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Entire Document

LEGAL ASPECTS OF BUSINESS
SYLLABI-BOOK MAPPING TABLE Legal Aspects of Business Syllabi Mapping in Book Law of Contract Law of Sale of Goods Law of Negotiable Instruments The Consumer Protection
Act, 1986 Unit 1: Nature and Kinds of Contracts (Pages 5-15) Unit 2: Offer and Acceptance (Pages 17–30) Unit 3: Consideration (Pages 31–40) Unit 4: Capacity of Parties (Pages 41–49) Unit 5: Free Consent (Pages 53–71) Unit 6: Legality of Object and Consideration (Pages 73–81) Unit 7: Void Agreements (Pages 83–91) Unit 8: Contingent Contracts (Pages 93–96) Unit 9: Performance of Contracts (Pages 99–108) Unit 10: Discharge of Contracts (Pages 109–119) Unit 11: Quasi-Contracts (121–125) Unit 12: Remedies for Breach of Contract (Pages 127–137) Unit 13:
Indemnity and Guarantee (Pages 141–154) Unit 14: Bailment and Pledge (Pages 155–170) Unit 15: Agency (Pages 171–193) Unit 16: Contract of Sale of Goods (Pages 195–206) Unit 17: Conditions and Warranties (Pages 209–219) Unit 18: Transfer of Property (Pages 221–229) Unit 19: Performance of Contract of Sale (Pages 231–236) Unit 20: Remedial Measures (Pages 237–246) Unit 21: Negotiable Instruments (Pages 249–268) Unit 22: Parties to Negotiable Instruments (Pages 269–276) Unit 23: Presentment of Negotiable Instruments (Pages 277–283) Unit 24: Negotiation of Negotiable Instruments (Pages 285–293) Unit 25: Dishonour and Discharge of Negotiable Instruments (Pages 297–305) Unit 26: Banker and Customer (Pages 307–319) Unit 27: Consumer Protection Act, 1986 (Pages 321-348)
Unit 28: General Provisions Regarding Arbitration (Pages 349-355) Unit 29: Arbitral Tribunal (Pages 359-364) Unit 30: Arbitration Proceedings (Pages 365-371) Unit 31: Conciliation (Pages 373-376) Unit 32: Enforcement of Certain Foreign Awards (Pages 377-387) Unit 33: Information Technology Act, 2000 (Pages 391-417) Unit 34: The Company (Pages 419-427) Unit 35: Kinds of Companies (Pages 429-442) Unit 36: Memorandum of Association and Articles of Association (Pages 443-464) Law of Arbitration and Concilliation Law of Information Technology Elements of Company Law (a) Basic Concepts of Company Law (b) Kinds of Companies (c) Memorandum and Articles of Association
CONTENTS INTRODUCTION 1–2 MODULE – 1 UNIT 1 NATURE AND KINDS OF CONTRACTS 5-15 1.0 Introduction; 1.1 Unit Objectives; 1.2

90% **MATCHING BLOCK 1/38** W

The Indian Contract Act, 1872; 1.3 Definition of Contract; 1.4 Essential Elements of a Valid Contract; 1.5 Kinds of Contracts; 1.6

Test Questions; 1.7 Practical Problems UNIT 2 OFFER AND ACCEPTANCE 17–30 2.0 Introduction; 2.1 Unit Objectives; 2.2 The Proposal or Offer; 2.3 The Acceptance; 2.4 Contracts Over the Telephone; 2.5 Test Questions; 2.6 Practical Problems UNIT 3 CONSIDERATION 31–40 3.0 Introduction; 3.1 Unit Objectives; 3.2

96% **MATCHING BLOCK 2/38** W

Definition; 3.3 Essentials of Valid Consideration; 3.4 Exceptions to the Rule "No Consideration, No Contract"; 3.5

Test Questions; 3.6 Practical Problems UNIT 4 CAPACITY OF PARTIES 41–49 4.0 Introduction; 4.1 Unit Objectives; 4.2 Minor; 4.3 Persons of Unsound Mind; 4.4 Disqualified Persons; 4.5 Test Questions; 4.6 Practical Problems MODULE – 2 UNIT 5 FREE CONSENT 53–71 5.0 Introduction; 5.1 Unit Objectives; 5.2 Coercion; 5.3 Undue Influence; 5.4 Misrepresentation; 5.5 Fraud; 5.6 Mistake; 5.7 Test Questions; 5.8 Practical Problems UNIT 6
LEGALITY OF OBJECT AND CONSIDERATION 73–81 6.0 Introduction; 6.1 Unit Objectives; 6.2 What Considerations and Objects Are Unlawful?; 6.3 Object or Consideration Unlawful in Part; 6.4
Effect of Illegal Agreements on Collateral Transactions; 6.5 Test Questions; 6.6 Practical Problems UNIT 7 VOID AGREEMENTS 83–91 7.0 Introduction; 7.1 Unit Objectives; 7.2 Expressly Declared Void Agreements; 7.3 Test Questions; 7.4 Practical Problems UNIT 8 CONTINGENT CONTRACTS 93–96 8.0 Introduction; 8.1 Unit Objectives; 8.2 Definition; 8.3 Essentials of Contingent Contract; 8.4 Rules Regarding the Performance
of Contingent Contracts; 8.5 Difference between a Contingent Contract and a Wagering Agreement; 8.6
Test Questions; 8.7 Practical Problems
MODULE – 3 UNIT 9

89% **MATCHING BLOCK 3/38** W

PERFORMANCE OF CONTRACTS 99–108 9.0 Introduction; 9.1 Unit Objectives; 9.2 Who Can Demand Performance?; 9.3 By Whom Contracts must be Performed?; 9.4 Performance of Joint Promises; 9.5 Assignment of Contracts; 9.6 Order of Performance of Reciprocal Promises; 9.7 Time and Place for Performance; 9.8 Appropriation of Payments; 9.9 Contracts which Need not be Performed; 9.10

Test Questions; 9.11 Practical Problems UNIT 10 DISCHARGE OF CONTRACTS 109–119 10.0 Introduction; 10.1 Unit Objectives; 10.2 Discharge
by Performance; 10.3 Discharge by Mutual Consent or Agreement; 10.4 Discharge by Subsequent or Supervening Impossibility or Illegality; 10.5 Cases not Covered by Supervening Impossibility; 10.6
Discharge
by Lapse of Time; 10.7 Discharge by
Operation of Law; 10.8 Discharge by Breach of
Contract; 10.9
Test Questions; 10.10 Practical Problems UNIT 11 QUASI-CONTRACTS 121–125 11.0 Introduction; 11.1 Unit Objectives; 11.2 Quasi-Contractual Obligations; 11.3 Test Questions; 11.4 Practical Problems UNIT 12
REMEDIES FOR BREACH OF CONTRACT 127–137 12.0 Introduction; 12.1 Unit Objectives; 12.2 Rescission of The Contract; 12.3 Suit for Damages; 12.4
Duty to Mitigate Damage Suffered; 12.5 Liquidated Damages and Penalty; 12.6
Summary of the Rules Regarding the Measure of Damages; 12.7 Suit for Specific Performance; 12.8 Suit for an Injunction; 12.9 Test Questions; 12.10 Practical Problems MODULE – 4 UNIT 13 INDEMNITY AND GUARANTEE 141–154 13.1 Unit Objectives; 13.2 Contracts of Indemnity; 13.3 Contracts of Guarantee; 13.4 Test Questions; 13.5 Practical Problems UNIT 14 BAILMENT AND PLEDGE 155–170 14.1 Unit Objectives; 14.2 Bailment; 14.3 Finder of Lost Goods; 14.4 Pledge or Pawn; 14.5 Test Questions; 14.6 Practical Problems UNIT 15 AGENCY 171–193 15.1 Unit objectives; 15.2 Definitions

W

MATCHING BLOCK 4/38

of Agent and Principal; 15.3 General Rules of Agency; 15.4 Kinds of Agents; 15.5 Creation of an Agency; 15.6 Extent of Agent's Authority; 15.7 Delegation of Authority; 15.8

Principal's Liability for the Acts of the Agent; 15.9 Termination of Agency; 15.10 Irrevocable Agency; 15.11 Test Questions; 15.12 Practical Problems UNIT 16

