer's ownership of the products in exchange for payment. Two parties, goods, price, transfer of property, all essential elements of a valid contract are some if the key components of this act. Section 2(10) defines price "as a money consideration for a sale of goods". We also discussed about different types of goods included under this act which range from existing goods, future goods and contingent goods. Act also defined how conditions are different from warranties in case of durable goods. Caveat Emptor which means "Let the buyer beware" which is a fundamental principle of the law of sale of goods is also discussed above.

5.9 ANSWERS TO IN-TEXT QUESTIONS

1. 1st July 1930 2. False 3. All of the above 4. Contingent goods 5. False 6. Barter 7. True 8. True	9. Voluntary Waiver by buyer 10. False 11. True 12. When condition to be treated as warranty 13. Implied condition of merchantability

5.10 SELF-ASSESSMENT QUESTIONS

1. Define the term 'agreement to sell' and 'sale' and distinguish between the two. Also give illustrations.
2. What is a 'good'? Discuss about different types of goods.
3. What is a contract of sale of goods? When was the act related to it enacted? Discuss the essential characteristics of this contract.
4. C agrees to sell D, 10 bags of rice of superior quality out of 100 bags lying in his godown for Rs. 5500. The rice was completely destroyed by fire. Can D compel to C to supply the wheat as per agreement? (*Hint: Yes, D can compel C*)
5. State the doctrine of *caveat emptor* and explain the exceptions to it.
6. Define and distinguish between a condition and a warranty. Under what circumstances a breach of condition is to be treated as a breach of warranty?
7. "In a contract for the sale of goods, there is no implied condition or warranty as to the quality of the goods or their fitness for any particular purpose". Comment.

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LESSON 6

TRANSFER OF PROPERTY IN CONTRACTS OF SALE OF GOODS

STRUCTURE

6.1 LEARNING OBJECTIVES

- To make the students understand various provisions related to transfer of property in contracts of sale of goods.
- To let learners, understand different rights of an unpaid seller.
- To help students communicate effectively using legal terminologies.

6.2 INTRODUCTION

While defining the contract of sale we saw that a sale means primarily the transfer of property in goods from a seller to a buyer. The phrase "transfer of property in goods" means transfer of ownership of the goods. 'Property in goods' is different from possession of goods, possession refers to custody over the goods. Here different cases can arise, one of them may be the property in goods may still be with seller although the goods may be in possession of the buyer or his agent.

6.3 TRANSFER OF PROPERTY

The most important consequence of a contract of sale of goods is the transfer of property in the goods from the seller to the buyer because risk always follows such a transfer of ownership and the time of payment as well as the time of delivery of the goods is not an essential consequence of such a contract.

The most important point regarding the transfer of ownership is that it can take place only in case of ascertained and specific goods. According to Sec. 18 "No transfer of property in the goods can take place from the seller to the buyer unless and until they are ascertained".

Illustration: A sells 200 mounds of wheat out of a total of 618 mounds stored in a warehouse and gives a delivery order to B, the purchaser, directing the warehouse men to deliver 200 mounds of wheat to B. B lodges the delivery order with the warehouse men to no transfer of property takes place from A to B so far as the quantity to be sold to him is concerned because the goods were unascertained.

6.3.1 Transfer of Property in Specific and Ascertained Goods

According to Sec. 19 where there is a contract of sale of specific or ascertained goods, the property in them shall pass from the seller to the buyer when the parties have intended it to pass.

In order to find out the intention of parties in this regard, consideration is to be given to the terms of the contract, conduct of the parties and circumstances of the case.

But if the parties fail to lay down their intentions regarding the transfer of property in the goods, certain rules have been laid down for ascertaining the intention of the parties as to the

time at which the property in the goods is to pass to the buyer, which are contained from Sec. 20 to 24 and which are the following:

1. **When goods are in a deliverable state:** According to Section 20 of Sale of goods act, 1930, where there is an unconditional contract for the sale of specific goods in a deliverable state the property in the good passes to the buyer when the contract of sale is made and it is immaterial whether the time of payment of the price or the time of delivery of the goods or both is postponed.

   Illustration: Where there is a contract between A & B for the purchase of a specific quantity of hemp stored on the premises of the seller A; price to be paid on 4th February and the delivery to be given on 1st of May while the contract is being made on 20th January the property in the specific lot of hemp shall be transferred from A to Bon 20th January itself.

   As goods under this rule are in such a state they can be immediately delivered to the buyer, there remains nothing which can prevent a transfer of ownership. But if the parties in such cases themselves decide that no transfer of property shall take place till the entire price is paid, or till the delivery of goods has been given to the buyer, there would be no transfer of property in the goods in spite of the fact that the goods are specific and in a deliverable state. As for example goods sold under hire purchase agreement.

2. **When goods are not in a deliverable state:** According to Section 21 where there is a contract for the sale of specific goods, but the seller is bound to do something to the goods in order to put them in a deliverable state, property in them shall not be transferred until such thing is done by the seller and buyer has notice thereof.

   Illustration: There was a contract for the wood of Oak trees in a certain forest. The buyer purchased the wood from the seller selecting certain portion of trees and rejecting others. According to the custom of trade the seller was to separate the selected portions from the rejected portions. But the buyer threw upon himself the duty of separating the two portions. The court decided that no transfer of ownership has taken places so far as wood is concerned.

3. **When goods are to be measured etc.:** According to Section 22, where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to measure, weight or count the goods in order to determine the price, there would be no

change of ownership from the seller to the buyer till such act is done and the buyer has notice thereof.

Illustration: There was a contract for the sale of 289 bales of goat skin. Every bale was to contain 5 dozen smaller bales and according to the contract the price was to be determined according to the price of smaller bales so that the seller was to count the number of smaller bales in every bigger bale. It was decided that no transfer of property has taken place when the bales were destroyed by the fire during the process of counting by the seller.

Transfer of property in unascertained goods: According to section 18 no transfer of property can take place from the seller to the buyer in unascertained goods. Therefore, some acts have got to be done in order to convert unascertained goods into ascertained or specific goods. Such acts are collectively and technically called 'appropriation'. According to Section 23 "Where there is a contract for the sale of unascertained or future goods by description and goods of that description as well as in deliverable state are unconditionally appropriated to the contract, either by the seller with the consent of the buyer or by the buyer with the consent of the seller, the property in the goods shall be transferred from the seller to the buyer, as soon as such appropriation is made, the consent of the buyer or the seller as the case may be obtained either before or after appropriation.

6.3.2 Appropriation of Goods

Thus, appropriation of goods is the most important act which permits the transfer of property from the seller to the buyer. Appropriation may be defined as the application of the goods for the purposes of a contract of sale such an act must have the following essentials.

1. **Goods which are appropriated must be of the same description under which they are sold:** For example, where an order was placed for tea sets, jars and glasses made of China clay and where the seller while supplying the goods also placed some other things in the parcel it was held that there was no appropriation because the goods did not exactly answer the description given in the contract.
2. The goods appropriated to the contract must be in a deliverable state because unless they are in such a state no transfer of property can take place.
3. **The goods must be unconditionally appropriated to the contract:** According to section 23 sub-section 2. "Goods are said to be unconditionally appropriated to the contract when the seller gives them to the buyer or a carrier or some other bailee

(whether named by the buyer or not) for the purpose of transmission to the buyer. The most common form of appropriation is the delivery of goods to person for the purpose of transporting them to the buyer and as soon as this is done, generally speaking, the property shall be transferred to the buyer if the seller has not reserved the right of disposal as defined by section 25.

4. **Basis of appropriation:** Appropriation of goods is done on the basis of consent of either the buyer or the seller. Such a consent may be obtained either before or after appropriation.

By the buyer with the consent of the seller: Where the buyer is holding the goods on behalf of the seller as an agent, the buyer can appropriate the goods for the purpose of the contract, inform the seller regarding the same, obtain his consent only them the property shall be transferred to the buyer.

By the seller with the consent of the buyer

Illustration No.1 A agrees to purchase 10 tons of petrol from Band already sends the steel tins to B for packing the petrol. As soon as B will fill the petrol in the steel tins sent to him by the buyer, the property shall be transferred from B to A because the consent of the buyer to the appropriation made by the seller shall be taken to have been given by the buyer himself supplying the steel tins (consent of buyer before appropriation).

Illustration No. 2 A of Madras orders certain goods from B a manufacturer of Calcutta. After the goods are ready, B appropriates the goods to the contract informing A that the goods are ready for delivery upon which A requests B to send them by Rail to Madras after affecting the Insurance thereon. The property in the goods shall pass from B to A as soon as the goods after being insured, are handed over to the Railway Authorities (consent of the buyer after appropriation).

Illustration No. 3 A sells 500 mounds of rice out of bigger quantity to Band the rice is packed in seller's gunny bags and the words "wait orders of the buyer" are pasted on the gunny bags with the address of the buyer, it was decided that the property has not changed hands although the goods are in a deliverable state because the buyer's consent to the appropriation has not yet been obtained.

5. **Method of Appropriation:** Appropriation of goods for the purpose of the contract may be made:

(a) By packing the goods in suitable containers.

(b) By separating the goods from a larger quantity.

(c) By the delivery of the goods to a common carrier or bailee for the purpose of transmission to the buyer without reserving the right of disposal which has been defined by Section 25 of the Sale of Goods Act as follows:

1. Where there is a contract for the sale of specific goods or unascertained goods which are unconditionally appropriated to the contract, the seller may under the terms of the contract or appropriation lay down certain conditions to be fulfilled by the buyer. In such a case although goods may be delivered to the common carrier or other bailee for the purpose of transmission to the buyer the property shall not be transferred to the buyer.

   Illustration: A sells 500 bales of cotton to B on the condition that certain bills of exchange which have been drawn by B on A and which are still in circulation should be withdrawn by the buyer. The delivery of the bales was to be given in instalments. The buyer fails to withdraw the bills of exchange and the seller stopped the delivery of instalments claiming the price of the bales already delivered, it was decided that no transfer property has taken place even in the bales which have been delivered because the buyer has not fulfilled a condition laid down in the contract.

2. Where the seller sends the goods and takes a bill of lading or railway receipt, deliverable to himself or his order it is presumed that the seller has reserved the right of disposal over the goods.

3. Where the seller sends the goods and draws upon the buyer for the price, sending to him the bill of lading of the railway receipt along with a bill of exchange to be either accepted or paid by the buyer, the buyer shall not acquire the ownership of the goods till he has accepted or paid the bill of exchange and if by mistake he acquires the bill of lading without accepting or paying the bill of exchange, the property does not pass to him.

Illustration: A sells goods to B. He weights the goods at his own place of business, sends them to B's placed, taking the railway receipt and sending the same to his bander at B's place of business instructing him to surrender the R/R to the buyer B only when he pays the Bill of exchange. The banker surrenders the receipt to the buyer B upon his acceptance of the bill. Later on, B refuses to honour the goods. A file a suit for the recovery of the price. Held that A has no right to recover the price because the property in the goods has not passed to B, it being contingent upon the payment and not the acceptance of the bill.

Consequence of the transfer of property: The most important consequence of the transfer of property under a contract of sale goods is the risk passes with the property. According to section 26, where the property in the goods remains with the seller, the seller bears the risk and when the property passes to the buyer, the risk devolves on the buyer whether the delivery has been made or not. But if there is any deal in the transfer of property due to the fault of any one of the parties to the contract, the risk shall remain with the party but for whose fault the property would have been transferred.

In other words, there can be conditions under which there may be divorce between risk and ownership.

Illustration 1: There was a contract between A & B for the sale of 814 tons of kerosene oil B, the purchaser, paid Rs. 1000 as part payment of the price. The seller A was himself to receive the consignment from A third party. On the receipt of the Railway receipt, A endorsed the same to the buyer

B. The consignment was destroyed in transit, held that B is liable for the loss and cannot get back the refund of part payment made by him because as the R/R was endorsed in his name, he became the owner of the good and therefore shall have to bear the risk of loss.

But where the goods have been dispatched by the seller "on the risk and on account of the buyer" but the railway receipt was taken in the name of the seller or it was taken in the name of the buyer but was sent to the seller's agent with the instructions to part with the same upon the fulfilment of certain conditions by the buyer, the risk shall remain with the seller because he has reserved the right of disposal.

Transfer of property in transaction of sale or return: According to section 24 where the goods are sent to the buyer "on approval or on sale or return" or similar other terms the property in them shall pass to the buyer:

(a) When the buyer expresses his approval or acceptance to the buyer or does any other act adopting the transaction:

Illustration: A gives a diamond to B on sale or return. B gives the same to C on similar terms and C delivers the same to D on sale or return. The diamond was lost from the custody of D. As B cannot return the diamond to A, his act in giving the diamond to C shall be tantamount to adopting the transaction. Similarly, if the buyer on sale or return pledges the goods to a third party the act of pledge shall be taken to be an act adopting the transaction.

(b) Where the goods were sent to the buyer on sale or return with a fixed period of time within which he is to express his approval, the property shall pass to the buyer as soon as that period of time expires although the buyer does not give his approval or acceptance and if no such time is fixed upon the expiry of reasonable time.

6.3.3 Transfer of title

Transfer of title: In the performance of a contract of sale of goods by a seller there are three stages, namely, the transfer of property in the goods, the transfer of possession of the goods, i.e., delivery of the goods and the passing of the risk. The main object of a contract of sale of goods is the transfer of property in goods from the seller to the buyer. The term 'property in goods' is different from the term 'possession of goods': 'property in goods' means the ownership of the goods whereas 'possession of goods' means custody or control of goods.

According to Sec. 27 only that person has a right to sell goods who is a real owner of them so that a sale by non-owner may create certain legal complications to avoid which Sec. 27 had laid down the following exceptions:

IN-TEXT QUESTIONS

1. According to Section _____, where there is a contract for the sale of specific goods but the seller is bound to do something to the goods in order to put them in a deliverable state after which property could be transferred.
2. Goods which are appropriated need not to be of the same description under which they are sold. **True/ False**
3. C buys a scooter which was in deliverable state for Rs. 10,000 on a month's credit and ask the shopkeeper to send it to his house. The shopkeeper agrees to do so. The scooter immediately becomes the property of C. **True / False**
4. The term 'property in goods' is different from the term 'possession of goods'. **True / False**
5. In the performance of a contract of sale of goods by a seller there are three stages involved, which of the following is not a stage of the contract of sale?

   a) transfer of property in the goods
   b) passing of the risk
   c) the transfer of possession of the goods
   d) selling of items

6.4 SALE BY NON-OWNERS

1. Provisions of Indian Sale of Goods Act: There are certain conditions laid down by the Sale of Goods Act itself in which a non-owner can sell the goods not belonging to him. For example, according to Sec. 54 of this Act an unpaid seller of goods has a right to sell them even though the property in them might have passed to the buyer and the purchaser of the goods shall acquire a good title to them.

2. Provisions of any other law for the time being in force in India. There might be certain other enactments which may prescribe conditions under which a sale effected by an apparent owner shall confer a good title on the purchaser. As for example a finder of lost goods under Sec. 76 of the Indian Contract Act can sell the goods under a certain condition and similarly under section 168 a pledgee can also sell the goods and in both these cases a bonafide purchaser shall get a good title to the goods.

3. The real owner may by an act or omission prevents himself from later on denying the authority of the seller to sell the goods which means that the doctrine of estoppel applies to him. For example, where an agent when authority has been conferred exceeds the same and affects a sale of the goods, the buyer would get a good title or where the real owner of goods accepts the payment of the goods from the agent knowing that the sale has been affected by the agent without his authority.

4. Sale by a Mercantile Agent: According to paragraph 2 of Sec. 27, where a mercantile agent is in possession of the goods or of a document of title to them with the consent of the real owner and effects a sale of them in the ordinary course of his business the buyer gets a good title to goods provided, he acts in good faith and without any knowledge of the defect in the title of the mercantile agent.

   (a) The person must be a mercantile agent. For example, where a person was entrusted with jewellery to be sold in the countryside it was held that he was a mercantile agent capable of conferring a good title on the purchaser.

   (b) He must be in the possession of the goods for document of title to the goods. For example, a railway receipts a bill of lading, a warehouse certificate etc. This means that the agent must be either in actual or constructive possession of the goods.

   (c) The mercantile agent must enjoy such possession with the consent of real owner. If the consent of the real owner is not free, the possession by the mercantile agent under this rule is vitiated, and he cannot confer a good title on purchased. But these are cases where although the act of the mercantile agent does not amount to either fraud or misrepresentation which may vitiate his possession yet he has acquired the same by playing a trick in which case he has the authority to confer a good title on the purchaser. For example a person was duly entrusted with the possession of a car with instructions not to sell it below a specified price but, from the beginning, the agent had no intention of selling the car at that price and later on effects a sale it was decided that the buyer gets a good title because agent was duly entrusted with the possession of the car and it is not the duty of the purchaser to investigate any flaw in such possession although the agent has not fulfilled the instructions of the principal.

(d) The sale must be effected in the usual course of business. For example, where the agent acquired the possession of a car from the real owner on the representation that he has prospective buyer in sight and later on obtained on employment with a motor company selling the car in that capacity, it was held that the buyer would not get a good title to the car because the sale has been effected in the course of business.

(e) The purchaser must act in good faith.

(f) He must have no knowledge about any defect in the title of the owner or the mercantile agent. Such a knowledge may be acquired by him directly or it may be obtained by him through any source whatsoever which would not entitle him to claim the benefit of this rule.

5. Sale by a co-owner: According to Sec. 28 where one of the several joint owners has the sole possession of the goods with the consent of the other co-owners a sale effected by such a co- owner in possession shall confer a good title to the buyer if he acts in good faith and without any knowledge of the defect in the title of the seller. If one of the several co-owners is holding a jewel in safe custody, the buyer in good faith will get a good title (Sec.28).

6. Where the possession of the goods has been obtained by a person under a contract voidable under Sec. 19 or 19A, of Indian Contract Act. A sale of the goods by such a person before the contract is rescinded confers a good title on the buyer if he acts in good faith and without any knowledge of the defect in the title of the seller (example of a voidable contract (Sec. 20).

7. Sale by a seller in possession after sale: According to Sec. 30(1) if the goods or document of title to the goods are in possession of a seller, and the goods have already been sold by him to a third party but the seller again effects a disposition of the goods or the documents either by means of pledge or sale, the buyer would get a good title if he acts in good faith and without any knowledge of the defect in the title of the seller.

8. Buyer in possession after sale: According to Sec. 30(2) where a purchaser is in possession of the goods which he has either purchased or agreed to purchase with the consent of the seller and effect a disposition of the same either by pledge or sale, the buyer will get good title if he acts in good faith and without any knowledge of the defect in the title of the seller. B agreed to buy a car and pay for it if his solicitor

approved and having obtained possession of car sold it to C, but the solicitor subsequently did not approve of the transaction. C will get a good title to the car.

6.5 RESERVATION OF RIGHT OF DISPOSAL BY SELLER

As a rule, the property in the goods can be transferred from the seller to the buyer, if the goods are either specific or ascertained. In addition to this, for passing the property to the buyer form seller, the seller should not have reserved his right of disposal of the goods. A seller reserves the right of disposal of the goods till the fulfilment of certain conditions. For example, if according to a term of a contract the buyer is to make payment of price of the goods before delivery, it means the seller has reserved the right of disposal of the goods. In this case the property in the shall not pass to the buyer until the condition of payment of price of goods is fulfilled. The position will remain the same even if the goods have been delivered to the buyer or to carrier of goods for the purpose of carrying to the buyer.

A through there can be express reservation of the right of disposal of goods by the seller, he is deemed to reserve the right of disposal of goods in the following cases.

(1) In case the goods are handed over for shipment or carriage by railway and if the goods are deliverable to the order of the seller or his agent as per the bill of lading or railway receipt.

(2) In case the seller sends a bill of exchange for the amount of the price of the goods to the buyer, along with the bill of lading or railway receipt, for his acceptance. In this case, the property in the goods does not pass from the seller to the buyer till the acceptance of the bill of exchange by the buyer. In case the buyer does not accept the bill or dishonours the bill, the buyer must return the bill of lading or railway receipt; if he retains them wrongfully; the property in the goods does not pass to the buyer.

6.6 RIGHTS OF UNPAID SELLER AGAINST GOODS

6.6.1 Rights of Unpaid Seller Against Goods

A seller who is not paid has legal recourse against the products and the purchaser. We shall look at the rights of an unpaid seller against goods, such as rights of lien and rights of stoppage in transportation, by referring to the sections of the Sale of Goods Act, 1930.

A) Rights of Lien (Section 47)

An unpaid seller who is in possession of the goods may keep it until payment, in accordance with subsection (1) of Section 47 of the Sale of Goods Act of 1930. These scenarios make it possible:

1. Where he sells the goods without any stipulation for credit
2. Where the goods are sold on credit but the credit term has expired.
3. Where the buyer becomes insolvent.

According to subsection (2), the unpaid seller may exercise his right of lien even if he is in possession of the goods on behalf of the buyer as an agent or bailee. Additionally, Section 48 specifies that a seller who has not been paid may use his right of lien on the remaining items if he makes a partial delivery. Unless the buyer and seller have a waiver agreement for the lien under partial delivery, this is valid.

Termination of Lien (Section 49): According to sub section (1) of Section 49 of the Sale of Goods Act, 1930, **an unpaid seller loses his lien:**

a. When he delivers the goods to a carrier or other bailee for transmission to the buyer without reserving the right of disposal of the goods.
b. When the buyer or his representative lawfully takes possession of the goods.
c. By way of waiver.

B) Right of Stoppage in Transit

The lien right is expanded by this right. The right to stoppage in transit refers to the ability of an unpaid seller to halt the shipment of his goods, recover control, and hold onto them until he is paid in full.

Duration of Transit (Section 51)

From the moment the seller gives the products to a carrier or a bailee for transmission to the buyer until the buyer or his representative accepts delivery of the said items, the goods are in transit.

The transit is deemed to be at an end and seller cannot exercise his right of stoppage in the following cases:

When the buyer or his agent obtain delivery before the goods reach the destination. In such cases, the transit ends once the delivery is obtained.

Once, the goods reach the destination and the carrier of bailee informs the buyer or his agent that he holds the goods, then the transit ends.

When the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent, the transit ends

In some circumstances, the buyer charters a ship to get the goods. It is determined if the master is acting as the goods' agent or carrier depending on the circumstances.

C) Right of Resale (Section 54)

A crucial right for an unpaid seller is the right of resale. The lien and stoppage rights are useless if he does not have this right. Under the following circumstances, a seller who has not received payment may use his right of resale:

a. **When goods are perishable in nature:** In such cases, the seller does not have to inform the buyer of his intention of resale.

b. **When seller gives a notice to the buyer of his intention of resale:** The buyer must pay the item's price and request delivery within the notice's specified time frame. If he doesn't, the seller will be able to resell the products. If the sale price is lower than the contract price, he may also be entitled to the difference. The seller, however, keeps the gains if the resale price is higher.

c. **When unpaid seller resells, the goods post exercising his right of lien or stoppage:** The subsequent buyer acquires a good title to the goods even if the seller has not given a notice of resale to the original buyer.

d. **Where resale is mentioned in the contract**: The seller reserves his right to sell if the purchase agreement states that if the buyer defaults, the seller may resell the goods. Even if he doesn't send the original buyer a notice of resale, he can still sue him for damages.

6.6.2 Rights of Unpaid Seller Against the Buyer Personally

The seller becomes an unpaid seller when the buyer of the goods fails to pay his debt to the seller. And the seller now has some legal recourse against the purchase. These rights are the seller's remedies for the buyer's contract violation. In addition to the rights, he already has against the things he sold, the unpaid seller also has these rights.

There is always a reciprocal promise in a deal. Both the buyer and the seller are still required to fulfil their obligations under a contract of sale. Additionally, the seller becomes an unpaid seller if the buyer fails to pay the seller what is owed. This indicates that the seller in question has some claims against the customer. If a seller who hasn't been paid has given the buyer ownership of the goods and the buyer goes bankrupt, the seller may ask the carrier to return the goods.

1) Suit for Price (Sec 55): If the property of the products has already been transferred but the buyer refuses to pay for the goods, the seller becomes an unpaid seller under the terms of the contract of sale. In this situation, the seller may bring legal action against the buyer for illegally withholding payment. However, suppose the sales agreement specifies that the price will be paid later, regardless of when the products are delivered. And if the buyer refuses to pay on such a day, the unpaid vendor may file a lawsuit for the cost of the items. According to the legislation, it is not important how the items are delivered.

2) Suit for Damages for Non-Acceptance (Sec 56): The seller may file a lawsuit against the buyer for damages resulting from his failure to accept the products if the buyer wrongly refuses or neglects to do so and fails to pay the unpaid seller. Due to the buyer's ill-informed refusal to purchase the items, the seller may suffer some losses. Take for example the case of seller X. He agrees to sell to Y, 200 litres of milk for a decided price. On the day, Y refuses to accept the goods for no justifiable reason. X is not able to find another buyer and the milk goes bad. In such a case, X can sue Y for damages.

3) Suit for Interest: (Sec 61): The seller may file a lawsuit to recover the interest owed to him by the buyer if there is a specific agreement between the parties. This occurs when the interest rate to be paid to the seller starting on the date the payment becomes due has been formally agreed upon by the parties.

IN-TEXT QUESTIONS

6. Suit for price is covered under section _____.
7. The seller may file a lawsuit to recover the interest owed to him by the buyer if there is a specific agreement between the parties. **True / False**
8. Which of the following is not considered as the rights of an unpaid seller:

   a) Right of Lien b) Right of Stoppage in Transit

   c) Right of Resale d) Right to contract
9. The right to stoppage in transit refers to the ability of an unpaid seller to halt the shipment of his goods, recover control, and hold onto them until he is paid in full. **True/ False**
10. In case of _____ goods the seller does not have to inform the buyer of his intention of resale.

6.7 SUMMARY

Almost all types of commercial transactions include the sale and purchase of items. To sell their goods, businesses frequently enter into contracts of sale. The Sale of Goods Act, 1930, one of the most significant categories of contracts under Indian law, governs all of these sales. "Transfer of property in goods" means transfer of ownership of the goods. In this chapter we discussed about appropriation of goods which is the most important act that permits the transfer of property from the seller to the buyer. The rule of transfer of title on sale is expressed by the maxim "nemo det quod non habet," which means that no one can give what he has not got. But this rule also has some exceptions that are mentioned above under the heading, sale by non-owners which covers sale by a mercantile agent, sale by joint owner, sale by person in possession under voidable contract, sale by seller in possession after sale and sale by buyer in possession after 'agreement to buy'. We also learned about various

rights of unpaid seller which includes right of lien, right of stoppage of goods in transit and right of resale of goods.

6.8 ANSWERS TO IN-TEXT QUESTIONS

1. Section 21 2. False 3. True 4. True 5. selling of items 6. Section 55 7. True 8. Right to contract	9. True 10. Perishable goods

6.9 SELF-ASSESSMENT QUESTIONS

1. 'Nemo Det Quod Non Habet' (No one can give what he has not got), Comment on this statement and give exceptions to this rule. Also, illustrate your answer.
2. Discuss various provisions of law under which a non-owner can convey a good title to a buyer.
3. State the rules of ascertaining the intention of the parties as to the time when the property in the specific goods is to pass to the buyer.
4. Define Unpaid seller. What are his rights against the sale of goods act?
5. Distinguish between an unpaid seller's right of lien and right of stoppage of goods in transit. When can the unpaid seller resell the goods? Explain.

6.10 SUGGESTED READINGS

- *Bhushan, B., Kapoor, N.D., Abbi, R. (2020). Elements of Business Laws. Sultan Chand*
- *Dagar, I., & Agnihotri, A., (2020). Business Laws, Sage Textbook*
- *Jagota, R. (2021). Business Laws. MKM Publishers ScholarTech Press.*
- *Kuchhal, M. C., & Kuchhal, V. (2013). Business Laws. New Delhi. Vikas Publishing House.*
- *Singh, A. (2008). The Principles of Mercantile Law. Lucknow. Eastern Book Company.*

6.11 ADDITIONAL READINGS

- *Arora, S. (2021) Business Laws. New Delhi. Taxmann.*
- *Das, & Roy, (2018). Business Laws. Oxford University Press*
- *The Sale of Goods Act, 1930.*

UNIT V

LESSON 7

MEANING OF LIMITED LIABILITY PARTNERSHIP

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STRUCTURE

7.1 LEARNING OBJECTIVES

- To help the students to understand concepts and characteristics of LL.P. under Limited

  Liability Partnership Act, 2008.
- To help students know how an LLP is incorporated and how it is different from a company and a normal partnership.
- To let students, discover the procedure for change of name of an LLP.

7.2 INTRODUCTION

In the year 2008, the Limited Liability Partnership (LLP) idea was introduced in India. An LLP combines elements of a company and a partnership firm. Due to the fact that it combines the advantages of both a partnership firm and a company into a single form of organisation, it is the most popular type of organisation among entrepreneurs. The Limited Liability Partnership Act of 2008 governs LLPs in India. Features of an LLP includes Similar to companies, LLPs are a distinct legal entity. Low costs and less restrictions and compliances apply to LLPs. Each partner's liability is only for the amount of their contribution i.e., limited liability exists. Only LLPs whose yearly turnover or contribution surpass Rs. 40 lakhs in any fiscal year are required to have their financial statements audited by a certified chartered accountant. Process of incorporation of an LLP takes place when two or more persons come in collaboration and have a DPIN and DSC, then availability for the name of the LLP is checked on the MCA portal, after that some agreements and forms are to be filled and finally the certificate of registration is to be obtained.

7.3 MEANING OF LIMITED LIABILITY PARTNERSHIP

Limited Liability Partnership (LLP) is a concept in which features of two types of business entities combined namely Partnership and joint stock company. As we all know major drawbacks of partnership is unlimited liability and main disadvantage of company form of

organization is excessive legal formalities and both disadvantages overcome by Limited Liability Partnership form of business. LLP combines the advantages of both partnership and joint stock company or we can say LLP is much like Private form of company.

Definition of Limited Liability Partnership - Section 2(1)(n)

Limited Liability Partnership means a partnership formed and registered under the Limited Liability Partnership Act, 2008,

Various expert committees have recommended for legislation of LLP's and these are Abid Hussain Committee (1997), The Naresh Chandra Committee (2003) and Dr.J.J.Irani committee (2005).

Finally in year 2008 law of L.L.P. was formed and was notified in the official gazette on 9th January,2009 and it contains 81 sections and 4 schedules and finally came into force on 31st March, 2009.Some provisions of that also made effective on 31st May, 2009.It extends to the whole of India and came into force with effect from 31-32- 009.

7.4 ADMINISTRATION AND AMENDMENTS IN THE ACT

Administrative Mechanism of LLP Act

The regulatory functions and control of the Act is with the Central Government, Registrar of Companies (ROC) has been assigned the administrative and supervisory duties and functions by the Central Government. The Registrar of Companies is appointed by the Central Government in each State and he shall act also as Registrar of LLPs, who shall supervise and regulate the LLPs. Section 79 of the LLP Act has given powers to the Central Government to make rules for carrying out the provisions of this Act.