69% **MATCHING BLOCK 5/38** W

CONTRACT OF SALE OF GOODS 195–206 16.0 Introduction; 16.1 Unit objectives; 16.2 Definition and Essentials of a Contract of Sale; 16.3 Kinds of Goods; 16.4 The Price; 16.5 Earnest or Deposit; 16.6 Document of Title to Goods; 16.7

Test Questions; 16.8 Practical Problems
MODULE – 5 UNIT 17 CONDITIONS AND WARRANTIES 209–219 17.0 Introduction; 17.1 Unit Objectives; 17.2

100% **MATCHING BLOCK 6/38** W

Condition Defined; 17.3 Warranty Defined; 17.4 Implied Conditions; 17.5 Implied Warranties; 17.6 Doctrine of Caveat Emptor; 17.7

Test Questions; 17.8 Practical Problems UNIT 18 TRANSFER OF PROPERTY 221–229 18.0 Introduction; 18.1 Units objectives; 18.2 Essentials of Transfer of Property; 18.3 Rules Regarding Transfer of Property; 18.4 Essentials of Valid Appropriation; 18.5 Rule of Transfer of Title on Sale; 18.6 Test Questions; 18.7 Practical Problems UNIT 19 PERFORMANCE OF CONTRACT OF SALE 231–236 19.0 Introduction; 19.1 Unit Objective; 19.2

100% **MATCHING BLOCK 7/38** W

Delivery; 19.3 Rules as to Delivery of Goods; 19.4 Acceptance of Delivery by Buyer; 19.5

Test Questions; 19.6 Practical Problems UNIT 20 REMEDIAL MEASURES 237–246 20.1 Unit Objectives; 20.2 Rights of Unpaid Seller; 20.3 Buyer's Rights Against Seller; 20.4 Auction Sale; 20.5
Test Questions; 20.6 Practical Problems MODULE – 6 UNIT 21 NEGOTIABLE INSTRUMENTS 249–268 21.0 Introduction; 21.1 Unit Objectives; 21.2 Promissory Note; 21.3 Bill of Exchange; 21.4 Cheque; 21.5 Hundis; 21.6 Test Questions; 21.7 Practical Problems UNIT 22 PARTIES TO NEGOTIABLE INSTRUMENTS 269–276 22.1 Unit Objectives; 22.2 Holder; 22.3 Capacity of Parties; 22.4 Test Questions; 22.5 Practical Problems UNIT 23 PRESENTMENT OF NEGOTIABLE INSTRUMENTS 277–283 23.0 Introduction; 23.1 Unit Objective; 23.2 Presentment for Acceptance; 23.3 Presentment for Sight; 23.4 Presentment for Payment; 23.5 Test Questions; 23.6 Practical Problems UNIT 24 NEGOTIATION OF NEGOTIABLE INSTRUMENTS 285–293 24.0 Introduction; 24.1 Unit Objectives; 24.2 Negotiable Instruments; 24.3 Negotiation by Unauthorised Parties; 24.4 Test Questions; 24.5 Practical Problems MODULE – 7 UNIT 25 DISHONOUR AND DISCHARGE OF NEGOTIABLE INSTRUMENTS 297–305 25.0 Introduction; 25.1 Unit objectives; 25.2 Dishonour of Negotiable Instruments; 25.3 Dischange of the Instrument and the Parties; 25.4 Test Questions; 25.5 Practical Problems UNIT 26 BANKER AND CUSTOMER 307–319 26.0 Introduction; 26.1 Unit Objective; 26.2 Crossing of Cheques; 26.3 Types of Crossing; 26.4 Liability of Banker; 26.5 Rights of Holder against Banker; 26.6 Bouncing of Cheques; 26.7 Test Questions; 26.8 Practical Problems
UNIT 27 CONSUMER PROTECTION ACT, 1986 321-348 27.0 Introduction; 27.1 Unit Objectives; 27.2

80% **MATCHING BLOCK 8/38** W

Definition of Consumer; 27.3 Who can File a Complaint; 27.4 Grounds on which a Complaint can be Made; 27.5 Unfair Trade Practice; 27.6 Restrictive Trade Practice; 27.7 Consumer Protection Councils; 27.8 Consumer Disputes Redressal Agencies; 27.9 District Forum; 27.10 State Commission; 27.11National Commission; 27.12 Powers of the Consumer Forums; 27.13

Test Questions UNIT 28 GENERAL PROVISIONS REGARDING ARBITRATION 349-355 28.0 Introduction; 28.1 Unit Objectives; 28.2 Types of Arbitration; 28.3 Arbitration Defined; 28.4 Arbitration Agreement; 28.5 Test Questions; 28.6 Practical Problems MODULE – 8 UNIT 29 ARBITRAL TRIBUNAL 359-364 29.1 Unit Objectives; 29.2

100% **MATCHING BLOCK 9/38** W

Arbitrator; 29.3 Appointment of Arbitrators; 29.4 Effect of Death or Insolvency of a Party to Arbitration; 29.5 Removal of Arbitrator; 29.6 Jurisdiction of Arbitral Tribunals; 29.7 Powers of Arbitrators; 29.8 Duties of Arbitrators; 29.9

Test Questions; 29.10 Practical Problems UNIT 30 ARBITRATION PROCEEDINGS 365-371 30.1 Unit Objectives; 30.2

100% **MATCHING BLOCK 10/38** W

Equal Treatment of Parties; 30.3 Rules of Procedure for Arbitration; 30.4 Place and Commencement of Arbitration; 30.5 Arbitration Procedure; 30.6 Arbitral Award; 30.7 Form and Contents of Arbitral Award; 30.8 Costs of Arbitration and Deposits; 30.9 Correction and Interpretation of Award; 30.10 Additional Award; 30.11

Test Questions UNIT 31 CONCILIATION 373-376 31.0 Introduction; 31.1 Unit Objectives; 31.2 Procedure for Conciliation; 31.3 Confidentiality; 31.4 Deposits; 31.5 Test Question UNIT 32 ENFORCEMENT OF CERTAIN FOREIGN AWARDS 377-387 32.0 Introduction; 32.1 Unit Objective; 32.2 New York Convention Awards; 32.3 Geneva Convention Awards; 32.4 Test Question MODULE – 9 UNIT 33 INFORMATION TECHNOLOGY ACT, 2000 391-417 33.0 Introduction; 33.1 Unit Objectives; 33.2 Rationale behind the IT Act, 2000; 33.3 Information Technology Act, 2000; 33.4 Scheme of the IT Act, 2000; 33.5 Digital Signature; 33.6

85% **MATCHING BLOCK 11/38** W

Electronic Governance; 33.7 Attribution, Acknowledegment and Despatch of Electronic Records; 33.8 Secure Electronic Records and Secure Digital Signatures; 33.9 Regulation of Certifying Authorities; 33.10 Powers of Controller; 33.11 Duties of Certifying Authority; 33.12 Digital Signature Certificates; 33.13 Duties of Subscribers; 33.14 Penalties and Adjudication; 33.15 The Cyber Regulations Appellate Tribunal; 33.16 Offences; 33.17 Test Questions UNIT 34 THE COMPANY 419-427 34.0

Introduction; 34.1 Unit Objectives; 34.2 Companies Act and its Administration; 34.3 Definition of Company and its Characteristics; 34.4 Characteristics of Company; 34.5 Incorporation of Company; 34.6 Test Questions
UNIT 35

94% **MATCHING BLOCK 12/38** W

KINDS OF COMPANIES 429-442 35.0 Unit Objectives; 35.1 Kinds of Companies according to the Mode of Incorporation; 35.2 Kinds of Registered Companies on The Basis of Number of Members; 35.3 Kinds of Registered Companies on The Basis of Liability of Members; 34.4 Other kinds of Companies; 35.5 Exemptions and Privileges of Private Companies; 35.6 Distinction Between a Private and Public Company; 35.7 Conversion of Companies; 35.8

Test Questions UNIT 36 MEMORANDUM OF ASSOCIATION AND ARTICLES

76% **MATCHING BLOCK 13/38** W

OF ASSOCIATION 443-464 36.0 INTRODUCTION; 36.1 UNIT OBJECTIVES; 36.2 DEFINITION AND IMPORTANCE; 36.3 Contents of Memoradum; 36.4 Alteration of Memorandum; 36.5 The Doctrine of Ultra Vires; 36.6