Amendments in LLP Act,2008

The LLP Act amended several times to improve its viability. Recently LLP Act amended on 15th November,2016 and as a result of this amendment 'Inability to pay debts' has been deleted from the compulsory winding up by the Tribunal. Another amendment was done on 12 June 2018 and it amended a major requirement of obtaining DPIN (Designated Partner Identification Number) by individual who want to become a Designated Partner.

The LLP Act also amended rules 11 and 13 on 02 October 2018. Rule 11 state about incorporation of LLP. New form FiLLiP (Form for incorporating LLP) needs to be filled to be incorporated as an LLP.

7.5 FEATURES OF LLP

1. Body Corporate [Sec.3(1)]; LLP is to be treated like a body corporate which is formed and incorporated under LLP Act 2008.

2. Liability (Limited). The partners of LLP would be liable to the extent of their agreed contributions in the LLP but in some cases the liability of the partners can be unlimited when the partner (s) found to have acted with an intention to defraud creditors. Sometimes the liabilities of the LLP shall be met out of the property of the LLP. [Sec.27(4)]

3. Separate Legal Entity [Sec.3(2)]: A LLP is a legal entity separated from its partners. All assets and liabilities are assets and liabilities of LLP only. The creditors of LLP cannot bring any action against the partners personally. Saloman vs Saloman & Co. Ltd. support the concept fully.

4. Minimum Number of Partners: Minimum number of partners in an LLP must be two and that same applicable to Designated Partners also. However, there is no limit on maximum number of partners.

5. LLP is an artificial person: An LLP is an artificial person. It is created by law and comes to an end by law (legal process) only.

6. Perpetual Succession [Sec. 3(2)]; LLP enjoy benefits of perpetual succession. It is created by a legal process, so it comes to an end only by way of law. Any changes in the partner's status of a LLP shall not effects the existence, rights or liabilities of the limited liability partnership.

7. Common Seal: However not mandatory but if LLP wants then it can have a Common Seal.

8. Partners of a LLP; Any individual can become a partner in a LLP.

9. Applicability of Partnership Act 1932: No provision of Partnership Act 1932 applicable to LLP unless needed.

10. Managing the affairs of an LLP: Partners specifically Designated partners are responsible for management of business if LLP.

11. Investigating the affairs of LLP: Central Government has the power to investigate the affairs of an LLP

12. Conversion to LLP. A firm, Private Company or an Unlisted Public Company are allowed to converted into LLP in accordance with the provisions of the LLP Act 2008and Schedule II, III, IV respectively.

13. Conversion of LLP into Joint Stock Company; Under the Companies Act, 2013 it is allowed to an LLP to get registered as Company and as per the Companies Act ,2017, upon registration as a company, LLP incorporated under LLP Act ,2008 shall have right to dissolved as accompany.

14. LLP Agreement: A LLP must have a LLP Agreement for describing rights and duties of partners so in case of any disputes, can be resolved with the help of agreement.

15. Accounts. Every LLP has to maintain annual accounts showing the financial position of the LLP and they must have to be filed with the Registrar after being audited, if required.

16. Taxation of LLP: The LLP Act ,2008 does not give any information regarding taxation of LLP. Hence, the provisions of Income Tax Act, 1961, shall apply in taxation matters.

17. Financial Year of a LLP: Financial year of a LLP commence from 1st April of a year and ends on 31st March of a year but if LLP commence after 30th September, then the financial year comes to an end on 31st March of next year. For Example: if LLP starts its operation on 15 October 2018, then its financial year comes to an end on 31st March 2020.

18. Winding up: An LLP may be wound up voluntarily or by the Tribunal or Court under the Insolvency and Bankruptcy Code ,2016.

IN-TEXT QUESTIONS

1. The Limited Liability Partnership Act, 2008 came into force on _____.
2. Rule 11 of the act state about incorporation of LLP. **True / False**
3. From the following a limited liability partnership is:
   a) Not a separate entity from that of its partners
   b) A legal entity separates from that of its partners
   c) A body corporate
   d) Only B and C are correct
4. Central Government don't have the power to investigate the affairs of an LLP. **True/ False**
5. A firm, Private Company or an Unlisted Public Company are allowed to converted into LLP in accordance with the provisions of the LLP Act 2008and Schedule II, III, IV respectively. **True/ False**

7.6 LIMITED LIABILITY PARTNERSHIP AGREEMENT

LLP agreement has been as defined under Section 2(1)(o) and its means any written agreement between the partners of the LLP or between the LLP and its partners which determiners the mutual rights and duties in relation to that LLP.

The LLP Agreement is very important to a LLP and its partners and it must be filed with the Registrar within 30 days of the incorporation of an LLP. Any change in the agreements is also to be filed within 30 days of the change. In absence of LLP Agreement provisions of LLP Act ,2008 must be followed. LLP Agreement is not a public document, and it must be properly stamped.

7.6.1 Contents of LLP Agreement

- Name of LLP.
- Addresses of LLP registered Office.
- Name and address of partners and designated partners.
- Salary of partners

- Profit Sharing Ratio of partners
- Rights and duties of partners in LLP.
- Proposed Business of LLP.
- Rules relating to management of LLP.
- Any other matter relating to LLP

7.6.2 Advantages Of LLP

1. Separate Legal Entity. LLP is a legal entity distinct and separate from its partners. It means that LLP can sue and be sued in its own name. It can own and hold or dispose of property in its own name. Hence, LLP can do or undertake any act or thing as a natural person may do or undertake.

2. Limited Liability. The liability of the LLP is limited to extent of its assets and the liability of a partner is limited to his contribution in the LLP. Hence there is no liability on the partners' personal assets.

3. Capital Requirement. For an LLP there is no legal requirement in regard to any minimum capital.

4. Freedom of Operations. An LLP enjoys full freedom in the matter of conducting its business and operations.

5. Number of Partners. There is no restriction as to the maximum number of partners under LLP hence it is an opportunity for expansion or diversification of its activities.

6. Responsibility for Compliances. A designated partner is made responsible for various compliances and filing requirements of the LLP. Hence the other partners of LLP are relieved of this pressure.

7. Flexibility. It provides flexibility without imposing detailed legal and procedural requirements.

8. Taxation. LLP has to pay no surcharge, DDT (Dividend Distribution Tax) or wealth tax so it’s a relaxation to the LLP on its income.

7.6.3 Disadvantages Of LLP

1. Unlimited liability. There may be unlimited liability on the LLP or its partners in some cases.

2. Time consuming. It takes more days to form an LLP as signatures of all the partners are required for each and every document.

3. Assets contribution. The Cash or other assets contributed by a partner are not returned to a continuing partner unless mentioned in LLP Agreement.

4. Transfer of ownership. Ownership rights are not transferable easily without obtaining consent of all the partners of LLP.

5. Conversion to LLP. A firm, private company or unlisted public company cannot convert to an LLP unless all partners or shareholders become the partners of LLP.

6. Liabilities of designated partner. LLP makes designated partners responsible for compliance of the provisions of the Act and liable for all offences and penalties thereby putting unnecessary pressure on designated partners.

7. Lack of secrecy. LLP is required to disclose its financial information hence the secrecy of information is lost.

8. No access to public money. LLP has to function from contribution made by partners hence it cannot raise money through public.

7.7 DIFFERENCE BETWEEN PARTNERSHIP, COMPANY AND LLP

The following are the points of difference between partnership, company and LLP:

Basic	Partnership	Company	LLP
1. Regulating Act	Governed by Partnership Act, 1932	Governed by Companies Act, 2013	Governed by the Limited Liability Partnership Act, 2008.
2. Creation	Created by Contract.	Created by Law	Created by Law
3. Separate Entity	It is not a separate legal entity.	It is a separate legal entity.	It is a separate legal entity.

4. Perpetual succession	It does not have perpetual succession as it depends upon the will of partners.	It has perpetual succession, and the members may come and go.	It has perpetual succession, and the partners may come and go.
5.Management	Managed by partners itself.	The affairs of the company are managed by the Board of Directors.	The business of LLP is managed by the partners including designated partners as per requirements of LLP agreement.
6. Liability	Liability of Partners are unlimited and can go to the personal assets as well.	Liability is limited and only to the extent of amount not paid on shares held by shareholders.	Liability is limited to the extent of amount of contribution but can extend if there is any fraud or omission.
7. Common Seal	There is no commons seal.	There is an option to use common seal which denotes official signature of a company.	LLP may have a common seal; it is not mandatory
8.Legal action in case of fraud	Partnership who are registered can sue or be sued by third party.	Joint stock company can sue and be sued by third party.	LLP can also sue and be sued by third party.

9. Number of members	Minimum 2 and maximum 50.	Minimum 2 and maximum 200 members in case of private company. Minimum 7 members are case of public company and maximum no limit. Only one person is required in case of One Person Company.	Minimum 2 partners and there is no limit for maximum number of partners.
10.Registration	Optional.	Compulsory with ROC.	Compulsory with ROC.
11. Name	Any name as per choice.	Name to contain 'Limited in case of public company and 'Private Limited' in case of Private company.	Name to contain 'Limited Liability Partnership' or 'LLP' as suffix.
12. Annual Return Filing	Annual return is not mandatory to be filed every year.	Annual return must be filed every year and must disclose every aspect in a prescribed way.	In case of LLP Annual return and Statement of Solvency must be filed every year with the registrar of companies.

13. Audit of Accounts	Partnership firms are required to have their accounts audited if the annual sales, turnover or gross receipts exceeds ` 1crore (in case of business) and Rs. 50 Lakhs (in case of profession)	Companies are to get their accounts audited annually.	If the turnover of LLP exceeds ` 40 lakhs or contribution exceeds ` 25 lakhs in any financial year they have to get their accounts audited.
14. Dissolution	By mutual consent, insolvency and by Court order.	Voluntary or by order of Tribunal or Court.	Voluntary or by order of Tribunal or Court.
15.Amount of default for Insolvency Resolution	Defaults in payments of debts of Rs.1,000 or more shall be a ground	Default in payment of debts of Rs.1,00,000 or more shall be a ground for filling application for insolvency resolution	Not Applicable

7.8 INCORPORATION OF LLP-SECTION 11

For incorporating a LLP, two or more persons associated for carrying on a lawful business with a view of making profit shall subscribe their names to an incorporation document. However, the process of incorporation was tough and lengthier but with effect from 02 October 2018 it has been made simpler by the Ministry of Corporate Affairs through the LLP

(Second Amendment) Rules, 2018.According to amended rules the incorporation process is as discussed below:

Registration process of Limited Liability Partnership

The registration process of LLP is discussed below:

Step 1 : Two or more persons come together to form an LLP.

Step 2 : Deciding the partners and Designated partners of LLP

It must be noted that DPIN (Designated Partner Identification Number), DSC (Digital Signature Certificate) now is no longer a requirement for incorporation of LLP

Step 3 : Checking the availability of the name (Free name availability checking facility is available on MCA portal)

(An application for reservation of name can also be made through form FiLLiP.)

Step 4 : Filing of incorporation document along with requisite fees.

Step 5 : Registrar examine the documents and find everything is in order then he issue the Certificate of Incorporation.

Step 6 : Filing of LLP Agreement The above steps are discussed in detail below:

Step 1 : Two or more persons join together to form an LLP

Step 2 : Deciding the Partners and Designated Partners of LLP

After deciding the formation of LLP next step is to register the names of proposed partners and proposed designated partners. Any individual who wants to become partner can give their consent to become a partner. Every LLP must have two Designated Partners. Out of which one Designated Partners must be a resident of India and both of them must be individuals.

Step 3 : Checking the Availability of the Name

Checking for availability of name of the LLP to be registered by filling Form 1 called RUN-LLP (i.e., Reserve Unique Name-LLP) for checking the availability of the name. Any partner or designated partner in the proposed LLP may submit Form 1 with requisite fee.

Details of two designated partners (minimum) of the proposed LLP, one of whom must be resident in India, is required to be filled in the application for reservation of name and also two names of proposed partners must be entered in the form.

It is also to be noted that an application for reservation of name can also be filled through Form FiLLiP (If not made through RUN –LLP).

If registrar find everything in order in according to requirements in Form FiLLiP, then he will approve the registration and issue certificate of Incorporation. Once the Form has been approved, the proposed LLP shall receive an email regarding the same and the status of the form will get changed to approved.

But if registrar is not satisfied with the form filled or information given in the form or form is incomplete, he shall tell to the applicant to remove defects and re-submit the form within 15 days from the date of intimation.

Step 4 : Filing of Incorporation Document and Statement

Once the name is reserved by the Registrar, Form 2 called FiLLiP (i.e., Form for incorporation of Limited Liability Partnership) has to be filled in with prescribed fee based on total monetary value of contribution of partners in proposed LLP. Earlier, i.e., before 2nd October, 2018, Form 2 ("Incorporation Document and Subscriber's Statement") had to be filled for this purpose. FiLLiP has two parts, namely, Part A: INCORPORATION DOCUMENT and Part B: STATEMENT.

Penalty

A partner who makes false declaration and know that it is not true shall be punishable with:

(a) Imprisonment (can go up to maximum two years).

(b) Fine minimum of Rs. 10,000 and maximum up to Rs.5,00,000.

Contents of the Incorporation Document (Section 11(2)]

The incorporation document of the LLP serves the same purpose as the Memorandum of Association in respect of a Company.

The contents of the incorporation document are as follows:

(a) Name of LLP,

(b) Proposed business,

(c) Address of its registered office,

(d) Name address of each person who is to be designated partner on incorporation,

(e) Name and address of each person who wants to become partner in an LLP.

(f) Any other information concerning the proposed LLP as the rules may prescribe.

Step 5: Certificate of Registration

Incorporation by Registration - Section 12

When all the requirements as mentioned above relating to incorporation document have been complied with, the Registrar on being satisfied will keep the incorporation document with itself and register the LLP within 14 days and give a certificate that the limited liability partnership is incorporated with the name mentioned in the incorporation document.

In Registrar office, Registrar maintain a Register in which the names of all LLP's are there, and names of LLP's entered in order of their registration. Every LLP so registered shall be assigned a LLP identification number (LLPIN). The certificate issued shall be conclusive evidence that the limited liability partnership is registered and now known to be by the name specified.

Conclusiveness of Certificate of Incorporation - Section 12(4)

The LLP have been incorporated with the name mentioned on the Certificate of Incorporation. Hence now an LLP can carry on business as a legal entity. The incorporation certificate granted by the Registrar of Companies (ROC) on the registration of an LLP the LLP Act shall be conclusive evidence that all the requirements of the Act with respect to registration and other matters related to it have been duly complied with, bringing into existence an LLP which is duly registered under the Act.

Step 6: Filing of LLP Agreement – After incorporation of LLP, a LLP Agreement has to be filed with the registrar within 30 days of incorporation of LLP in Form -3. Where there are no LLP Agreement provisions of Schedule I of the LLP Act shall be applicable to LLP.

IN-TEXT QUESTIONS

6. There is a restriction as to the maximum number of partners under LLP. **True / False**
7. LLP can also sue and be sued by third party. **True / False**
8. Under Partnership Act 1932, a partnership firm does not have a separate legal entity. **True/ False**
9. How many designated partners are required in LLP?
   a) Seven designated partners
   b) At least two designated partners
   c) Only two partners
   d) Five designated partners
10. The LLP shall file the Statement of Account and Solvency in the prescribed form. Name the Form number?
11. At which place the LLP shall maintain books of accounts?
    a) At its Corporate Office
    b) At its Head Office
    c) At office of its owners
    d) At its Registered Office

7.9 REGISTERED OFFICE OF LIMITED LIABILITY PARTNERSHIP-SECTION 13

Registered Office [Sec.13(1)]: Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received.