Test Questions

Introduction Self-Instructional Material 1 NOTES INTRODUCTION The study of law is of enormous practical value, for law is a vital and ever-present force in modern life and no one is beyond its influence and effect. It is not only on those relatively rare occasions when we buy a house or are involved in an automobile accident that we come into contact with the law. On the contrary, every time we purchase a book, entrust our car to the mechanic for repairs, or take dinner at a restaurant, our actions are regulated by various laws. Hence, the need for the knowledge of law cannot be overemphasized. It is obvious that a businessman needs even more thorough knowledge of the law than the person not so engaged. Every day that he carries on his business, he is confronted with problems arising out of contracts, agency, bailments, sale of goods, negotiable instruments, property rights, insurance, bouncing of cheque, etc. Furthermore, the present day businessman is faced with a more formidable problem in understanding the complicated legal provisions than the businessman of past generations. In economies like ours that have recently exposed themselves to global competition and followed the path of economic liberalization, business enterprises are becoming more and more subject to various specialized fields of law. The modern businessman must therefore acquaint himself with the main business laws. He need not become an expert in all or even any one of them, but he should be sufficiently aware of their scope to be able to operate his business within their confines and to know when he should seek the services of a competent lawyer. It is for this reason that the study of 'business law' forms an essential part of commerce and management curriculum with varying titles. According to the Oxford English Dictionary, the word 'Law' refers to the ' rule made by authority for the proper regulation of a community or society or for correct conduct in life.'
In the words of Woodrow Wilson, 'Law is that portion of the established habit and thought of mankind which has gained distinct and formal recognition in the shape of uniform rules backed by the authority and power of the Government.'
Broadly speaking, the term '
Law' denotes rules and principles either enforced by an authority or self-imposed by the members of a society
to control and regulate people's behaviour
with a view to securing justice, peaceful living and social security.
With the growth of,
people's social and economic behaviour has assumed a multi-dimensional character. It is therefore neither desirable nor feasible to control all kinds of people's activities through a uniform set of rules and principles. Most civilized societies, therefore, provide and enforce different sets of rules and guiding principles for different kinds of social behaviour. Hence, there are several branches of law, such as International Law, Constitutional Law, Criminal Law, Civil Law,
Mercantile or Business Law,
etc. In this book, the discussion is confined only to the last of the aforesaid branches of law, namely, mercantile or business laws as they exist in India. The term '
Mercantile Law' may be defined as that branch of law which
comprises laws concerning trade, industry and commerce.
It is an ever growing branch of law with the changing circumstances of trade and commerce.
With the increasing complexities of the modern business world, the scope of Mercantile Law has enormously widened.
It is generally understood to include the
laws relating to Contracts, Sale of Goods, Partnership, Companies, Negotiable Instruments, Insurance,
Insolvency, Carriage of Goods, and Arbitration.
Prior to the enactment of the various Acts constituting mercantile law, business transactions were regulated by the personal laws of the parties to the suit. The rights of Hindus and Muslims were governed by their respective laws and usages. Where both parties were Hindus, they were regulated by the Hindu Law and where both parties were Muslims, the Mohammedan Law was applied.
In cases
where one party was a Hindu and the other was
Business Law 2 Self-Instructional Material NOTES a Muslim, the personal law of the
defendant was applied. In case of persons other than Hindus and Muslims, and also where laws and usages of Hindus or Muslims were silent on any point, the courts generally applied the principles of English Law.
Gradually, need for the enactment of a uniform law regulating the contracts was realiszed and this gave birth to the Indian Contract Act, 1872.
Since then a number of statutes have been enacted, viz..
The Negotiable instruments
Act, 1881; The Sale Goods Act, 1930; The Indian Partnership Act, 1932; The Insurance Act, 1938,
etc.
The
main sources of Indian Mercantile Law are as follows: 1.
English Mercantile Law.
The English Mercantile Law constitutes the foundation on which the super-structure of the Indian Mercantile Law

has been built.
Even now, despite the enactment of various statutes relating to matters falling within the purview of the Mercantile Law, our courts generally take recourse to the English Law where some principles are not expressly dealt within an Act, or where there is ambiguity. 2. The Statute Law.
When a Bill is passed by the
Parliament and signed by the President, it becomes an 'Act' or a 'statute'. The
bulk of Indian Mercantile Law is Statute Law.
The Indian Contract Act, 1872: The Negotiable Instruments
Act, 1881; The Sale of Goods Act, 1930; The Indian
Partnership, Act, 1932; The
Companies Act, 1956
are instances of the
Statute Law. 3.
Judicial decisions or Case Law. Judicial decisions are usually referred to as precedents and are binding on all courts having jurisdiction lower to that of the Court which gave the judgement. They are also generally followed even by those of equal jurisdiction in deciding similar points of law. Whenever an Act is silent on a point or there is ambiguity,
the judge has to decide the case according to the principles of justice, equity and good conscience. 4.
Customs and usages. Custom or usage of a particular trade also guides
the courts in deciding disputes arising out of mercantile transactions, but such a custom or usage must be
widely known, certain
and
reasonable, and must not be opposed to any legislative enactment.
But where a statute specifically provides
that the rules of law contained therein are subject to any well recognised custom or usage of trade,
the latter may over-ride the statute law.
The subject matter has been discussed in a simple and intelligible language maintaining clarity and cohesion throughout the book so that even a student without any background of law will be able to understand the otherwise difficult provisions of various legislations covered. A large number of illustrations explain the practical implications of the law. The text unfolds in a lucid manner the intricate points of law and seeks to answer the tricky questions which might intrigue the mind of a curious reader. Section numbers have also been given so that reference may be made to the relevant Act for details. English and Indian Cases have been cited with a view to ensure necessary authenticity and clarity on the subject. Review questions and practical problems along with the hints to solutions thereof have been given at the end of each unit to enable the students to evaluate their understanding of the subject. Review problems illustrate the key points in the text. These have been included to give students an opportunity to apply the provisions discussed in the book to real life situations.
MODULE - 1
Nature and Kinds of Contracts Self-Instructional Material 5 NOTES UNIT 1 NATURE AND KINDSUNIT OF CONTRACTS
Structure 1.0 Introduction 1.1
Unit Objectives 1.2

Test Questions 1.7 Practical Problems 1.0 INTRODUCTION
The law of contract
is the foundation upon which the superstructure of modern business is built. It
is
common knowledge that in business transactions quite often promises are made at one time and the performance follows later. In such a situation if either of the parties were free to go back on its promise without incurring any liability, there would be endless complications and it would be impossible to carry on trade and commerce. Hence the law of contract was enacted which lays down the legal rules relating to promises: their formation, their performance, and their enforceability. Explaining the object of
the law of contract Sir William Anson observes: "
The law of contract is intended to ensure that what a man has been led to expect shall come to pass; that what has been promised to him shall be performed".

The law of contract is applicable not only to the business community, but also to others. Everyone of us enters into a number of contracts almost every day, and most of the time we do so without even realising what we are doing from the point of law. A person seldom realises that when he entrusts his scooter to the mechanic for repairs, he is entering into a contract of bailment; or when he buys a packet of cigarettes, he is making a contract of the sale of goods; or again when he goes to the cinema to see a movie, he is making yet another contract; and so on. Besides, the law of contract furnishes the basis for the other branches of Mercantile Law. The enactments relating to sale of goods, negotiable instruments, insurance, partnership and insolvency are all founded upon the general principles of contract law. That is why the study of the law of contract precedes the study of all other sub-divisions of Mercantile Law. 1.1

UNIT OBJECTIVES ? Understand meaning of the terms 'agreement' and 'contract'. ? Learn the essential elements of a valid contract. ? Be clear about various types of contracts.

THE INDIAN CONTRACT ACT, 1872

The law of contract in India is contained in the Indian Contract Act, 1872. This Act is based mainly on English Common Law which is to a large extent made up of judicial precedents. (There being no separate Contract Act in England). It extends to the whole of India except the State of Jammu and Kashmir and came into force on the first day of September 1872. The Act is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts which deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc. Again the Act does not affect any usage or custom of trade (Sec. 1).

A minor amendment in Section 28 of the Act was made by the Indian Contract (Amendment) Act, 1996.

Scheme of the Act. The scheme of the Act may be divided into two main groups: 1. General principles of the law of contract (Secs. 1–75). 2. Specific kinds of contracts, viz.: (a) Contracts of Indemnity and Guarantee (Secs. 124–147). (b) Contracts of Bailment and Pledge (Secs. 148–181). (c) Contracts of Agency (Secs. 182–238). Before 1930 the Act also contained provisions relating to contracts of sale of goods and partnership. Sections 76–123 relating to sale of goods were repealed in 1930 and a separate Act called the Sale of Goods Act was enacted.