Other Address in addition to Registered Address

If an LLP wants the he can make another address as his Registered Office address in addition to previous one by following the process given in LLP agreement but if LLP agreement is silent about the provision of additional address to registered office, then with the approval of all partners LLP can decide and declare additional address. Registrar of LLP must inform about the other address within 30 days of finalization of other address.

Change Of Registered Office - Section – 13(3)

LLP may change its registered office from one place to another within the same State or from one State to another State according to the procedure mentioned.

Change from one place to another in the same State:

According to the procedure mentioned in LLP agreement and if nothing has been mentioned in agreement then with the consent of all the partners. If the change is from the jurisdiction of one Registrar to another Registrar within the State (e.g., Maharashtra and Tamil Nadu) then file a notice with ROC from where LLP proposes to shift its registered office with a copy of such change to the ROC under whose jurisdiction the registered office is proposed to be shifted	Notice of change of registered office to be given to ROC same State within 30 days of complying the requirement with requisite free.

Change from one State to another involves following procedure:

As per the manner laid down in the LLP Agreement, if the Agreement is silent then with the consent of All the partners the change can be initiated. The LLP is also to obtain the consent of secured creditors (if any) for initiating this change.	LLP shall publish a general Notice, at least 21 days before filing notice with ROC in a daily newspaper published in English and in principal language of the district in which the registered office of the LLP is situated circulating the notice of change of the registered office.	File a notice with ROC from the State where LLP proposes to shift its registered office with a copy of such change to the ROC of the State under whose jurisdiction the registered office is proposed to be shifted.

Notice of change of registered office to be given to ROC within 30 days of complying the requirement with requisite fee.

With the change of registered office, any conviction, ruling or judgement of any Court initiated against the LLP for the alleged offences under the LLP Act shall be stated in change of place of registered office and is to be filed with the ROC.

Penalty for Contravention [Sec.13(4)] If the Limited Liability Partnership does not follow any of the provisions of this section, then the Limited Liability Partnership and its every partner shall be punishable with fine which shall not be less than 2,000 and which may extend to Rs. 25,000.

EFFECT OF REGISTRATION -SECTION 14

On registration, a limited liability partnership shall be capable of

(a) suing and being sued by others in its own name.

(b) acquiring, owing, holding or disposing off property whether movable or immovable, tangible or intangible.

(c) having a common seal, if it decides to have one, and

Pre-incorporation contracts: Pre-incorporation contracts are not binding on LLP unless the LLP adopts them after incorporation. Otherwise, such a contract is binding on the person making it for want of ratification by the LLP.

7.10 PROVISIONS RELATING TO NAME OF LLP AND CHANGES THEREIN-SECTION 15

1. The name of every Limited Liability Partnership must end with the words 'Limited Liability Partnership" or can use 'LLP" in the name of LLP.
2. No LLP shall be registered by a name which in the opinion of the Central Government is
   (a) undesirable, or
   (b) identical or too nearly resembles to the name of any other
      - partnership firm or
      - LLP, or

- body corporate, or
- registered trademark, or
- trademark the application of which is pending.

(c) When it uses words prohibited under the Emblems and Names (Prevention of Improper use) Act, 1950 such as pictorial representation of any national leader or symbol of any organization.

(d) When it uses words such as Insurance, Banking, Stock Exchange, Venture Capital, Mutual Fund without approval.

The Word 'BANK' may be used in the name of a LLP when such entity produces 'No Objection Certificate' from the RBI and if want to use word Stock Exchange then will be allowed only when No Objection Certificate has been issued by SEBI (Securities and Exchange Board of India).

7.10.1 Reservation of Name -Section 16

A LLP can apply to the Registrar of the state in whose state Registered Office of the LLP is situated through its partners for reservation of name registered in RUN-LLP.

CHANGE OF NAME OF LLP-BY CENTRAL GOVERNMENT - SECTION 17

If Central Government has the opinion that the name with which LLP is registered is:

(a) undesirable, or

(b) identical with or too many similarities in the name of any other LLP or body corporate then Central Government may direct such LLP to change its name and the LLP has to change it within 3 months after the date of direction by Central Government or such longer period as Central Government may allow.

(c) Partners of LLP wants to change the name of LLP afterwards.

Penalty for improper use of words "Limited Liability Partnership" or LLP (Sec.20).

Any LLP which does not comply with above provision shall be punishable with

(a) Fine which shall be not less than Rs. 10,000 but which may extend to Rs. 5,00,000 and

(b) Also Designated Partners are responsible for improper use and must be fined with an amount minimum of Rs.10,000 and maximum of Rs. 1,00,000.

7.10.2 Procedure for Change of Name

To comply with the direction of Central Government the following procedure needs to be followed

LLP may change its →	Notice of change of →	On being satisfied
name by following the	Name shall be given	ROC shall change
procedure laid down	to the ROC within	the name of LLP
in LLP Agreement, if	30 days of change	and issue a
the agreement is silent	along with requisite	fresh Certificate of
then with consent of all	fee	Incorporation
partners		

7.10.3 Change of Name by Roc on Request by Another Entity – Section 18

Any other entity having name similar to the name of limited liability partnership which has been incorporated may apply to the ROC to give direction to the LLP to change its name but such application for change name must be received by the ROC within 24 months from the date of registration of the LLP

7.10.4 Change of Name - Voluntarily by LLP - Section 19

Any LLP may change its name with the ROC by filing with him a notice of such change in the form and manner and on payment of such fee as may be prescribed.

(For the change of name, LLP has to apply to the ROC as per provisions of Section 15 and 16 and the follow the procedure for change of name as mentioned earlier)

7.10.5 Publication of Name and Limited Liability - Section 21

(a) Every LLP shall ensure that its invoices, official correspondence and publications bear the

- name,
- address of registered office and
- registration number of LLP, and

(b) A statement that it is registered with limited liability.

Penalty for Contravention Any Limited Liability Partnership which are not following above provision shall be punishable with fine minimum of Rs. 2,000 but which may extend to Rs. 25,000.

ACTIVITY

Examine the RUN form and FiLLip webform from notification on MCA portal and enlist the mandatory fields. Try to share the same information with your friends, relatives and family members,

IN-TEXT QUESTIONS

12. Penalty for Contravention is governed under section _____.
13. Change of name voluntarily By LLP is governed under section 20. **True / False**
14. A partner who makes false declaration and know that it is not true shall be punishable with:
    a) Imprisonment (max upto 2 years) b) Fine minimum of Rs. 10,000
    c) Fine of minimum Rs. 1000 d) Both A and B
15. An application for reservation of name can also be made through a form named_____.

7.11 SUMMARY

Limited Liability Partnership (LLP) is a new concept combining the features of partnership and joint stock company. As we all know major drawbacks of partnership is unlimited liability and main disadvantage of company form of organization is excessive legal formalities and both disadvantages overcome by Limited Liability Partnership form of business. LLP combines the advantages of both partnership and joint stock company or we can say LLP is much like Private form of company. it contains 81 sections and 4 schedules

and finally came into force on 31st March, 2009.Some provisions of that also made effective on 31st May, 2009.It extends to the whole of India and came into force with effect from 31-3-2009.

The regulatory functions and control of the Act is with the Central Government, Registrar of Companies (ROC) has been assigned the administrative and supervisory duties and functions by the Central Government. The Registrar of Companies is appointed by the Central Government in each State and he shall act also as Registrar of LLPs, who shall supervise and regulate the LLPs. The LLP agreement is of fundamental importance to the LLP and its partners.

A Limited Liability Partnership who wants to be registered itself then the partners who are carrying lawful business of LLP can apply for incorporation with the proper documents and must follow all the requirements of incorporation. However, the process of incorporation was tough and lengthier but with effects of. 02 October 2018 it had been made simpler by the Ministry of Corporate Affairs. Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received. LLP may change its registered office from one place to another within the same State or from one State to another State as per the manner laid down in act.

7.12 ANSWERS TO IN-TEXT QUESTIONS

1. 31st March 2009	9. At least two designated partners
2. True	10. Form 8
3. Only B and C are correct	11. At its Registered Office
4. False	12. Sec.13(4)
5. True	13. False
6. False	14. Both A and B
7. True	15. Fillip
8. True	

7.13 SELF-ASSESSMENT QUESTIONS

SHORT QUESTION ANSWERS

1. Define Limited Liability Partnership and its features. (B.Com. (H), Delhi, 2011)
2. Explain the disadvantages of LLP form of business structure. [B. Com (Hons) 2014]
3. Explain the advantages of Limited Liability Partnership. [B. Com 2013]
4. Distinguish between Company and Limited Liability Partnership.

a. Distinguish between Partnership. Company and Limited Liability Partnership. [B. Com (Hons) 2017]

5. Can a limited liability partnership have any other address in addition to registered address?
6. Any person can carry on business under any name having last words as "LLP" without being incorporated as an LLP? Comment on the Statement. [B. Com (Hons) 2016]
7. Discuss the contents of Incorporation document of a Limited Liability Partnership. [B. Com (Hons) 2015]
8. 'Incorporation Document' is a public document while 'Incorporation Agreement' is not a public document. Comment [B. Com (Hons) 2011]
9. What are the various steps involved in the incorporation of Limited Liability Partnership under LLP Act ,2008. [B.Com (Hons) 2013]

LONG ANSWER QUESTIONS

1. "An LLP is a legal person distinct from its members taken individually or collectively." Comment. [B. Com(H), 2014, 2016)
2. Discuss the feature of separate legal entity and perpetual existence in relation to an LLP. (B.Com. (H), Delhi, 2012)
3. "An LLP is a definite improvement over the partnership in the matter of promoting entrepreneurship." Discuss. (B.Com. (H), Delhi, 2012, 2016)
4. How can an LLP be incorporated and registered under LLP Act, 2008? [B.Com. (H), Delhi, 2011]
5. Discuss the contents of incorporation document of an LLP. [B.Com. (H), Delhi, 2011]

6. How is an LLP formed under the LLP Act, 2008? Enumerate the various documents to be filed with the Registrar in this connection. [B.Com. (H), Delhi, 2012]
7. Explain the rules regarding change of name of Limited Liability Partnership. [B.Com. (H), Delhi, 2012, 2015]
8. "The validity of a Certificate of Incorporation cannot be disputed on any ground whatsoever." Critically examine the statement. [B. Com(H), 2013]
9. State the process of formation of LLP. [B. Com(H), 2016]
10. State the provisions of LLP Act, 2008 relating to change in registered office of an LLP.

7.14 SUGGESTED READINGS

- *Dagar, I., & Agnihotri,A., (2020). Business Laws, Sage Textbook*
- *Jagota, R. (2021). Business Laws. MKM Publishers ScholarTech Press.*
- *Maheshwari, S. N., & Maheshwari, S. K. (2011). A Manual of Business Laws. Himalaya Publishing House Pvt. Ltd.*

7.15 ADDITIONAL READINGS

- *Arora, S. (2021) Business Laws. New Delhi. Taxmann.*
- *Das, & Roy, (2018). Business Laws. Oxford University Press*
- *The Limited Liability Partnership Act, 2008.*

LESSON 8

PARTNERS, THEIR RELATIONS AND LIABILITIES IN An LLP

Sumita Jain

STRUCTURE

8.1 LEARNING OBJECTIVES

- To help the students to understand concepts and characteristics of LL.P. under Limited Liability Partnership Act, 2008.
- To help students know about eligibility conditions for being a partner in a LL.P.
- To let students, explore the concept of designated partners and whistle blowers.

8.2 INTRODUCTION

From last lesson we have already got an idea about what is a Limited liability partnership and what features it has. In this lesson we will discuss about various entities who can be a partner in an LLP and the desired qualifications for it. In a LLP minimum number of partners are two whereas there is no limit on maximum number of partners with this every LLP is required to have at least 2 designated partners who are individuals and at least one of them shall be resident in India. We will also discuss about liabilities of designated partners and on what grounds a partner can be terminated. In fact, every partner of a limited liability partnership plays the role of an agent of the LLP but not of other partners. The concept of whistle blowing is also discussed in this lesson which means providing information through a partner or employee of limited liability partnership which alerts the concerned authorities to any wrongful acts committed or being committed, which involves violation of any laws or rules.

8.3 WHO CAN BE PARTNERS OF LLP-SECTION 5

According to Section 2(1)(q), A Partner in a limited liability partnership means any person who becomes a partner in it, in accordance with the limited liability partnership agreement as per Sec .5 and it includes;

(a) Any individual, or

(b) A Body corporate including:

- Indian company
- Foreign company
- Indian LLP
- Foreign LLP AND

Who can't become partners of LLP

(a) Hindu Undivided Family (HUF)

(b) Any other body corporate notified by Central Government.

(c) A Partnership Firm formed under Indian Partnership Act ,1932

8.3.1 Qualifications to Become a Partner in an LLP

Who can become a partner in an LLP (Sec 22)

The following are eligible to become a partner in a LLP

There are two ways to become a a partner in a LLP one is by following the conditions given in LLP Agreement and another is by way of subscribing their names in incorporation documents.

8.3.2 Disqualification of A Partner of LLP - Section 5

An individual will be disqualified to become a partner in a limited liability partnership If:

(a) He has been found to has of unsound mind and

(b) He is an undischarged insolvent.

(c) He has applied to be adjudicated as insolvent and his application is pending.

8.4 MINIMUM AND MAXIMUM NUMBER OF PARTNERS-SECTION 6

In a LLP minimum number of partners are two whereas there is no limit on maximum number of partners. Partners may be

- 2 individuals, or
- one individual and a body corporate, or
- both the partners may be body corporate.

Reduction of number of partners below 2 - Section 6(2)

Section 6 also provides that If at any time, the number of partners of an LLP is reduced below two and LLP carries business with such reduced numbers for more than six months, then such partners shall be liable personally, if all the following conditions are present.

(a) Number of partners is reduced below two.

(b) LLP carries business even after such reduction.

(c) Sole partner has knowledge of the above 2 facts.

(d) Business is carried on for more than six months with such reduction.

(e) LLP incurs obligation in the period after the expiry of six months.

If that happens then present partners are liable personally for all the liabilities of Limited Liability Partnership after reduction and may be pass through the compulsory dissolution.

8.5 DESIGNATED PARTNERS-SECTION 7

According to Sec 2(1)(j) of the act, the term 'Designated Partner" means any partner designated as such according to Sec.7 of the Act.

Every LLP shall require having at least 2 designated partners who are individuals and at least one of them shall be resident in India.

Provided, if in a LLP all the partners are bodies corporate or in which one partner individual and other are bodies corporate then at least 2 individuals who are partners of such LLP or nominees of such body's corporate being individual shall act as designated partners.

Prior Consent to act as Designated Partner [Sec 7(3)]

A partner shall intimate his consent to become a designated partner to be L.L.P.

8.5.1 Manner of Appointment of Designated Partner

The designated partner can be appointed in the following ways:

(a) By mentioning their names in the incorporation documents.

(b) If incorporation document states that each of the partners from time to time is to be designated partners then every such partner shall be a designated partner.

(c) Mentioning their names in Limited Liability Partnership Agreement as Designated Partners and if wants to resign then same process should be followed.

(d) To become a partner, an individual must give prior consent to act as designated partner of limited liability partnership in form and manner prescribed. The partner has to give the consent even if the incorporation document or LLP agreement specifies the persons to be designated partners.

(e) Details of every designated partner must be filed with the Registrar providing full information who gave their consent to become designated partners of LLP.

(f) Each partner shall be designated partner if no designated partner is appointed by the incorporation document or by the LLP agreement or by the LLP.

8.5.2 Designated Partner Identification Number (DPIN) [Sec 7(6)] and DPIN Rule 10(1) and 10(4)

Designated Partners Identification Number means an Identification Number (DPIN) which the central government may allot to an individual, want to appointed as Designated Partners in a Limited Liability Partnership. Those who wants to become a designated partner in a liability partnership shall submit an application electronically to the Central Government for allotment of DPIN in form and manner as prescribed with requisite fee. Central Government shall decide on the approval or rejection of DPIN within 30 days from receipt of such application and intimate the applicant.

Rule 10 of LLP Rules ,2009 suggest the conditions and procedures which have to be fulfilled by an individual for obtaining Designated Partner Identification Number. (DPIN)The DPIN is valid for lifetime.

Integration of Director's Identification Number (DIN) and Designated Partner Identification Number (DPIN) - If a person holds both DIN (Director Identification Number) and DPIN, his DPIN shall stand cancelled and DIN shall be sufficient for being appointed as Designated Partner under LLP.

DPIN allotted is valid for the lifetime of the applicant. It is a useful and smart way of keeping a check on the people who are running LLPs and who have responsibility for fulfilling the legal requirements of the LLP. In case of any misconduct or fraud by them it becomes easy to identify and penalize them and it is easy to keep a record of such misconduct by the concerned authorities.

With effect from 02 October,2018, DPIN or DIN is no more pre requirement to get for partners in LLP. Those who want to become Designated Partner in a LLP can get DPIN through FiLLiP.

As per rule 10(1): "Every individual, who intends to be appointed as a Designated Partner of an existing Limited Liability Partnership, shall make an application electronically in Form DIR -3 Under Companies Rules,2014for obtaining DPIN and such DPIN shall be sufficient for being appointed as Designated Partner under the Limited Partnership Act,2008"

8.5.3 Disqualifications for a person to be designated partner

A person shall not be appointed as a designated partner of an LLP, if he

(a) declared as adjudged insolvent in preceding 5 years.

(b) Has not given payment to his creditors and become suspended in previous years and also not making any part payment or any kind of compensation to them

(c) has been convicted by a court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than 6 months, or

(d) has been convicted by a court for an offence involving section 30 of the Act (Section 30 - If LLP or any of its partners carried on the business of LLP with a view to defraud creditors or for fraudulent purpose it would be considered an offence under the Act)

The Central Government may, by notification in the Official Gazette, removed the disqualification incurred by any person by virtue of above clauses (a) or (b) either generally or in relation to any limited liability partnership specified in the notification.

IN-TEXT QUESTIONS

1. Central Government shall decide on the approval or rejection of DPIN within 60 days from receipt of such application and intimate the applicant. **True/ False**
2. Every LLP shall require having at least 2 designated partners who are individuals and at least one of them shall be resident in India.**True / False**
3. Disqualification Of a Partner of LLP is governed under which section:
   a) Section 3 b) Section 4
   c) Section 5 d) Section 10
4. From the following, who can't become partners of LLP?
   a) Hindu Undivided Family (HUF) b) Indian Company
   c) Foreign Company d) Foreign LLP

8.6 LIABILITIES OF DESIGNATED PARTNERS-SECTION 8

Unless otherwise provided, A designated partner shall be:

(a) Responsible for Legal Compliance: Responsible for all the acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of the Act including filing of any document, return or statement etc. according to the act and as may be specified in Limited Liability Partnership Agreement: and

(b) Responsible for contravention of LLP: Designated Partners are also responsible for any kind of breach of contract or any contravention made by LLP and has to bear penalties therefore.

8.6.1 Changes in Designated Partner–Section 9

(a) According to section 9(a) a limited liability partnership may appoint a designated partner within 30 days of a vacancy arising for any reason: and

(b) If at any time if no designated partner is appointed or there is only one designated partner then each partner shall be deemed to be a designated partner.

8.6.2 Partners and Their Relations

Determined by LLP Agreement:

1) Section 23(1) of the act provides that the mutual rights and duties of the partner inter se and those of the LLP and its partners shall be determined by the LLP Agreement between the partners.

2) Pre –Incorporation Agreement between Subscribers must be ratified by the partners. {Section 23(3)}

3) The agreement along with the changes made therein, if any, must be filed with the registrar in such manner as prescribed {Sec.23(2)}

8.6.3 Punishment for Contravention of Provisions of Section 7,8& 9

For contravention of provision under Section 7(1) (appointment of at least 2 individuals as designated partners), the partnership and every partner become punishable with a fine which is not to be less than` 10,000 but may extend to` 5,00,000.

For contravention of Section 7(2), (4) and (5) (failure to inform ROC of appointments and persons appointed being not qualified) and for contravention of Section 8 and 9 (failure of the designated partner to fulfil their responsibility and default in filling casual vacancy), the fine is to be not less than` 10,000 but may extend upto ` 1,00,000.

8.7 TERMINATION OF PARTNERSHIP INTEREST-SECTION 24

8.7.1 Termination of Partnership Interest -Section 24

A partner may be terminated according to the terms given in partnership agreement and in the absence of such agreement then partner can be removed by giving a notice of 30 days stating the reasons and with the consent of all other partners.

(The agreement may not be in writing the agreement may cover even an informal or implied understanding between the partners, if the agreement specifies a time lesser than 30 days then such time shall be applicable).

Retirement of a partner

A partner of an LLP may retire upon happening of any event / circumstances as mentioned in the LLP Agreement, which generally may be upon reaching a particular age.

Removal / Expulsion of a partner

A partner of an LLP may be removed/expelled as per the LLP Agreement. If the agreement is silent on this issue, then Schedule I would be applicable to the LLP and Schedule I says that majority of partners cannot expel a partner. In other words, consent of all partners would be required to expel a partner.

A partner can be terminated in following methods.

1) On dissolution of LLP
2) On declaration of insolvent or as adjudged insolvent
3) On the death of a partner
4) On declaration of unsound mind of a partner

8.7.2 Obligations of a former partner

Where any person has terminated to be a partner (former partner) of a limited liability partnership, he is under no obligation from the date of his termination but other partners still have same responsibilities as a continuing partner and be responsible for all the work done by LLP and treated as a responsible partner unless:

(a) the third person has notice that former partner has ceased to be so, or

(b) a notice of his ceasing to be a partner has been delivered to the ROC.

But if above mentioned conditions do not fulfil then termination itself does not discharge partner from his responsibilities towards to the other partners or to any other third person while he was a partner. He can be discharged in such a situation only when.

(a) either LLP or other partners agree to absolve him by (LLP Agreement or agreement with partners), or
(b) Third party agrees to release him, or

8.8 REGISTRATION OF CHANGES IN PARTNERS-SECTION 25

(1) Every partner has to inform the LLP of any change in his name or address within a period of 15 days of such change.

(2) When a person becomes a partner, retires, is expelled or ceases to be So, the LLP has to inform the Registrar within 30 days of the date, on which that happened.

(3) When there is a change in the name or address of a partner, such change is to be filed with Registrar within 30 days of the change.

(4) Notice so filed shall be in form prescribed with requisite fee.

(5) If the notice relates to an incoming partner, it should contain a statement by such partner that he consents to be a partner.

(6) In case of notices filed by the partners themselves, ROC has to obtain a confirmation to this effect from the LLP unless the LLP has also filed the notice. If no confirmation comes from the LLP within 15days, the Registrar has to register the notices filed by the partner.

(7) In addition, whenever there is a change in partners either by removal, expulsion, admission or cessation, it would result a change in the LLP Agreement. The amended LLP Agreement is also to be filed with the Registrar within 30 days of the amendment.

Penalty. If there is contravention of provision of filing the change of name and address with ROC by any partner such partner shall be liable for a minimum fine of 2,000 but which may extend to 25,000.

If there is contravention by LLP of filing of notices to Registrar then each designated partner shall be punishable with a minimum fine of 2,000 but which may extend to*25,000.

IN-TEXT QUESTIONS

5. Every partner has to inform the LLP of any change in his name or address within a period of _____ days of such change.
6. Can designated partners held responsible for any kind of breach of contract or any contravention made by LLP and have to bear penalties therefore? **Yes/No**
7. A partner can be terminated in following cases:

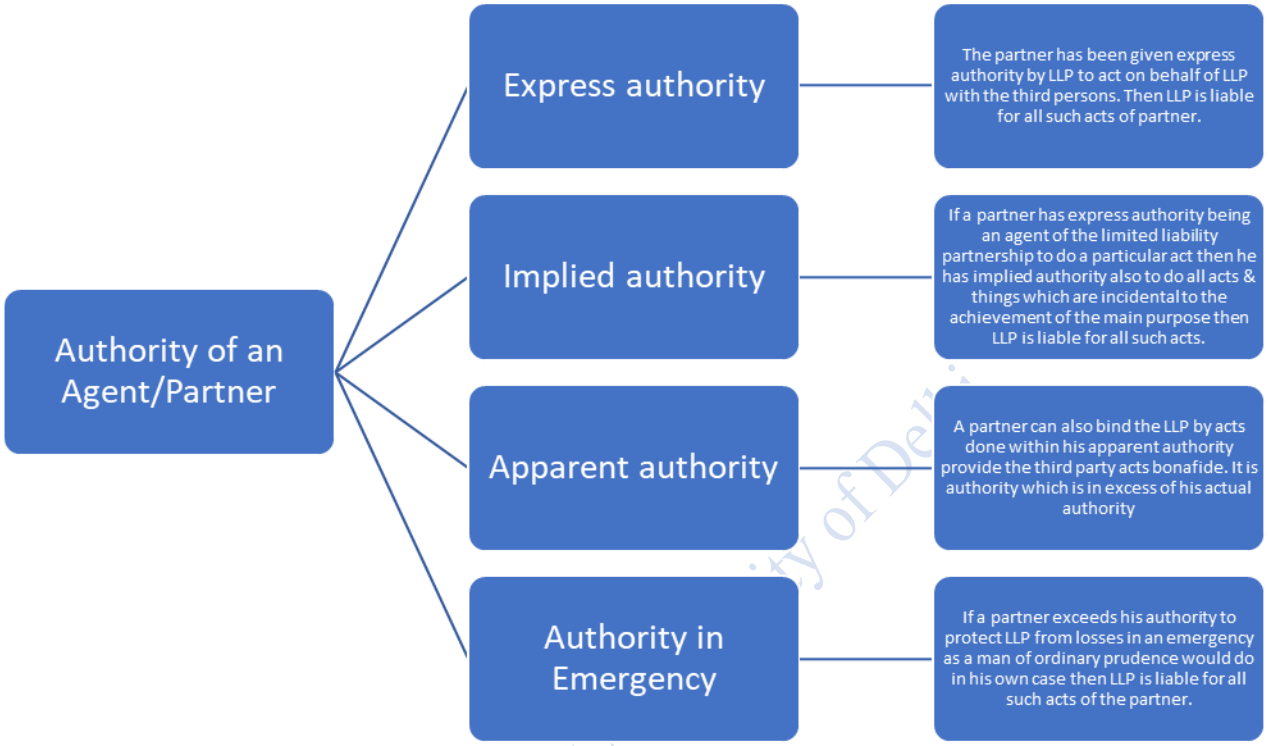
   a) On dissolution of LLP b) On the death of a partner

   c) On declaration of insolvent d) All of the above
8. A limited liability partnership may appoint a designated partner within 30 days of a vacancy arising for any reason. **Yes/No**
9. If there is contravention of provision of filing the change of name and address with ROC by any partner such partner shall be liable for a minimum fine of 1,000 but which may extend to 15,000. **True/ False**

8.9 PARTNER AS AGENT OF LLP-SECTION 26

Every partner of a limited liability partnership is for the business of the limited liability partnership, play the role of an agent of the LLP but not of other partners. It means that a partner shall bind the LLP by its acts and not the other partners.

Since a partner is an agent of the LLP, he is employed to do any act and represent LLP in dealing with third person and the agent can bind the principal only if he acts within the scope of his authority and the scope of agent's authority is determined by express, implied, apparent authority and authority in emergency.



8.10 EXTENT OF LIABILITY OF LLP-SECTION 27

To fix the liability of LLP for acts done by its partners the following conditions must exist:

(a) The act or omission by the partner must be wrongful.

(b) The act or omission must be in the course of LLP's business.

(c) The act or omission must be with the LLP's authority and

(d) The wrongful act or omission must result in the partner's liability to some other person

If the act or omission takes place outside the LLP's business or is unrelated to the business of the LLP it would not result in any liability for the LLP.

8.10.1 Limits of LLP liability

1) LLP is not liable:1) LLP's partners liability is limited to acts done within the scope and not made responsible for the acts done outside the limits and same with the partner in a dealing with third party if:

(a) The partners have no authority to act on behalf of Limited Liability Partnership for doing something particular.

(b) The third party is not aware that the partner has no authority or does not know or does not believe him to be a partner of LLP.

2) LLP is liable—The LLP is liable for acts of its partners if

(a) The wrongful act or omission is done in the course of business of the LLP, or

(b) The wrongful act or omission is done with the authority of the LLP.

3) Liability in case of holding out (Section 29)—LLP when receives credit or any financial benefit by a third person due to wrong representation made by another person then LLP is liable to the extent of the credit received by it or any financial benefit derived there on.

4) Unlimited liability (Section 30)—If any event is carried out by the LLP or any of its partners with an intent to defraud creditors of the LLP or any other person or for any fraudulent purpose, then the liability of the LLP shall be unlimited for all such debts unless it is proved that LLP has no knowledge of it, or the act is carried out without authority of LLP.

5) LLP's liability towards property—The liabilities of the LLP shall be met out the property of the LLP only.

6) Liability for compensation (Section 30)— LLP shall be liable to pay compensation to any person who has suffered any loss or damage by reason of wrongful conduct of LLP in carrying on the business of LLP. If such conduct is committed without knowledge of LLP without any authority by LLP, LLP shall not be liable.

8.10.2 Extent of Liability of Partners of LLP - Section 28

The liability of partners of LLP for their acts is discussed below:

1) Partner is not liable— "A partner is not personally liable for an obligation of the LLP arising in contract or otherwise by reason solely of the fact that he is a partner of the LLP."

2) Partner not liable for acts of other partners—A partner is not personally liable for the wrongful act or omission of any other partner of the LLP.

3) Partners liable—A partner is liable for his wrongful act or omission without any authority (express or implied) from the LLP.

4) Liability by holding out (Section 29)— "If a Person by his words or conduct represents himself to be a partner is a limited liability partnership, such a person is liable to any person who has on such representation given credit to the LLP."

5) Liability of deceased partner (Section 29)— "Where after a partner's death LLP continues the use of the name of the deceased partner, the continued use of the name of the deceased partner shall not itself make his legal representatives or his estate liable for any act of the LLP done after his death."

6) Unlimited liability (Section 30)— "If any event is carried out by any of its partners with an intent to defraud creditors of the LLP or any other person or for any fraudulent purpose the liability of the partners who acted with such intent shall be unlimited (extending to their personal assets) for the debt of the LLP."

7) Liability for compensation (Section 30)— "The partner shall be liable to pay compensation to any person who has suffered any loss or damage by reason of wrongful conduct of the partner."

8) Penalty (Section 30)— "When there is unlimited liability for a partner under section 30 then besides the unlimited liability for the debts of the LLP, the partner shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less thanRs 50,000 but which may extend toRs 35,00,000."

8.10.3 Liability by Holding Out - Section 29(1)

"A person by his words (spoken or written) or conduct represents himself to be a partner in a limited liability partnership, although he is not a partner, then such a person is liable to any person who has an such representation given credit to the LLP."

To fix the liability on the person holding out, the following conditions must be satisfied:

(a) He by himself or having knowledge that others to be represented as a partner in a LLP.

(b) Such representation has reached another person who has given credit to the LLP and

(c) Credit has been given on the faith of such representation.

LLP is liable to the extent of the credit received by it or any financial benefit deprived there on.