Similarly, Sections 239–266 relating to partnership were repealed in 1932 when the Indian Partnership Act was passed.

Basic assumptions underlying the Act. Before we take up the discussion of the various provisions of the Indian Contract Act, it will be proper to see some of the basic assumptions underlying the Act. These are: 1. Subject to certain limiting principles, there shall be freedom of contract to the contracting parties and the law shall enforce only what the parties have agreed to be bound. The law shall not lay down absolute rights and liabilities of the contracting parties. Instead it shall lay down only the essentials of a valid contract and the rights and obligations it would create between the parties in the absence of anything to the contrary agreed to by the parties. 2. Expectations created by promises of the parties shall be fulfilled and their non-fulfillment shall give rise to legal consequences. If the plaintiff asserts that the defendant undertook to do a certain act and failed to fulfil his promise, an action at law shall lie. 1.3
DEFINITION OF CONTRACT
According to
Section 2 (h) of the
Indian
Contract Act: "An agreement
enforceable by law is a contract."
A contract,
therefore, is
an agreement
the object of which is to create a legal obligation
i.e., a duty enforceable by law.
From the above definition,
we find
that
a
contract essentially consists of two elements: (1) An agreement, and (2)
Legal obligation i.e.,
a duty enforceable by law. We shall now examine these elements in detail. 1.
Agreement.
As per
Section 2(e): "
Every promise and
every set of promises, forming
the
consideration for each other,
is an
agreement."
Thus it is clear
from this definition that a 'promise' is an agreement.
What is a 'promise'? The answer to this question is contained
in
Section 2(b) which
defines
the term: "
When the
person to whom the
proposal
is made signifies his assent
thereto,
the proposal is said to be accepted.
A proposal, when accepted, becomes a promise."
An
agreement,
therefore, comes into existence only when one party
Nature and Kinds of Contracts Self-Instructional Material 7 NOTES
makes a proposal or offer to the other party and that other party
signifies his assent (
i.e., gives his acceptance)
thereto.

In short, an agreement is the sum total of 'offer' and 'acceptance'. On analysing the above definition the following characteristics of an agreement
become evident: (
a) Plurality of persons.
There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself. (
b)
Consensus-ad-idem.
Both
the parties to an agreement must
agree about the subject- matter of the
agreement in the same sense and at the same time. 2.
Legal obligation. As stated above,
an agreement to become a contract must give rise to a legal obligation
i.e.,
a duty enforceable by law.
If an agreement is incapable of creating
a duty enforceable by law, it is not a contract.
Thus
an agreement
is a wider term than
a contract. "
All contracts are agreements but all agreements are not contracts."
Agreements of
moral,
religious or social nature e.g., a promise to lunch together at a friend's house or to take a walk together
are not contracts because they are not likely to create
a duty enforceable by law for the simple reason that the parties never intended that they should be attended by legal consequences. In
business agreements the presumption is usually that the parties intend to create legal relations.
Thus an agreement to buy certain specific goods at an agreed price
e.g., 100 bags of wheat
at Rs 430 per bag is a contract because it gives rise to a duty enforceable by law, and in case
of
default on the part of
either party an action for breach of contract could be enforced through
a court provided other essential elements of a valid contract
as laid down in Section 10 are present,
namely, if the contract was
made by
free consent of the
parties competent to contract, for a lawful consideration and with a lawful object. 1
Thus it
may be concluded that the Act restricts the use of the word 'contract' to only those agreements which give rise to legal obligations between the parties. It will be appropriate to point out here that the law of contract deals only with such legal obligations which spring from agreements. Obligations which are not contractual in nature are outside the purview of the law of contract. For example, obligation to maintain wife and children (status obligation), obligation to observe the laws of the land, and obligation to comply with the orders of a court of law do not fall within the scope
of the Contract Act.
Salmond has rightly observed: "
The law of contracts is
not the whole law
of agreements,
nor is it the whole
law
of obligations. It
is the law of those agreements which create obligations, and

those obligations, which have their source in agreements" 1.4
ESSENTIAL ELEMENTS OF A VALID CONTRACT A contract has been defined in Section 2(h) as "an agreement enforceable by law." To be
enforceable by law, an agreement must possess the
essential elements
of a valid contract as
contained in Sections 10, 29 and 56.
According to Section 10,
all agreements are contracts
if they are
made by
the free consent of
the
parties,
competent to contract,
for a lawful consideration, with a lawful object,
are not expressly
declared
by the
Act to be void, and, where necessary, satisfy the requirements of any law as to writing or attestation or registration.
As the details of these essentials form the subject-matter of our subsequent units, we
propose to discuss them in brief here. 1 For details refer heading
Essential Elements of a Valid Contract.
Nature and Kinds of Contracts 8 Self-Instructional Material NOTES
The essential elements of a valid contract
are as follows: 1.
Offer and acceptance.
There must be a 'lawful offer' and a 'lawful acceptance'
of
the
offer,
thus resulting in an agreement.
The adjective 'lawful' implies that the offer and acceptance must satisfy the requirements
of the Contract Act in relation thereto. 2.
Intention to create legal relations. There must be an intention among the parties
that the agreement should be attached by legal consequences and create legal obligations.
Agreements
of a social or domestic nature do not contemplate legal
relations, and as such they do not give rise to a contract. An agreement to dine at a friend's house is not an agreement intended
to create legal relations and therefore is not a contract. Agreements between husband and wife
also lack the intention to create legal relationship and thus do not result in contracts. Illustrations. (a) M promises his wife N to get her a saree if she will sing a song. N sang the song but M did not bring the saree for her. N cannot bring an action in a Court to enforce the agreement as it lacked the intention to create legal relations. (b) The defendant was a civil servant stationed in Ceylon. He and his wife were enjoying leave in England. When the defendant was due to return to Ceylon, his wife could not accompany him because of her health. The defendant agreed to send her £30 a month as maintenance expenses during the time they were thus forced to live apart. She sued for breach of this agreement. Her action was dismissed on the ground that no legal relations had been contemplated and therefore there was no contract. (Balfour vs Balfour 2) In commercial agreements an intention to create legal relations is presumed.
Thus, an agreement to buy and sell goods intends to create legal relationship, hence is a contract,
provided other requisites of a valid contract are present. But if the parties have expressly declared their resolve that the agreement is not to create legal obligation, even a business agreement does not amount to
a contract. The case of Rose & Frank Co. vs Crompton & Brothers Ltd., 3 provides a good illustration on
the point. Illustration. In the above case R company entered into an agreement with
C Company, by means of which the former was appointed as the agent of the latter. One clause
of
the agreement was as follows: "

This
arrangement is not entered into as a
formal or legal agreement, and shall not be subject to legal jurisdiction in the law
courts".
It
was held that there was no intention to create legal
relations
on the part of parties to the agreement and hence there was no contract. 3.
Lawful consideration. The third essential element of a valid contract is the presence of 'consideration'. Consideration
has been
defined as the price paid by one party for the promise of the other.
An agreement is legally enforceable only when each of the parties to it gives something and gets something.
The something given or obtained
is the price for the promise and is called 'consideration'.
Subject to certain exceptions, gratuitous promises are not enforceable at law.
The 'consideration'
may be an act (doing something) or forbearance (not doing something)
or a
promise to do or not to do something.
It may be past, present or future.
But
only those considerations are
valid which are '
lawful'. The consideration
is 'lawful', unless—
it is forbidden by law; or
is
of such
a
nature that, if permitted
it would defeat
the provisions of any
law;
or
is fraudulent;
or involves or implies injury to the person or property of another;
or is
immoral; or is opposed to public policy (
Sec. 23). 4.
Capacity
of
parties.
The
parties to an agreement must be competent to
contract,
otherwise it cannot be enforced by a court
of law.
In order to be
competent to contract the parties must be
of
the age of
majority and
of sound mind and must not be
disqualified from contracting by any law
to which
they are subject (
Sec. 11). If any of the