Where after a partner's death LLP continues the use of the name of the deceased partner, the continued use of the name of the deceased partner shall not itself make his legal representatives or his estate liable for any act of the LLP done after his death.

8.10.4 Unlimited Liability in Case of Fraud - Section 30

1. "Liability of LLP and Partners—If any event is carried out by a limited liability partnership or any of its partners with an intent to defraud creditors of the limited liability partnership or any other person or for any fraudulent purpose the liability of the LLP and guilty partners shall be unlimited for all or any of the debts of the LLP."

2. Penalty— "Every person guilty for such acts shall be punishable with

   (a) imprisonment for a term which may extend to 2 years and

   (b) fine which shall not be less than`50,000 but which may extend to ₹ 5,00,000."

3. Compensation— "Limited liability partnership or a partner(s) or a designated partner(s) shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct. LLP shall not be liable if the partner or designated partner has acted fraudulently without knowledge of the LLP (whether LLP is in knowledge of such act or not can be inferred from the course of the conduct also).'

4. Liability extends to partner in knowledge—The above provision is applicable to that partner also who has become aware of the element of fraud or the fraudulent purpose in the carrying of the LLP's business but who is not involved in it but he also does not take any corrective action.

8.11 WHISTLE BLOWING-SECTION 31

"The act of providing information by a partner or employee of limited liability partnership which alerts the concerned authorities to any wrongful acts committed or being committed, which involves violation of any laws or rules is called whistle Blowing and the person who provides such information is called whistle Blower."

The legal position of the whistle blower under Section 31 is discussed below:

According to Section 31 the court or tribunal may reduce the penalty levied against any partner or employee of an LLP on a condition that such partner or employee has provide useful information during the investigation of LLP for finding out the offences and finding out the main culprit. No such partner or employee threatened, discharged, demoted, harassed or in other way discriminated against the terms and conditions of his LLP or employment merely because of his providing useful information to the court or tribunal. A whistle blower who helps in the conviction of the guilty will thus be protected. Such protection shall not be available to partner or employee if such information is provided by a third party like supplier of goods & services.

Form of contributions -Section 32

A partner may make contribution to the LLP in many forms. The provision related to contributions is discussed below.

Partners' contribution in the form of money or property towards the capital of an LLP is just like contribution of share capital in a joint stock company formed under companies act 2013.Total contribution of capital forms the security for the creditors of the LLP same as in case of company's share capital is the security belt for the shareholders.

As such in case of company reduction of share capital is guarded by companies act and further requires permission of concerned authorities same like in case of LLP, LLP act also provides safety for preservation and maintenance of LLP's capital.

Partner's contribution towards LLP's capital may include Tangible, intangible assets and some other benefits including promissory notes any contracts for services performed. Rule 23 of LLP act provides that where the contributions is in gorm of tangible or intangible, movable or immovable property or other benefits contributed by way of contract of services shall be valued by a practicing Chartered Accountant or Cost Accountant or by an approved value rap pointed by Central Government.

Obligation to Contribute - Section 33

1. As per LLP Agreement— "The obligation of a partner to contribute money or other property, other benefit or perform services for the LLP is to be as per the LLP Agreement. (But partners can modify this agreement, in regard to form and computation of value of obligation which is to be registered with ROC)"

2. Obligation to creditor— "A creditor of an LLP, who extends credit to the LLP or extends credit to the LLP in reliance of an original obligation described in the LLP Agreement, can enforce such original obligation on the LLP and its partner even if there is modification in contribution by a partner later and creditor has no notice of such modification at the time of extending the credit then he can enforce original obligation to his knowledge."

3. Original obligation— "It does not necessarily refer to the obligation mentioned in the LLP Agreement, it any means the obligation for contribution by a partner as on the date when the third party has extended credit to the LLP)"

Withdrawal of Contribution

The Act is silent as to whether a partner can withdraw his contribution from the LLP. The withdrawal of contribution by a partner would depend upon the LLP Agreement. But in case of termination or death or retirement of a partner from LLP, if agreement is silent, then former partner is entitled to receive his share in the LLP and shall be entitled to receive from the LLP

(a) His share in capital of LLP.

(b) also, his share in accumulated gains of the LLP, after deducting all losses and that shall be in the prescribed profit-sharing ratio on the date of his termination.

IN-TEXT QUESTIONS

10. The partner has been given express authority by LLP to act on behalf of LLP with the third persons. Then LLP is liable for all such acts of partner. Guess the type of authority?

11. According to Section____ the court or tribunal may reduce the penalty levied against any partner or employee of an LLP on a condition that such partner or employee has provide useful information during the investigation.

12. The person who provides information which alerts the concerned authorities to any wrongful acts committed or being committed, which involves violation of any laws or rules is called _____.

8.12 SUMMARY

Limited Liability Partnership is a combination of advantages of two main form of business organization i.e., Partnership and Joint Stock Company, with an objective of carrying a legal business and making profits thereof. The mutual rights and duties of the partners and those of the LLP and its partner are governed by the LLP agreement and in the absence of any agreement the mutual rights and liabilities shall be as provided for under Schedule I to the act. The Limited Liability Partnership shall indemnify each partner in respect of payments made and personal liabilities incurred by him. Management of an LLP is done by Partners and Designated Partners.

Whistle Blowing is an act of providing information by a partner or employee of Limited Liability Partnership which alerts the concerned authorities to any wrongful acts committed, which involves violation of any laws or rules is called 'Whistle Blower' and the person who do such acts is called 'Whistle Blower'. LLP Act has given sufficient protection to the Whistle Blower.

8.13 ANSWERS TO IN-TEXT QUESTIONS

1. False	9. Yes
2. True	10. Express Authority
3. Section 5	11. Section 31
4. Hindu Undivided Family (HUF)	12. Whistle Blower
5. True	
6. 15 days	
7. Yes	
8. All of the above	

8.14 SELF-ASSESSMENT QUESTIONS

Short Answer questions

1. Who can be appointed as designated partner in an LLP? B.Com. (H), Delhi 2011, 2014)

2. How can a person become a partner of an Limited Liability Partnership?
3. Define Designated Partner.
4. State the liability of the LLP for the wrongful act of partner. B.Com. (H), Delhi 2012, 2014)
5. State the Maximum and Minimum numbers of partners.
6. Discuss the Qualification and Disqualifications of partners in Limited Liability Partnership.
7. Define Whistle Blowing and its effects on LLP. B.Com. (H), Delhi 2012, 2015)
8. Every partner of an LLP is an agent of the LLP only and not of other partners. Explain.

Long Answer Questions

1. How can a person become a partner of an LLP? What are the qualifications for becoming a partner in an LLP? [B.Com. (H), Delhi 2011)
2. Discuss the provisions regarding appointment and eligibility condition for a designated partner under the LLP Act, 2008 [B.Com. (H), Delhi 2012]
3. State the liability of the LLP for the wrongful act of partner. [B.Com. (H), Delhi 2012]
4. The partners of LLP have no liability for the acts done a behalf of LLP? Do you agree?
5. 'A partner or LLP shall never be liable to an unlimited extent for the debts of LLP.' Critically examine the statement. [B.Com. (H), Delhi, 2015)
6. State the provisions related to whistle blowing in case of LLP. [B.Com(H), 2013, 2015)
7. The partners of LLP have no liability for the acts done an behalf of LLP? Do you agree?
8. What do you understand by the term 'holding out'? What is the liability of LLP in such a situation?
9. 'A partner or LLP shall never be liable to an unlimited extent for the debts of LLP.' Critically examine the statement. [B.Com. (H), Delhi, 2015)
10. Write a short note on:

Contributions

Whistle blowing.

11. State the provisions related to whistle blowing in case of LLP. [B. Com(H), 2013, 2015)
12. The responsibility for carrying out the legal obligation as laid down by the LLP Act shall be solely of the designated partners. [B. Com(H), 2016)
13. Every partner of an LLP is an agent of the LLP only and not of other partners.

    [B. Com(H), 2016)
14. Who can become partner in an LLP? What are the disqualifications for becoming a partner? How can a person become a partner of an LLP? [B. Com(H), 2016]

8.15 SUGGESTED READINGS

- *Bhushan, B., Kapoor, N.D., Abbi, R. (2020). Elements of Business Laws. Sultan Chand*
- *Kuchhal, M. C., & Kuchhal, V. (2013). Business Laws. New Delhi. Vikas Publishing House.*
- *Maheshwari, S. N., & Maheshwari, S. K. (2011). A Manual of Business Laws. Himalaya Publishing House Pvt. Ltd.*
- *Dagar, I., & Agnihotri, A., (2020). Business Laws, Sage Textbook*
- *Jagota, R. (2021). Business Laws. MKM Publishers ScholarTech Press.*
- *Sharma, J. P., & Kanojia, S. (2018). Business Laws. New Delhi. Bharat Law House Pvt. Ltd.*

8.16 ADDITIONAL READINGS

- *Arora, S. (2021) Business Laws. New Delhi. Taxmann.*
- *Das, & Roy, (2018). Business Laws. Oxford University Press*
- *The Limited Liability Partnership Act, 2008.*

LESSON 9

FINANCIAL DISCLOSURE AND WINDING UP OF L.L.P.

Sumita Jain

STRUCTURE

9.1 LEARNING OBJECTIVES

- To help the students to understand concepts and characteristics of LL.P. under Limited Liability Partnership Act, 2008.
- To help students know about various financial disclosures required to run a LLP.
- To let students, explore how the process of taxation and winding up takes place in an LLP.

9.2 INTRODUCTION

As we have already discussed an LLP is an entity that has components of partnership and a joint stock company. So, the act also requires every LLP to maintain books of accounts on a regular basis in which record of all assets and liabilities, details of receipts and payments and proper record of inventories is to be mentioned. Another aspect of this chapter is Audit, LLP whose turnover does not exceed, in any financial year, Rs. 40 lakhs on contribution does not exceed Rs25 lakhs, is exempted from getting its accounts audited. In this chapter we will also discuss about different provisions of conversion of a company, partnership and a unlisted company into an LLP. In the end we will discuss, how an LLP goes through the process of winding up and what are different modes of winding- up.

9.3 MEANING OF FINANCIAL DISCLOSURES OF LLP

The LLP Act requires every LLP to maintain books of accounts on a regular basis. In order to ensure transparency, the act also make it mandatory for an LLP to make proper disclosure of prescribed books of accounts such as Statement of accounts and Solvency and also make it compulsory to get accounts audited and file annual returns every year.

9.3.1 Maintenance of books of account [sec. 34]

Obligation to maintain proper books (Sec. 34(1)). Every LLP has required to maintain books of accounts.

Form and Content. Rule 24 (2) of LLP Rules, 2009 provides that the books of account shall contain:

(a) Details of all receipt and payment of money by LLP and also the sources of receipt and payment.

(b) A record of the assets and liabilities of LLP.

(c) Proper records of inventories, work in progress, finished goods, cost record to know about the cost of goods.

Apart from the above-mentioned matters, any other matter may be included in the books of account which the partners may decide.

Period of Preservation. The books of account of every LLP relating to a period of not less than eight years immediately preceding the current year must be preserved at registered office

Statement of account and solvency

Obligation to prepare Statement of account and solvency [Sec. 34(3)]. "Every LLP is required to prepare Statement of Account and Solvency' every year and to file the same with the registrar of companies (ROC)."

Time Period for Preparation. The statement of account and solvency is required to prepare within a period of 6 months from the end of Financial Year (FY). In case the financial year ends on 31st March 2012, the LLP must prepare its annual statement by 30th September, 2012.

Time Period for Filing. Once the statement is prepared, a copy of it has to be filed with the registrar, within a period of thirty days from the end of six months from the end of financial year along with applicable fees. In case the financial year ends on 31st March 2012, such statement be filed within a period of 60 days.

Form and Contents: A statement of account and solvency must be filed in Form 8. The statement is divided into two parts: Part A. Statement of Solvency Part B. Statement of Account

The first part contains an affirmation and declaration by the designated partners they have made full enquiry into the affairs of the LLP and sure about the position of solvency of LLP

the weather the LLP would be able to pay its debts in full in the normal course of its business or not.

Part B present a detailed summary of financial position of the LLP It consists of two statements (i) a Statement of Assets and Liabilities and (ii) Statement of Income and Expenditure.

Auditing of accounts of LLP [Sec. 34(4)]

Section 34 lays down that "the accounts of an LLP shall be audited in accordance with such rules as may be prescribed. However, the Central Government may, by notification in the official Gazette, exempt any class or classes of LLPs from the aforementioned requirement".

> Audit not Mandatory. According to Rule 24(8) of the LLP Rules "an LLP whose turnover does not exceed, in any financial year, Rs. 40 lakhs on contribution does not exceed Rs25 lakhs, is exempted from getting its accounts audited. The turnover limit has been raised from Rs 40 lakhs to Rs 60 lakhs by the Finance Act, 2010. But such LLPs who are exempted from mandatory audit may also get their accounts audited as per the LLP Rules, 2009."

9.3.2 Annual return (Sec. 35]

The second important document to be filed with the registrar every year by an LLP is an Annual Return. Every LLP is required to file an annual return duly authenticated with the registrar of Companies within sixty days of closure of its financial year.

The annual return shall be filed in a prescribed form i.e., Form no.11 annexed to LLP rules,2009 Briefly stated it contains following information:

1. The name and address of registered office of LLP (including other address if decided by the partners under Section 13(2), for service of documents).
2. Date of closure of financial year.
3. Details of business classification (trade/profession/service).
4. Principal business activities of the LLP.
5. The summary of partners and designated partners and DPIN of designated partners.
6. Number of individual(s) as partners and number of bodies corporate as partners.
7. Obligation of the partners to contribute
8. Particulars of penalties imposed on the LLP/partners/designated partners.
9. Particulars of compounding of offences.

10. Certificate to be signed by designated partner.

9.3.3 Other legal compliances relating to financial disclosures

1. Penalty for Non-Compliances under Section 34 or Under Section 35. "In case any LLP fails to comply with the provisions stated under Section 34 or 35, such LLP shall be punishable with fine which shall not be less thanRs 25,000 but which may extend toRs 5,00,000 and every designated partner of such LLP shall be punishable with fine which shall not be less thanRs10,000 but which may extend toRs1,00,000"

2. Inspection of Documents (Sec. 36]

   (i) The incorporation document, statement of account and solvency and annual return filed by each LLP with the registrar shall be available for inspection by any person.

   (ii) In case a person wants to obtain a copy or extract of any of afore mentioned documents to be certified by the registrar, he will have to payRs5 per page or fractional thereof.

3. Penalty for false statement [Sec. 37). Any LLP fails to comply with the provisions of filing the Annual return in the prescribed form on or before due date shall be punishable with fine ranging from twenty-five thousand to five lakhs' rupees. In addition, if in any return, statement or other document for the purposes of any of the provisions of this Act, any person makes a statement:

(a) which is false in any material particular, knowing it to be false; or

(b) which omits any materials fact knowing it to be material,

He shall be punishable with imprisonment for a term which may extend to 2 years and shall also be liable to fine which may extend toRs 25,00,000 but which shall not be less thanRs 1,00,000.

9.4 TAXATION OF LLP

The union budget 2009 which is announced on July 6, 2009 has given the guidelines for taxation of LLP in India.

LLP Treated at Par with General Partnerships. The new provisions do not treat the LLP as separate entity but treat it at par with the general partnership.

Eligibility (Sec. 184]

For an LLP to be assessed as firm, the following conditions are to be satisfied:

1. There must be LLP written LLP agreement.
2. The profit /loss shares of partners must be very clearly specified in the LLP agreement/deed.
3. An LLP agreement copy (certified properly) must accompany with the return of income of LLP of the previous year in which the partnership was formed must be submitted to Income Tax Authority.
4. If constitution of LLP changes or profit-sharing ratio changes in last year then a certified copy of revised LLP agreement shall be submitted along with Annual return of income.

TAXATION TREATMENT OF LLP

1. LLP is liable to pay tax at the flat rate of 30% on its total income. Surcharge: The amount of income-tax (as computed above) shall be further increased by a surcharge at the rate of 12% of such tax, where total income exceeds one crore rupees. However, the surcharge shall be subject to marginal relief. The amount of income-tax and the applicable surcharge, shall be further increased by education cess and secondary and higher education cess calculated at the rate of four per cent of such income-tax and surcharge.
2. Partner's Liability to Pay Tax. Every partner of an LLP is jointly and severally liable for the taxes to be paid by LLP (subject to the conditions stated under Sec. 167) for the period during which he is a partner.
3. Intangible Contribution. It shall be taxable only at the time of transfer, cessation and winding up of LLP.
4. Filing and Signing of ITR. In LIP 'designated partner' is responsible for the legal compliances of LLP therefore, it is his duty to sign the ITR of LLP unless any unavoidable reasons are there.

5. Alternate Minimum Tax (AMT). In order to save revenue on account of companies converting to LLPs, Finance Act, 2011 has introduced a new Chapter XII-BA under the Income-tax Act,1961 which provides for levy of Alternate Minimum Tax. It provides that if regular income tax payable by a LLP for a particular financial year is less than the corresponding alternate minimum tax computed on its adjusted total income, then such alternate minimum tax shall be deemed to be the income tax liability of such LLP. LLP is liable to AMT @ 18.5% plus an education cess of 3% on the adjusted total income of Limited Liability Partnerships (The effective rate of AMT including cess is 19.0596).

Excess amount paid over normal income tax payable u/s 115JC is allowed to be carried forward for a period upto 10 assessment years. In the given example, AMT credit to be carried forward would be`62,500 (`92,500 - `30,000) which is allowed to be set off for a period upto 10 assessment years.

6. Benefits of Presumptive Taxation not Available to LLP. According to IT Act, 1961 LLPs are not eligible for presumptive taxation i.e., they are not entitled to avail benefits of Sec. 44AD.

7. No Capital Gain on Conversion. No capital gain provided on conversion of:

   (i) Partnership firms into LLP (ii) company into LLP provided prescribed conditions are complied with.

8. Submission of Audit Report. LLPs are also required to submit audit report under section 115JC (3) on a before the due date of filing of ITR certifying the total income as well as Alternate Minimum Tax (AMT).

9. Not Liable for Dividend Distribution Tax (DDT). If a company declares or distributes dividends, it is required to pay additional income tax @ 15%. LLP is not liable for dividend distribution tax as there is no such form of dividends payable [Sec. 115-0).

10. Surcharge. LLP is liable to pay surcharge @ 12% of Income Tax if net income exceeds ₹ 1 crore. In case surcharge is levied, EC and SHEC will be computed on the combined amount of Income Tax plus Surcharge.

11. Due Date for Filing ITR. According to Explanation 2 of Section 139(1) of the Income-tax Act, an LLP is required to file an Income Tax Return:

(i) on or before July 31, if accounts are not to be audited.

(ii) on or before September 30, if accounts are to be audited.

12. Mode of LLP Tax Payment. LLP tax payment can be made in physical mode through designated banks or through e-payment mode. LLPs that are required to get its accounts audited are required to pay tax through e-payment mode only. To pay tax at designated banks, Challan ITNS 280 must be provided with the tax payment.

IN-TEXT QUESTIONS

1. Any LLP fails to comply with the provisions of filing the Annual return in the prescribed form on or before due date shall be punishable with fine ranging from twenty-five thousand to five lakhs' rupees. **True/ False**
2. Audit is mandatory for an LLP. **True / False**
3. According to section 34, books of account shall contain:
   a) Details of all receipts and payments b) Record of inventories
   c) Record of the assets and liabilities d) All of the above
4. LLP is liable to pay surcharge at _____of Income Tax if net income exceeds 1 crore.
5. The annual return shall be filed in a prescribed form i.e., Form no._____ annexed to LLP rule.

9.5 CONVERSION INTO LLP

9.5.1 Conversion from Partnership Firm into LLP [Sec. 55]

The LLP Act ,2008 has provide provisions for the conversion of a private limited company, a partnership, and a joint stock company (Unlisted) into LLP. (Sec 55-58)

A partnership firm have the right to convert itself into LLP by following the provisions of Chapter X of the Act and the Second Schedule.

Meaning of Conversion. The conversion of the partnership firm into LLP means the transfer of the property, whether tangible or intangible, assets, interests, rights, privileges, liabilities,

obligations and whole of the undertaking of the partnership firm to the LLP as a going concern.

Eligibility for conversion of partnership firm into LLP

A partnership firm may apply to ROC for its conversion into an LLP provided all the partners of the converting partnership firm become the partners of proposed LLP. No other person is allowed to become the partner during the process of conversion.

Procedure for conversion

The following steps are required to be taken for conversion of the partnership firm into LLP:

1. Deciding the partners and the designated partners.
2. Checking the name availability of LLP from ROC.
3. Getting LLP agreement and incorporation document drafted and printed.
4. Filing of conversion application.
5. Obtaining certificate of registration from the ROC.
6. Informing the Registrar of Firms about conversion.

Filing of Conversion Application [Rule 38(1)]. Partners of the LLP are required to submit conversion application in e-form 17 (Part A). The conversion application must be accompanied by:

(i) Incorporation document and subscription statement (Sec. II]

(ii) A statement by all of its partners in Form 17 (Part B) containing:

- Name and registration No. (if any) of the firm,
- Date of registration (if registered).

(iii) A statement in the prescribed form made by a person prescribed under the Act as to compliance of all requirements of the Act in respect of incorporation.

(iv) Assets and liabilities statement of LLP duly certified by C.A. (Chartered Accountant) as true and correct and must be submitted within thirty days from the application.

(v) Consent of creditors that they agree for conversion must also be attached.

(vi) The clearance, approval or permission for the conversion into LLP from the concerned body/authority, if required.

(vii) Other attachments such as details of ITR(s) filed, particulars of pending proceedings (if any), refusal letter by ROC (if applied earlier).

(viii) Prescribed filing and registration fees.

All the required e-forms will be digitally signed by the designated partner and shall be certified by an advocate/CS/CA/Cost Accountant in practice engaged in the formation of LLP.

Obtaining Certificate of Registration from ROC [Rule 38(2)]

(i) Issue of certificate by ROC. On receipt and then scrutinization of the above-mentioned documents if the Registrar is satisfied that all formalities and filing have been complied with, he shall register the documents and issue a certificate in form 19 (annexed to LLP Rules, 2009) stating that the LLP is registered with the name and from the date specified in the certificate. The certificate of registration shall be the conclusive evidence of the conversion of LLP.

(ii) Power of ROC to Refuse Conversion. The Registrar has the power to refuse the conversion in case he is not satisfied with details of the information filed as required by the Act.

(iii) Appeal to the Tribunal in Case of Refusal. "In case the Registrar has refused the registration of conversion, the applicant may apply to tribunal within 60 days from the date of receipt of such intimation of refusal."

7. Informing the Registrar of Firms About Conversion [Rule 38(3)] After partnership firm gets converted and registered, then the partnership firm has to inform to the registrar of firms about the conversion and also give the full details of conversion in form 14.

Penalty in Case of Delay Under Section 69. LLP is liable to pay fee of ` 100 per day.

Effects of registration of conversion of partnership into LLP (SEC. 58]

On and from the date of registration of conversion the effects of registration of conversion shall be as follows:

1. Existence of LLP. A LLP must be registered with the name mentioned din documents.
2. Automatic Transfer and Vesting of Assets and Liabilities in LLP. After partnership gets converted into LLP, all the assets, liabilities, property obligation of firms and whole business of partnership automatically gets transferred to LLP.
3. Dissolution of converting entity. The partnership firm after conversion deemed to be dissolved and its name will be removed from the records of the registrar of firms.

9.5.2 Conversion from Private Company into LLP [Sec. 56]

A private company may convert itself into a limited liability partnership in accordance with the provisions of Chapter X of the Act and the Third Schedule (by filling e-form 18).

Procedure for Conversion

The following steps are required to be taken for conversion of the private company into LLP:

1. Deciding the partners and the designated partners.
2. Checking the name availability of LLP from ROC.
3. Getting LLP agreement and incorporation document drafted and printed
4. Filing of conversion application.

5 Obtaining certificate of registration.

6 Informing the Registrar of Companies about conversion.

5. Filing of Conversion Application (Rule 39). After taking the above-mentioned steps an application is to be made in e-form 18 (Part A) (annexed to LLP Rules, 2009) The conversion application must be accompanied by:

(i) Incorporation document and subscription statement [Sec. 11]

(ii) A statement by all of its shareholders in Form 18 (Part B) containing:

- Name and registration number of the company; and
- Date of registration of the company.

(iii) A statement in the prescribed form made by a person prescribed under the Act as to compliance of all requirements of the Act in respect of incorporation.

(iv) Assets and liabilities statement which is duly certified by C.A of a private company as true and correct and must be submitted within thirty days of application.

(v) List of all creditors along with their consent to the conversion.

(vi) The clearance, approval or permission for the conversion into from the concerned body/authority, if required.

(vii) Other attachments such as details of ITR(s) filed, particulars of pending proceedings (if any), refusal letter by ROC (if applied earlier).

(viii) Prescribed filing and registration fees. required e-forms will be digitally signed by the designated partner

All the required e-form will be digitally signed by the designated partner and shall be certified by an advocate/CS/CA/Cost Accountant in practice engaged in the formation of LLP.

Obtaining Certificate of Registration from ROC

(i) (Issue of certificate by ROC. On receipt and then scrutinization of the above-mentioned documents if the Registrar is satisfied that all formalities and filing have been complied with, he shall register the documents and issue a certificate in Form 19 (Annexed to LLP Rules, 2009) stating that the LLP is registered with the name and from the date specified in the certificate. The certificate of registration shall be the conclusion evidence of the conversion of LLP.

(ii) Power of ROC to Refuse Conversion. The Registrar has the power to refuse the conversion in case he is not satisfied with details of the information filed as required by the Act.

(iii) Appeal to the Tribunal in Case of Refusal: If registrar refuse for conversion, then the firm can go to tribunal within sixty days of such refusal

7. Informing the Registrar of Companies about Conversion

After converted into LLP the converted firm has to inform registrar of companies with whom it was earlier registered about the conversion under a period of fifteen days from the date of registration in Form 14 with full details.

Penalty in case of Delay. LLP is liable to pay fee of`100 for every day of such delay in informing the ROC under section 69.

Effects of registration of conversion of private company into LLP [sec. 58]

On and from the date of registration of conversion the effects of registration of conversion shall be as follows:

1. Existence of LLP.LLP has to registered itself with the name with which it was registered.
2. Automatic Transfer and Vesting of Assets and Liabilities in LLP. After partnership gets converted into LLP, all the assets, liabilities, property obligation of private company and whole business of private company automatically gets transferred to LLP.
3. Dissolution of converting entity. Name of private company which got converted has to be removed from the register of companies and treated it as dissolved.

9.5.3 Conversion from Unlisted Public Company into LLP [Sec. 57]

An unlisted company may convert itself into a limited liability partnership in accordance with the provisions of Chapter X of the Act and the Fourth Schedule by filling E Form 18

Meaning of Listed Company. It means a listed company as defined in the Securities Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 issued by the SEBI under Section 11 of the SEBI Act, 1992. "Unlisted Public Company" means a company which is not a listed company.

Meaning of Conversion. After getting converted an unlisted public company into LLP all the assets, liabilities, property rights, obligations of company must be transferred to LLP

Eligibility for Conversion

An unlisted public company can apply for conversion to Registrar.

(a) there is no security interest in its assets subsisting or in force at the time of application; and

(b) All the shareholders of private company will become the partners of LLP after gets converted into LLP.

On compliance of all the formalities relating to conversion, the company, its shareholders, the LLP and all the partners of the LLP shall be bound by the provisions of the Fourth Schedule.

Procedure for Conversion

The following steps are required to be taken for conversion of the unlisted company into LLP:

1. Deciding the partners and the designated partners.
2. Checking the name availability of LLP from ROC.
3. Drafting LLP agreement and incorporation document drafted and printed.
4. Filing of conversion application.
5 Obtaining certificate of registration from the ROC.
6. Informing the Registrar of Companies about conversion.
5. Filing of Conversion Application (Rule 40). After taking the above-mentioned steps an application is to be made in e-form 18 (Part A) The conversion application must be accompanied by:

(i) Incorporation document and subscription statement (Sec. 11]

(ii) A statement by all of its shareholders in Form 18 (Part B) containing:

- Name and registration number of the company; and
- Date of registration of company.

(iii) A statement in the prescribed form made by a person prescribed under the Act as to compliance of all requirements of the Act in respect of incorporation.

(iv) Statement of Assets and liabilities of private company must be certified by C.A.as true and correct and must be filed within thirty days of application.

(v) Consent for conversion by all creditors of public company which is converted

(vi) The clearance, approval or permission for the conversion into LLP from the concerned body/authority, if required.

(vii) Other attachments such as details of ITR(s) filed, particulars of pending proceedings (if any), refusal letter by ROC (if applied earlier).

(viii) Prescribed filing and registration fees.

All the required e-forms will be digitally signed by the designated partner and shall be certified by an advocate/CS/CA/Cost Accountant in practice engaged in the formation of LLP.

Obtaining Certificate of Registration from ROC

(i) Issue of certificate by ROC. On receipt and then scrutinization of the above-mentioned documents if the registrar is satisfied that all formalities and filing have been complied with, he shall register the documents and issue a certificate in Form 19 (annexed to LLP Rules 2009) stating that the LLP is registered with the name and from the date specified in the certificate. The certificate of registration shall be the conclusion evidence of the conversion of LLP.

(ii) Power of ROC to Refuse Conversion. The Registrar has the power to refuse the conversion in case he is not satisfied with details of the information filed as required by the Act.

(iii) Appeal to the Tribunal in case of Refusal. After getting refused by registrar for conversion the company can go to tribunal under a period of sixty days from the date of refusal.

7. Informing the Registrar of Companies about Conversion

The LLP after getting converted should inform the registrar under which it was registered earlier under a period of fifteen days from the date of registration of LLP with full details of conversion in form 14

Penalty in case of Delay. LLP is liable to pay fee of`100 for every day of such delay in informing the ROC under Sec. 69.

9.6 EFFECTS OF REGISTRATION OF CONVERSION [SEC. 58]

On and from the date of registration of conversion the effects of registration of conversion shall be as follows:

1. Existence of LLP: LLP must know by name with which it gets registered

2. Automatic Transfer and Vesting of Assets and Liabilities in LLP. After partnership gets converted into LLP, all the assets, liabilities, property obligation of private

company and whole business of private company automatically gets transferred to LLP.

3. Dissolution of converting entity. The unlisted public company shall deem to be dissolved and its name will be removed from the register of companies maintained by the Registrar of Companies.

9.7 WINDING UP OF LLP

LLP is an artificial person created by legal process and its existence also comes to an end by a legal process of winding – up.

9.7.1 Meaning of Winding- Up

Winding up of an LLP is a process to bring about an end to the life of an LLP. The process of winding up involves the realization of the assets, payments of the liabilities and distribution of surplus among the partners of the LLP by the Liquidator.

9.7.2 Modes of Winding Up of LLP (Sec.63]

Limited Liability Partnership may be wound up in the following ways:

I. Voluntary Winding up

II. Insolvency and Bankruptcy Code (IBC), 2016: Though this code provides steps for restructuring and revival of Corporate Debtor (LLP) yet under certain circumstances NCLT can pass order for liquidation of LLP. Therefore, it is included under the modes of winding up.