parties to the agreement suffers from minority, lunacy, idiocy, drunkenness, etc., the agreement is not 2 (1919), K.B. 571. 3 (1923), 2 K.B. 261.
Nature and Kinds of Contracts Self-Instructional Material 9 NOTES enforceable at law, except in some special cases e.g., in the case of necessaries supplied to a minor or lunatic, the supplier of goods is entitled to be reimbursed from their estate (Sec. 68). 5.
Free consent. Free consent of all the parties to an agreement is another essential element of a valid contract. ' Consent' means that the parties must have agreed upon the same thing in the same sense (Sec. 13). There is absence of 'free consent', if the agreement is induced by (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake (Sec. 14). If the agreement is vitiated by any of the first four factors, the contract would be voidable and cannot be enforced by the party guilty of coercion, undue influence etc. The other party (i.e., the aggrieved party) can either reject the contract or accept it, subject to the rules laid down in the Act.
If the agreement is induced by mutual mistake which is material to the agreement, it would be void (Sec. 20). 6.
Lawful object.
For the formation of a valid contract it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other of the reasons mentioned above the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on prostitution, he cannot recover the rent through a court of law. 7. Writing and registration.
According to the Indian Contract Act, a contract may be oral or in writing.
But in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be in writing and registered (Sec. 25). Similarly, certain other Acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration and Conciliation Act, 1996; (ii) an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882 before they can be legally enforced. 8. Certainty.
Section 29 of the Contract Act provides that " Agreements, the meaning of which is not certain or capable of being made certain, are void."
In

order to give rise to a valid contract the terms
of the agreement must not be vague or uncertain.
It must be possible to ascertain the meaning of the agreement, for otherwise,
it cannot be enforced. Illustration.
A, agrees
to sell B "a
hundred tons
of oil."
There is nothing whatever to show
what kind of oil was intended.
The agreement is void for uncertainty. 9.
Possibility of
performance. Yet another essential feature of a valid contract is that it must be capable of performance. Section 56
lays
down
that "
An
agreement to do an act impossible in itself
is void".
If
the act is impossible in itself, physically or legally, the agreement
cannot be enforced at law.
Illustration.
A, agrees with B, to discover treasure by magic. The agreement
is
not enforceable. 10.
Not expressly
declared
void. The agreement must not have been expressly declared
to be void
under the
Act.
Sections 24–30 specify certain
types of agreements which have been expressly declared
to be void.
For example, an
agreement in restraint of marriage, an agreement in restraint of trade, and an agreement by way of wager
have been expressly declared void under Sections 26, 27 and 30 respectively. Before dealing with the various essentials of a valid contract one by one in detail, it will be appropriate to discuss the 'kinds of contracts', first, because we shall be using the terms like 'voidable contract', 'void contract', 'void agreement', etc., very often in the course of our discussion.
Nature and Kinds of Contracts 10 Self-Instructional Material NOTES 1.5 KINDS OF CONTRACTS 1.5.1 Kinds of Contracts from the Point of View
of Enforceability From the point of view of enforceability a contract may be valid
or voidable or void or unenforceable or illegal. 1.
Valid contract. A valid contract is an agreement enforceable by law.
An agreement
becomes enforceable by law when all the essential elements of a valid contract as enumerated above are present. 2.
Voidable contract.
According to
Section 2(i), "
an agreement which is enforceable by law at the
option of one or
more
of the parties thereto,
but not
at the option of the other or others, is a voidable contract."
Thus, a

voidable contract
is
one
which
is enforceable
by
law at the option of
one
of the parties.
Until it
is avoided or rescinded by
the party entitled to do so
by exercising his option in that behalf, it is a valid contract.
Usually
a
contract becomes voidable when
the consent of one of the parties to the contract
is obtained by coercion, undue influence, misrepresentation
or fraud.
Such
a
contract is voidable at the option of the aggrieved party
i.e., the party
whose consent was so
caused (
Secs. 19 and 19A).
But the aggrieved party must exercise his option of rejecting the contract (i) within a reasonable time,
and (ii)
before the rights of third parties intervene, otherwise the contract cannot be repudiated. Illustrations. (a)
A, threatens to shoot B if he does not
sell his new Bajaj scooter to A for
Rs 2.000, B
agrees.
The contract has been brought about by coercion
and is voidable at the option of B. (b)
A,
intending to deceive B, falsely represents that five hundred
quintals of indigo are made annually at A's factory,
and thereby induces B to buy the factory. The contract
has been caused by fraud and is voidable at the option of B. Other circumstances under which a contract becomes
voidable. The Indian Contract Act has laid down certain other situations also under which a contract becomes voidable.
For example, (i)
When a contract contains reciprocal promises, and one party to
the contract
prevents the other from performing his promise, then
the contract becomes voidable at the option of the
party
so prevented (
Sec. 53). Illustration. A, contracts with B that A shall whitewash B's house for Rs. 100. A,
is ready and willing to execute the work accordingly,
but
B
prevents him from doing so. The contract becomes voidable at the option of
A. (
ii)
When a party to the contract promises to do a certain thing
within a specified time, but fails to do it,

then the contract
becomes voidable at the option of the
promisee,
if
the intention of the parties was that time should be of
the
essence of the contract (
Sec. 55). Illustration. X, agrees to sell and deliver 10 bags of wheat to Y for Rs. 2,500 within one week. But X does not supply the wheat
within the specified time. The contract becomes voidable at the option of
Y.
Consequences of rescission of voidable contract. Section 64 lays down the rights and obligations of the parties to a voidable contract after it is rescinded. The Section states that
when a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is
a promisor. If
the party rescinding a voidable
contract has received any benefit
from another party to such contract,
he must
restore such benefit, so far as may be, to the person from whom it was received.
For example, when a contract for the sale of a house is avoided on the ground of undue influence, any money received on account of the price must be refunded. Notice that the Section aims at placing both the parties to a voidable contract, after its rescission, on the same footing as for there had been no contract at all. But it must be remembered that the
Nature and Kinds of Contracts Self-Instructional Material 11 NOTES benefit which is to be restored must have been received under the contract. If an amount has been received as a security for the due performance of the contract, such earnest money deposit is not to be returned if the contract becomes voidable under Section 55 on account of the promisor's failure to complete the contract at the time agreed and has been rescinded by the promisee because it is not a benefit received under the
contract. 3. Void contract. Literally the word 'void' means 'not binding in law'.
Accordingly the term 'void contract' implies a useless contract which has no legal effect at all. Such a
contract is a nullity, as for there has been no contract at all.
Section 2(j) defines: "
A contract which ceases to
be enforceable by law becomes void, when it
ceases to be enforceable."
It
follows from the definition that a void contract is not void from its inception
and that it
is valid and binding on the parties when originally entered but subsequent to its formation it becomes
invalid and destitute of legal effect because of certain reasons. The reasons which transform a valid contract into a void contract, as given in the Contract Act, are as follows: (a) Supervening
impossibility (Sec. 56). A contract becomes void by impossibility of performance after
the formation
of
the contract.
For
example,
A and B contract to marry each other. Before the
time fixed for the marriage, A goes mad. The contract
to marry becomes void. (b)
Subsequent illegality (Sec. 56).
A contract also becomes void by subsequent illegality.
For
example, A agrees to sell B 100 bags of wheat at Rs. 650 per bag.
Before delivery, the

Government bans private trading in wheat. The contract becomes void. (c) Repudiation of a voidable contract.
A voidable contract becomes void, when the party, whose consent is not free, repudiates the contract. For example, M by
threatening to murder B's son, makes B agree to sell his car worth Rs 30,000 for a sum of Rs 10,000 only. The contract, being the result of coercion, is voidable at the option of B. B may either affirm or reject the contract. In case B decides to rescind the contract, it becomes void. (d) In the case of a contract contingent
on the happening of an uncertain future event, if that event becomes impossible.
A contingent contract to do or not to do something
on the happening of an
uncertain future event, becomes void, when the event becomes impossible (Sec. 32) For example, A contracts to give Rs 1,000 as loan to B,
if
B marries C. C dies without being married to B. The contract becomes
void.
Void agreement. "
An agreement not enforceable by law is said to be void" [
Sec. 2 (g)].
Thus, a void
agreement does
not
give rise to any legal consequences and is void
ab-initio.
In the eye of law such an agreement is no agreement at all from its very inception.
There is absence of one or more essential elements of a valid contract,
except that of 'free consent,' in
the case of a void agreement. Thus, an agreement with a minor is void ab-initio
as against him, because a minor lacks the capacity to contract. Similarly, an agreement without consideration is void ab-initio, of course with certain exceptions as laid down in Section 25. Certain agreements have been expressly declared void in the Contract Act e.g., agreements which are in restraint of trade or of marriage or of legal proceedings or which are by way of wager.
A 'void agreement' should be distinguished from a 'void contract'.
A 'void agreement' never amounts to a contract as it is void ab-initio. A 'void contract' is valid when it is entered into, but subsequent to its formation something happens which makes it unenforceable by law. Notice that a contract cannot be void ab-initio and only an agreement can be void ab-initio.
Obligation of person who has received advantage under void agreement or contract that becomes void.
In this connection Section 65 lays down
that
when an agreement is discovered to be void or when a contract
becomes void, any person who has received any
advantage under such agreement or contract is bound to restore it, or to make compensation
Nature and Kinds of Contracts 12 Self-Instructional Material NOTES
for it, to the person from whom he received it.
Thus, this Section provides for restitution of the benefit received;
so that both parties may stand unaffected by the transaction; in the following two cases: (a)
When an agreement is discovered to be void. In other words, when an agreement is void ab-initio but the fact of its being void being discovered
at a later stage. For example, A pays B Rs. 1,000 for
B's agreeing to sell his horse to him.
It turns out
that the horse was dead at the time of
the
bargain, though neither party was aware of the fact.
In this case the agreement is
discovered to be void and B must repay to A

Rs 1,000. It should, however, be noted that agreements which are known to be void or illegal, when they are entered into, are excluded from the purview of this Section. Thus, if L pays Rs 10, 000 to M to murder Z, the money cannot be recovered. Similarly, nothing can be recovered in the case of expressly declared void agreements, of course, subject to the following exceptions: (i) in the case of an agreement caused by bilateral mistake of essential fact (although it is expressly declared void under Section 20) restitution is allowed as it comes under the category of 'an agreement discovered to be void'. (ii) in the case of an agreement with a minor who commits fraud by misrepresenting his age (although agreement with a minor is known to be void) restoration is allowed in specie on equitable grounds because a minor cannot be allowed to cheat people, and also because the other party has not lost his title to the thing in question.
(b) When a contract becomes void. Restitution is also allowed in the case of a void contract.
For example, A agrees to sell B after one month 10 quintals of wheat at Rs 625 per quintal and receives Rs. 500 as advance. Soon after the
contract, private sales of wheat are prohibited by an Act of the legislature. The contract becomes void but A must return the sum of Rs. 500 to B. Similarly, where after accepting Rs 1,000 as advance
for singing at a concert for B, A is too ill to sing. A is not bound to make compensation to B for the loss of the profits which B would have made if A
would have been able to sing, but A must refund to B the 1,000 rupees paid in advance. 4. Unenforceable contract. An unenforceable contract is one which is valid in itself, but is not capable of being
enforced in a court of law because of some technical
defect such as absence of writing,
registration, requisite stamp, etc.,
or
time barred by the law of limitation.
For example, an oral arbitration agreement is unenforceable because the law requires an arbitration agreement to be in writing.
Similarly, a bill of exchange or promissory note, though valid in itself, becomes unenforceable after three years from the date the bill or note falls due, being time barred under the Limitation Act. 5.
Illegal or unlawful
contract. The word 'illegal' means 'contrary to law'
and the term 'contract' means 'an agreement enforceable by law.'
As such to speak of an 'illegal contract' involves a contradiction in terms, because it means something like this—an agreement enforceable by law and contrary to law. There is apparent contradiction in terms. Moreover, being of unlawful nature, such an agreement can never attain the status of a contract. Thus,
it will be proper if we
use the term 'illegal agreement' in place of 'illegal contract'. An illegal agreement is
void ab-initio.
An agreement is illegal and void
if its object or consideration: (
a)
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;
or (
e)
the court regards it as
immoral, or opposed to public policy (
Sec. 23).
Thus,

an agreement to commit murder or assault or robbery or to make a gift in consideration of illicit intercourse would be illegal and void ab-initio. Illegal and void agreements distinguished. Despite the similarity between an illegal and a void agreement that in either case the agreement is void ab-initio and cannot be enforced by law, the two differ from each other in the following two respects:
Nature and Kinds of Contracts Self-Instructional Material 13 NOTES (i) An illegal agreement is narrower in scope than a void agreement. ' All illegal agreements are void but all void agreements are not necessarily illegal.' The object or consideration of an agreement may not be contrary to law but may still be void. For example, an agreement with a minor is void as against him but not illegal. Again, an agreement the terms of which are uncertain is void but such an agreement is not illegal. (ii) An illegal agreement is wider in effect in relation to collateral transactions than a void agreement. When an agreement is illegal, other agreements which are incidental or collateral to it are also tainted with illegality, hence void, provided the third parties have the knowledge of the illegal or immoral design of the main transaction. The reason underlying this rule is that no person shall be allowed to invoke the aid of the court if he is himself implicated in the illegality. On the other hand, when an agreement is void (but not illegal), agreements which are collateral to it are not invalidated and remain valid. Illustrations, (a) A engages B to murder C and borrows Rs 5,000 from D to pay B. D is aware of the purpose of the loan. Here the agreement between A and B is illegal and the agreement between A and D is collateral to an illegal agreement. As such the loan transaction is illegal and void and D cannot recover the money.
But the position will change if D is not aware of the purpose of the loan. In that case the loan transaction is not collateral to the illegal agreement and is a valid contract. (b) In the above case if A borrows from D to pay his wagering debts (a wagering agreement is void under Section 30), the contract between A and D would not have been affected, even though D is aware of the purpose of the loan because an agreement collateral to avoid agreement is perfectly valid. 1.5.2 Kinds of Contracts from the Point of View of Mode of Creation From the point of view of mode of creation a contract may be express or implied or constructive. 1. Express contract.
Where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, it is an express contract. For example, A tells B on telephone that he offers to sell his car for Rs 20,000 and B in reply informs A that he accepts the offer, there is an express contract. 2. Implied contract.
Where both the offer and acceptance constituting an agreement enforceable at law are made otherwise than in words i.e., by acts and conduct of the parties, it is an implied contract. Thus, where A, a coolie in uniform takes up the luggage of B to be carried out of the Railway station without being asked by B, and B allows him to do so, then the law implies that B agrees to pay for the services of A, and there is an implied contract.
Similarly, where M, a professional shoe shiner starts polishing the shoes of N without being requested to do so, and N allows M to polish his shoes knowing that M expects to be paid for the service, there comes into existence an implied contract and N is under obligation to pay to M. It is relevant to state that in respect of mode of creation, certain contracts may be a mixture of the 'express' and 'implied' types of contracts,

that is, where out of the two components of an agreement, namely, offer and acceptance, one is expressed in words and the other is implied from acts and circumstances. Such contracts may be called as contracts of mixed character. For example, A offers to buy B's scooter for Rs 4,000 and B accepts the offer by sending the scooter itself. Here A's offer is expressed in words and B's acceptance is implied from his conduct. It is a contract of mixed character. 3. Constructive or quasi contract. The term 'constructive or quasi contract' is a misnomer. The cases grouped under this type of contracts have little or no affinity with
contract. Such a contract does not arise by virtue of any agreement, express or implied between the parties but the law infers or recognises a contract under certain special circumstances. For example, obligation of finder of lost goods to return them to
the true owner or liability of
Check Your Progress State whether the following are True or False: 1.
Law of contracts is not the whole law of agreements. 2.
An agreement of social nature is not
a contract. 3. A void contract is one which is void ab-initio. 4.
All void
agreements are not necessarily illegal. 5. Collateral transactions to an illegal agreement are not
void.
Nature and Kinds of Contracts 14 Self-Instructional Material NOTES
person to whom money is paid under mistake to repay it back
cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent, but these are very much covered under quasi contracts as per Sections 71 and 72 respectively. The Contract Act has rightly named such contracts as "certain relations resembling those created by contract".
A quasi contract is based upon
the equitable
principle
that a person shall not be allowed to retain unjust benefit at the expense of another.
Sections 68–72 of the Contract Act describe the cases which are to be deemed 'quasi contracts'. 1.5.3
Kinds of Contracts from the Point of View of the Extent of Execution From the point of view of the extent of execution a contract may be executed or executory. 1. Executed contract. A contract is said to be
executed when both
the parties to a contract have completely performed their share of obligation and nothing remains to be done by either party under the contract.
For example, when a bookseller sells a book on cash payment it is an executed contract because both the parties have done what they were to do under the contract. Where only one of the parties to a contract has performed his share of obligation and the other party is still to perform his share of obligation, then also the contract is called 'executed'. For example, M advertises a reward of Rs 1,000 to anyone who finds his missing son. B knowing the offer finds the missing boy and brings him. As soon as B traces the boy, there comes into existence an executed contract because B has performed his share of obligation and it remains for M to pay the amount of reward to B. This type of executed contracts are also called Unilateral Contracts because in such contracts only one obligation remains outstanding, the other obligation having being performed at the time of or before the formation of the contract. 2. Executory contract. It is one in which both the obligations are outstanding, one on either party to the contract, either wholly or in part,
at the time of the formation of the contract. In
other words, a contract is said to be executory when either both the parties to a contract
have still to perform their share of obligation in toto or there remains something to be done under the contract on both sides.
For example, where T agrees to coach R, a pre-medical student,
from First day of the next month and R in consideration promises to pay T Rs 500 per month, the contract is executory because it is yet to be carried out.
Similarly, where M promises to sell his car to N for Rs 10,000 cash down, but N pays only Rs 1,000 as earnest money and promises to pay the balance on next Sunday. On the other hand, M gives the possession of car to N and promises to execute a sale deed on receipt of the full amount. The contract between M and N is executory because there remains something to be done on both sides. Executory contracts are also known as Bilateral Contracts. 1.6 TEST QUESTIONS 1. "
An agreement enforceable by law is a contract." Discuss the
definition and bring out clearly
the essentials of a valid
contract. 2. "
All contracts are agreements, but all agreements are not