III. Compulsory winding up by the Tribunal.

9.8 VOLUNTARY WINDING UP (AS PER REGULATIONS 2017 W.E.F. APRIL 2017)

Chapter V of Part II of the Insolvency and Bankruptcy Code (IBC), 2016 provides for the various provisions for liquidation of corporate persons. According to sec. 59(1) of the code, a corporate person who intends to liquidate itself voluntarily and meets the conditions and procedural requirements as prescribed by IBBI may initiate voluntary liquidation procedure under the provisions of Chapter V of Part II of the IBC, 2016.

The various provisions of Secs. 35-53 of the Chapter III and Chapter IV shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be required. It further provides that if the affairs of the corporate persons have been completely wound up and its assets completely liquidated, the liquidator is required to make an application to Adjudicating Authority, i. e, NCLT for dissolution of such corporate person.

9.8.1 Steps Involved in The Process of Voluntary Liquidation Of LLP

1. Commencement of Liquidation

(a) Obtaining declaration of solvency (DOS) [Sec. 59(3) of the Code]. "A declaration of solvency duly verified by an affidavit has to be obtained from majority of designated partners of corporate person."

(b) Declaration to be accompanied with documents [Sec. 59(3) of the Code]. Dos shall be accompanied by:

(i) audited financial statements and record of business operations of the corporate person for the previous two years or for the period since its incorporation, whichever is later.

(ii) a report of the valuation of assets of the corporate person, if any, prepared by a registered valuer.

(c) Passing of resolution [Sec. 59(3) (c) of the Code). A resolution shall be passed by majority of the partners of corporate person for voluntary liquidation and appointing an insolvency professional to act as liquidator within 4 weeks of obtaining the declaration.

(d) Approval of voluntary winding up by the creditors [Proviso to Sec. 59(3) of the Code]. In case the LLP owes debt to any person, the creditors representing 2/3rd in value of the debt of the corporate person shall approve the resolution passed under Sec. 59(3)(c) of the Code within 7 days of such resolution.

(e) Notification to the Registrar and IBBI. The corporate person shall notify the Registrar and IBBI about the resolution to liquidate itself within 7 days of such resolution or the subsequent approval by the creditors, as the case may be.

(f) Commencement of liquidation proceedings. The liquidation proceedings of corporate person shall be deemed to have commenced from the date of passing of the resolution, subject to the creditors' approval.

9.8.2 Effect of Liquidation

- Carrying on of Business. The corporate person shall cease to carry on its business from the liquidation commencement date except if required for the beneficial winding up of its business.
- Continuance of its Existence. The corporate person shall continue to exist until it is dissolved.

2. Appointment and Remuneration of Liquidator.

(i) An insolvency professional to be appointed as liquidator should satisfy the eligibility conditions laid down under Regulation 6.

(ii) The resolution passed under regulation 3(2)(c) or under section 59(3)(c), as the case may be, shall contain the terms and conditions of the appointment of the liquidator, including the remuneration payable to him.

(iii) The remuneration payable to the liquidator shall form part of the liquidation cost.

Reporting. The liquidator shall prepare and submit—

(a) Preliminary Report.

(b) Annual Status Report.

(c) Minutes of consultations with stakeholders; and

(d) Final Report

in the manner specified under the Regulations.

3. Public Announcement by the Liquidator (Regulation 14 of the Voluntary Liquidation Regulation).

(i) Form and time of announcement. The liquidator shall make a public announcement in Form A of Schedule I within 5 days of his appointment.

(ii) Contents of announcement. The announcement shall invite the stakeholders to submit their claims due to the corporate person within 30 days from the liquidation commencement date.

(iii) Mode of publishing of announcement. The announcement shall be published:

(a) In one English and one regional language newspaper with wide circulation at the location of the registered office and principal office, if any, of the corporate person.

(b) On the website, if any, of the corporate person; and

(c) On the website, if any, designated by IBBI for this purpose.

4. **Verification of Claims.**

Chapter V of VL Regulations provides for the manner of submission of claims by creditors including workmen and employees and secured creditors), determination of number of claims, foreign currency claims, verification of claims etc.

According to Section 40 of the Code, the liquidator shall verify the claims submitted within 30 days from the last date for receipt of claims and may either admit or reject the claim, wholly or partially, as the case may be.

5. **Realization of Assets.**

(i) Manner of sale. It may be noted that VL Regulations allow the liquidator to value and sell the assets of the corporate person in the manner and mode approved by the corporate person.

(ii) Recovery of monies due: The liquidator shall make an effort to recover and realize all assets and dues to the corporate person in a time-bound manner keeping in mind the interest of the stakeholders.

(iii) Realization of unpaid capital contribution. The liquidator shall realize the unpaid capital contribution from the partners who have not yet paid.

6. **Deposit and Distribution of Proceeds of Liquidation (Regulation 35 of Liquidation Regulation).**

The liquidator shall open a bank account in the name of the corporate person followed by the words ‘in voluntary liquidation' in a scheduled bank and deposit all money received on behalf of corporate person.

The liquidator shall distribute the proceeds from realization within 6 months from the receipt of the amount to the stakeholders. The proceeds shall be distributed after deducting the liquidation cost there from.

7. **Completion of Liquidation and Preparation of Final Report (Regulations 37 and 38 of Liquidation Regulation).**

The liquidator shall endeavour to wind up the affairs of the corporate person within 12 months from the voluntary liquidation commencement date. In the event of voluntary liquidation continuing for more than 12 months, the liquidator shall present a 'Status report' indicating progress in liquidation.

On completion of the liquidation process, the liquidator shall prepare the final report which shall consist of audited accounts of liquidation, receipts. and payments pertaining to liquidation etc.

8. **Submission of Final Report (Regulation 38 of Liquidation Regulation).**

The liquidator shall submit the final report to the Registrar and IBBI.

9. **Passing of Order by NCLT [Section 59(7) and (8) of the Code].**

Where the affairs of the corporate person have been completely wound up, and its assets completely liquidated, the liquidator shall make an application to the NCLT for the dissolution of corporate person. If the NCLT is satisfied with the application, it shall pass an order that the corporate person shall be dissolved from the date of order and the corporate person shall be dissolved accordingly.

10. **Filing of Order with ROC.**

The order of NCLT must be filed under a period of fourteen days of the receipt of the order with the registrar

9.9 COMPULSORY WINDING UP BY THE TRIBUNAL

According to Sec. 64 of the Act, An LLP may be wound up compulsorily by the tribunal in the following circumstance:

(a) Petition by LLP. If the LLP decides that the LLP be wound up by the tribunal.

(b) Number of Partners below Statutory Minimum. If the number of partners reduced below the minimum limits for more than six months

(c) Inability to Pay its Debts2. If an LLP is unable to pay its debts, it shall be wound up by the tribunal according to rule 25 of the LLP (Winding up and Dissolution) Rules, 2012. An LLP shall be unable to pay its debts in the following 3 cases:

(i) If a LLP owes an amount exceeding.1,00,000 to a creditor and fails to pay such amount within a period of 21 days after the receipt of the demand made by the creditor or his assignee.

(ii) If it is proved to the satisfaction of the Tribunal that LLP is unable to pay its debts and in order to determine the inability of the LLP to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the LLP.

(d) LLP acting against the National Interest: If the LLP has against the interest of nation, its security, integrity of the state order then it is again a reason for compulsory winding up.

(e) Default in filing statement of account of solvency or AR with ROC. If the LLP has made a default in filing SAS or AR for any 5 consecutive financial year(s).

(f) Just and Equitable: An LLP may also be ordered to be wound up, if the tribunal is of the opinion that it is just and equitable that the LLP should be wound up. On the basis of judicial decisions, the following examples may be given where the tribunal may order winding up under the just and equitable:

(i) When the main object of the LLP has failed or its substratum is gone

(ii) When there is complete deadlock in the management of the LLP.

(iii) When the LLP was doing an illegal business.

(iv) When the business of the LLP cananot be carried on except at losses.

9.9.1 Steps in The Compulsory Winding Up

1. Filing of petition to the Tribunal and the same should be issued to the LLP.
2. Waiting for the court hearing on the petition.
3. Getting the order from the Tribunal for winding up.

4. Convening a meeting of creditors and other relevant parties.
5. Appointment of liquidator.
6. Realization of all assets and their distribution among the creditors.
7. Defining role of liquidator.
8. LLP will be dissolved under the supervision of the assigned liquidator.

In both the cases of winding up process, whether voluntary or compulsory, a liquidator is appointed for winding up the affairs of the LLP. The final dissolution order is passed by the Tribunal. Winding up is a long process spread over a period of 7-8 months.

9.10 LIQUIDATOR

The liquidator is an officer who conducts the liquidation proceedings, i.e.., all the assets of the business unit are realized and distributed amongst the creditors most fairly and surplus if any, is distributed between the owners of the business unit.

Provisional Liquidator. After receiving the winding up petition but before passing the winding up order, the Tribunal may appoint' provisional liquidator' for the time being who shall have the same powers as 'Liquidator' unless the Tribunal limits and restricts his powers by the order appointing him. When the winding up order is made, the 'provisional liquidator' shall become the 'Liquidator' of LLP.

Duties of Liquidator

(i) to carry on the business of the LLP as may be necessary for the beneficial winding up of the LLP.

(ii) to do all acts and to execute all deeds, receipts and other documents and for that purpose, to use the LLP's seal, if any;

(iii) to take custody of property, assets, books of account and other documents;

(iv) to inspect the records and returns of the LLP on the files of the registrar or any other authority;

(v) to draw, accept, make and endorse negotiable instruments on behalf of the LLP;

(vii) to apply to the Tribunal for such orders or directions as may be necessary for the winding up of the LLP;

(viii) to make necessary security arrangements to protect the property and assets of the LLP taken into his custody, in consultation with secured creditors or after giving them notice;

(ix) to appoint valuers to assess the value of the LLP's assets within 15 days after taking them into custody in consultation with secured creditors or after giving them notice;

(x) to carry out investigation into the affairs of the LLP relating to fraudulent conduct or other wrong doings and submit report on such investigation to the Tribunal;

(xi) to give an advertisement for the sale of the assets of the LLP within 15 days from the date of receipt of valuation report;

(xii) to invite claims from the creditors, examine the proof and prepare and submit the list of creditors and partners; and

(xiii) to maintain a separate bank account for each LLP under his charge for depositing the sale proceeds of the assets and recovery of the debts of each LLP;

(xvi) to do all such other acts and things as may be necessary for the winding up of the LLP and distribution of its assets.

IN-TEXT QUESTIONS

6. Appointment of liquidator is also an important step in case of compulsory winding up of an LLP. **True / False**
7. Conversion From Unlisted Public Company into LLP is governed under which section?_____
8. Which of the following are various modes of winding up of LLP:

   a) Voluntary Winding up b) Insolvency

   c) Compulsory winding up by the Tribunal d) All of the above
9. _____ maintains a separate bank account for each LLP under his charge for depositing the sale proceeds of the assets and recovery of the debts of each LLP in case of winding up of LLP.
10. The liquidator shall prepare and submit a Preliminary Report, Annual Status Report and a Final report. **True/ False**

9.11 SUMMARY

Every LLP has required to maintain books of accounts. Statement of accounts means statement of account and solvency and that must be filed in Form 8. The statement is divided into two parts:

Part A. Statement of Solvency Part B. Statement of Account. Section 34lays down that the accounts maintained of an LLP shall be audited. Every LLP must file an annual return with the registrar within 60 days of closure of its financial year (30th May) in Form 11with the prescribed fees. A penalty of Rs 100 per day is applicable for late filing of returns.

It is announced on July 6, 2009 has given the guidelines for taxation of LLP in India. The new provisions do not treat the LLP as separate entity but treat it at par with the general partnership for taxation purposes. Flat Tax Rate of 30%plus Education Cess (EC) @ 2% plus Secondary and Higher Education Cess (SHES)@ 1% will be payable by LLP but however no surcharge will be applicable. LLPs tax payment is lower than that of companies, which are required to pay @ 33.99% tax on profits. In order to save revenue on account of companies converting to LLPs, Finance Act, 2011 has introduced a new Chapter XII-BA under the Income-tax Act,1961 which provides for levy of Alternate Minimum Tax.

The LLP Act ,2008 has provide provisions for the conversion of a private limited company, a partnership, and a joint stock company (Unlisted) into LLP. (Sec 55-58) A partnership firm, private limited company and a joint stock company can be converted into LLP. The conversion of the partnership firm into LLP means the conversion of the property, assets, interests, rights, liabilities, obligations and whole of the undertaking of the partnership firm to the LLP as a going concern.

LLP is an artificial person comes in existence by a legal process and it's also coming to an end by legal process known as winding up. It is a process to wind up all the affairs of a company and where all the assets are disposed of by the liquidator to meet the liabilities of the LLP and if there is any profit, is distributed among the partners.

Limited Liability Partnership may be wound up in the following ways:

1) Voluntary Winding up 2), Insolvency and Bankruptcy Code (IBC), 2016: Though this code provides steps for restructuring and revival of Corporate Debtor (LLP) yet under certain circumstances NCLT can pass order for liquidation of LLP. Therefore, it is included under the modes of winding up, 3) Compulsory winding up by the Tribunal.

9.12 ANSWERS TO IN-TEXT QUESTIONS

1. True 2. False 3. All of the above 4. 12% 5. Form no. 11 6. True 7. Section 57 8. All of the above	9. Liquidator 10. True

9.13 SELF-ASSESSMENT QUESTIONS

Short Answers Questions

1. Explain the winding up of an LLP.
2. Write a short note on "Declaration of solvency". (B.Com. (H), Delhi, 2011)
3. Who may file a petition to the Tribunal in case of compulsory winding up?
4. In which cases LLP is deemed to be unable to pay its debts?
5. Explain the requirements as regards to maintenance of accounts.
6. Explain the procedure of conversion of a partnership into LLP.
7. Write a short note on Annual Returns of LLP
8. Describe the powers of Auditors of an LLP.

Long Answers Questions

1. Explain the winding up of an LLP. Discuss the various grounds under which an LLP can be wound up by the Court.
2. Which are the various steps involved in the process of voluntary winding up of an LLP? **(B.Com. (H), Delhi, 2018)**

3. In which cases LLP is deemed to be unable to pay its debts?
4. Explain the duties of a liquidator under LLP Act, 2008. **(B.Com. (H), Delhi, 2016)**
5. Write a short note on "Declaration of solvency". **(B.Com.(H), Delhi, 2011, 2016)**
6. Who may file a petition to the Tribunal in case of compulsory winding up? Discuss the powers of Court/Tribunal on hearing such petition.
7. "The Tribunal can wind up the LLP on just and equitable grounds." Explain.

   (B.Com. (H), Delhi, 2017,2018)
8. Distinguish between a winding and dissolution of LLP. **(B.Com. (H), Delhi, 2017)**
9. 'The statement of Account and Solvency is one of the most important disclosures made by an LLP annually." Comment. **(B.Com. (H), Delhi, 2018)**
10. State the procedure of conversion of partnership into LLP. **(B.Com. (H), Delhi, 2015)**
11. Discuss the provisions of third schedule (annexed to the LLP Act, 2008) for conversion from private company into limited liability partnership. **(B.Com. (H), Delhi, 2017)**
12. Discuss the provisions of fourth schedule (annexed to the LLP Act, 2008) for conversion from unlisted public company into limited liability partnership.

9.14 SUGGESTED READINGS

- *Bhushan, B., Kapoor, N.D., Abbi, R. (2020). Elements of Business Laws. Sultan Chand*
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978-93-95774-43-7

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