contracts."
Discuss the
statement explaining the essential elements
of a
valid contract. 3. "
The law of contracts
is not the whole law of agreements,
nor is it the whole law of obligations" (
Salmond). Comment. 4. Discuss
the essential elements of a valid contract. 5. What do you understand by the
terms 'void' and 'voidable' contracts? Discuss the rights and obligations of the parties to a void contract and to a voidable contract after its rescission.
Nature and Kinds of Contracts Self-Instructional Material 15 NOTES 6. Distinguish between: (a) Void and voidable contracts. (b) Void agreements and void contracts. (c) Void and Illegal agreements. 7.
Write short notes on: (a) Implied contract (b) Quasi contract (c) Executed contract, and (d) Bilateral contract. 1.7 PRACTICAL PROBLEMS Attempt the following problems, giving reasons
for your answers: 1.
A invites B to a dinner. B accepts the invitation.
A made elaborate arrangement but B
failed to turn up. Can A sue B for the
loss he has suffered? [Hint. No, A cannot sue B for the loss he has suffered because the agreement was of a social nature and hence lacked the intention to create legal relationship — one of the essentials of a valid contract.] 2. M agrees to pay N Rs 100 and in consideration N agrees to write for him 100 pages within five minutes. Is it a valid contract? [Hint. No, it is not a valid contract. It is a void agreement because
as per
Section 56 "
an
agreement to do an act impossible in itself is void."]
Offer and Acceptance Self-Instructional Material 17 NOTES UNIT 2 OFFER AND ACCEPTANCE Structure 2.0 Introduction 2.1 Unit Objectives 2.2 The Proposal or Offer 2.3 The Acceptance 2.4 Contracts Over the Telephone 2.5 Test Questions 2.6 Practical Problems 2.0 INTRODUCTION While discussing the essential elements of a valid contract in the preceding unit we observed that as a first step in the making
of
a contract there must be a 'lawful offer' by one party and a 'lawful acceptance' of the offer
by the other party.
Thus where A, offers to sell a wrist watch to B for Rs. 200 and B accepts
the offer, a contract comes into being provided other essentials of a valid contract like that of competency of parties to contract, etc., are present. We propose to discuss in this unit the legal rules relating to a 'lawful offer' and a 'lawful acceptance'. 2.1 UNIT OBJECTIVES ? Understand the concept of offer and be clear about rules regarding a valid offer. ? Understand the concept of acceptance and note the rules of valid acceptance. ? Understand the rules of communication of offer, acceptance and revocation. ? Be aware of the position of contracts over the telephone. 2.2 THE PROPOSAL OR OFFER
The words 'proposal' and 'offer' are synonymous and are used interchangeably.
Section 2(a)
of the Indian Contract
Act
defines
a '
proposal'
as, "
when one person
signifies to another his willingness to do or
to
abstain from doing anything,
with a view
to obtaining the assent of that other to such act or abstinence,
he is said to

make
a proposal".
This
definition
reveals the following
three
essentials of
a 'proposal': (i)
It must be an expression of the
willingness to do or
to abstain from doing
something. (
ii) The
expression of willingness to do or
to abstain from doing something
must be to another person.
There can be no '
proposal' by a person to himself. (
iii)
The
expression of willingness
to do or to abstain from doing
something
must
be
made
with a view to obtaining the assent of
the
other
person
to such act or abstinence.
Thus a casual enquiry — "Do you intend to sell your motorcycle?" — is not a 'proposal'. Similarly, a mere statement of intention — "I may sell my motorcycle if I can get Rs 14,000 for it" — is not a 'proposal'. But if M says to N, "Will you buy my motorcycle for Rs 14,000," or "I am willing to sell my motorcycle to you for Rs 14,000," we have a 'proposal' as it has been made with the object of obtaining the assent of N.
Offer and Acceptance 18 Self-Instructional Material NOTES
The person making the 'proposal' or '
offer'
is called the 'promisor' or '
offeror',
the person to whom
the offer is made is called the '
offeree,'
and
the person
accepting the offer is called the '
promisee' or '
acceptor'. 2.2.1
Legal Rules Regarding a Valid Offer A valid offer must be in conformity with the following rules: 1.
An offer may be '
express' or 'implied'. An offer may be made either by words or by conduct.
An offer which is expressed by words, spoken or written, is called an 'express offer'
and
the
one which
is
inferred from the conduct of a person or the circumstances of the

case
is
called an 'implied offer'. Illustrations. (a) M says to N that he is
willing
to sell his motorcycle to him for Rs 20,000. This is
an express offer. (b) X writes to Y that he offers to sell his house to him for Rs 80,000. There is an express offer. (
c) The
Delhi Transport Corporation runs omnibuses on different routes to carry passengers at the scheduled fares. This is an implied offer by the D.T.C. (d) A shoe shiner starts shining some one's shoes, without being asked to do so, in such circumstances that any reasonable man could guess that he expects to be paid for this, he makes an implied offer. 2. An
offer
must contemplate to give rise to legal consequences and be capable of creating
legal
relations. If the offer does not intend to give rise
to legal consequences, it is not
a valid offer
in the eye of law.
An offer to a friend to dine at
the offeror's place,
or
an offer to one's wife to show her a movie
is not a valid offer and
as such cannot give rise to a binding agreement,
even though it is accepted and there is consideration, because in social agreements or domestic arrangements the presumption is that the parties do not intend legal consequences to follow the breach of agreement.
But
in the case of agreements regulating business transactions the presumption is just the
other way. In business agreements it is taken for granted that parties intend legal consequences to follow. Even in the case of a business agreement if the parties agree that the breach of the agreement would not confer on either of the parties a right to enforce the agreement in a court of law, there is no contract (Rose & Frank Co. vs Crompton & Brothers Ltd. 1). 3.
The
terms of the
offer must be certain and not loose or vague.
If the terms of
the offer are
not definite and certain, it does not amount to a lawful offer.
Maugham L.J. has rightly observed: "
Unless all the material terms of the contract are agreed, there is no binding obligation." Thus an agreement to agree in future is not
a contract,
because
the terms of agreement are uncertain as they are yet to be settled.
Illustrations. (a)
X purchased a horse from Y and promised to buy another, if the first one proves lucky. X refused to buy the second horse. Y could not enforce the agreement, it being loose and vague (Taylor vs Portington). 2 (b) A offers to B lavish entertainment, if B does a particular work for him. A's offer does not amount to lawful offer being vague and uncertain. 4.
An invitation to offer is not an
offer. An offer must be distinguished from an 'invitation to
receive offer'
or
as it is sometimes expressed in judicial language
an 'invitation to treat.' In the
case of an 'invitation to receive offer' the person sending out the invitation
does not
make an offer but only invites the other party to make an offer.

His object is merely to circulate information that he is willing to deal with anybody who, on such information, is willing to open negotiations with him. Such invitations for offers are therefore not offers
in the eye of law and do not become agreements by their acceptance. We may give some examples of them here: 1 (1923), 2 K.B. 261. 2 (1855), 44 E.R. 128.
Offer and Acceptance Self-Instructional Material 19 NOTES (a)
An advertisement for sale of goods by auction does not
amount to an offer to hold such sale. It merely invites offers. Actual bids made at the auction are 'offers', each higher bid superseding the previous one,
and when the hammer falls on the highest bid, there is
an acceptance and the contract becomes complete. An advertisement for an auction sale does not even bind the auctioneer to hold the auction and the prospective bidders have no legal right to complaint if they have wasted their time and money in coming to the advertised place of the auction sale (Harris vs Nickerson 3). (b) Quotations, catalogues of prices or display of goods with prices marked thereon
do not constitute an offer.
They are instead an invitation
for offer and hence if a customer asks for goods or makes an offer, the shopkeeper is free to accept the offer or not. While explaining the logic behind the aforesaid rule. Lord Herschell has made an interesting observation in Grainger & Son vs Gough 4 . "The transmission of such a price-list does not amount to an offer to supply an unlimited quantity of the wine described at the price named, so that as soon as an order is given there is a binding contract to supply that quantity. If it were so, the merchant might find himself involved in any number of contractual obligations to supply wine of a particular description which he would be quite unable to carry out, his stock of wine of that description being necessarily limited." Illustration. There is a 'self service system' in a shop. A customer selects the
goods and takes them to the cashier for payment of the price.
The cashier totals the price and accepts the amount. The contract, in this case is
made, not when the
customer selects the goods, but when the cashier accepts the offer
by accepting the payment. The selection of goods by the customer constitutes an implied offer' to buy goods and the acceptance of payment by the cashier constitutes 'acceptance' of the
offer. [Pharmaceutical Society of Great Britain vs Boots Cash Chemists (Southern), Ltd.] 5 (
c)
A notice
that goods will be sold by 'tender' does not amount to an offer. It is
only an attempt to ascertain whether an offer can be obtained within such a margin as the seller is willing to adopt (Spencer vs Harding) 6 . The tenderers by submitting their tenders make offers and it is for the party inviting tenders to accept them or not. 5.
An offer may be 'specific' or "general'. An offer is said to
be 'specific'
when it
is
made to a
definite person or persons. Such
an
offer can be accepted only by
the person or persons to whom it is made.
Thus, where M makes an offer to N to sell his bicycle for Rs 200, there is a specific offer and N alone can accept it. A 'general offer',
on the other hand,
is one which
is made to the world at large
or public in general and
may be accepted by any person who fulfils the requisite conditions.
The
leading case
on the subject of 'general offer' is that of Carlill vs Carbolic Smoke Ball Co. 7
Illustration. In the above
case the Carbolic Smoke Ball Co., issued an advertisement in which the Company offered to pay £ 100 to any person who contracts influenza, after having used their Smoke Balls three times daily for two weeks,

according to
the printed directions.
Mrs Carlill, on the faith of the advertisement, bought and used the Balls according to the directions, but she nevertheless subsequently suffered from
influenza. She sued the company for the promised reward. The company was held liable.
Offers of reward made by way of advertisement, addressed to the public at large, for the rendering of certain services, or the restoration of lost article are also examples of general offers. Such offers may be accepted by performance of the conditions by an individual person in order to give rise to a contractual obligation to pay the reward. It is worth noting that there cannot be a contract with the public at large and as such a general offer cannot result into a contract until it has been accepted by an ascertained person. If a large number 3 (1873), L.R. 8 Q.B. 286. 4 (1896), A.C. 325. 5 (1952), 2 All. E.R. 456. 6 (1870), L.R. 5 C.P. 561. 7 (1893), 1 Q.B. 256.
Offer and Acceptance 20 Self-Instructional Material NOTES of persons accepted a general offer, there would be an equal number of separate contracts. Again, it is only the general offers of continuing nature, as it was in the Smoke Ball Company case discussed above, which can be accepted by a number of persons. In case of general offer of reward for some information or restoration of a missing thing, the offer is open for acceptance to
only one individual who performs the required condition first of all, and as soon as the condition is first performed the offer is closed. 6.
An
offer must be communicated to the offeree.
An offer is effective only when it is communicated to the offeree.
Until the offer is
made known to the offeree, there can be no acceptance
and no contract. Doing anything in ignorance of the offer can never be treated as its acceptance, for, there was never a consensus of wills. This applies to both 'specific' and 'general' offers. Illustrations. (a) A, without knowing that a reward has been offered for the arrest of a particular criminal, catches the criminal and gives the information to the superintendent of police. A, cannot recover
the reward as he cannot be said to have accepted the offer when he was not
at all aware of it. (b) In Lalman Shukla vs Gauri Datt, 8 the defendant's nephew absconded from home. He sent his servant, the plaintiff,
in search of the boy. After the servant had left, the defendant announced a reward of Rs 501 to anybody giving information
relating to
the boy. The servant, before seeing the announcement, had traced the boy and informed the defendant. Later, on reading the notice of reward, the servant claimed it. His suit was dismissed on the ground that he could not accept the offer,
unless he had knowledge of it. Communication of special terms. Regarding the communication of the special terms of the contract as contained in a ticket, receipt, or 'standard form documents', the more important rules adopted by the courts are as follows: (i) If the acceptor or the promisee had no knowledge of special terms, before or at the time of the contract, they are not binding upon the acceptor. Illustration. In Handerson vs Stevenson, 9 the plaintiff bought a steamer ticket which bore on its face the words: 'Dublin to Whitehaven.'
On the back of the ticket certain special terms were printed one of
which excluded the liability of the company for loss, injury or delay to the passenger or
his luggage.
The plaintiff never looked at the back of the ticket and no one told him to do so, and the front of the ticket bore no reference to the back. The plaintiff's luggage was lost in the shipwreck
caused by the fault of the company's servants. He claimed damages for its loss. It was held that
the plaintiff was entitled to recover his loss from the company as there was not sufficient communication of the terms and conditions contained on the back of the ticket. (ii) If the acceptor or the promisee had the knowledge or may be presumed to have the knowledge; because a reasonably sufficient notice has been given to him by suitable words on the document; of special terms, before or at the time of the contract, the terms are binding upon the acceptor whether he has read them or not is immaterial. The leading case on the point is Parker vs South Eastern Railway Co. 10 Illustration. In the above case P deposited his bag at the cloak-room at a railway station and received a ticket containing on its face the words, 'see back'. On the back of the ticket there was a condition that, "the company will not be responsible for any package exceeding the value of £ 10 unless extra charge was paid". A notice to the same
effect was hung up in the cloak-room. P's bag was lost
and he claimed the actual value of the lost bag, £ 24 Sh. 10.

P, admitted knowledge of the printed matter on the ticket, but denied having read it. It was held that, even though he had not read
the exemption clause, he was bound by it,
as the defendants had done what was reasonably sufficient to give him notice of its existence,
and therefore P was entitled to recover only £ 10. 8 (1913), 11 All. L.J. 389. 9 (1875), 32 L.T. 709. 10 (1877), 2 C.P.D. 416.
Offer and Acceptance Self-Instructional Material 21 NOTES Again,
where the terms are printed in a language which the acceptor does not understand,
he cannot set up this fact as a reason for not being bound by the terms, provided his attention is drawn to them by suitable words on the document. It is the acceptor's duty to ask for a translation of the terms before he actually accepts the offer and if he did not ask, he must suffer for his ignorance (MacKillican vs The Compagnie Marikcmas de France 11).
Similarly, the acceptor cannot plead that he was illiterate or blind,
provided the notice is reasonably sufficient for the class of persons to which he belongs (
Thompson vs L.M. & S. Railway Co. 12). It is important to note that the special terms and conditions become binding as part of the contract only if they
are
brought to the notice of the acceptor before or at the time of
contract.
A subsequent communication will not bind the contracting party unless he has assented thereto. The facts of Olley vs Marlborough Court Ltd. 13 case provide a good illustration on the point. Illustration. In the above case Olley
and her husband hired a room at a hotel and paid for a week's board and lodging
in advance. When they went to occupy the room there was a notice on one of the walls which contained the clause; ' The proprietors will not hold themselves responsible for articles lost or stolen, unless handed to the manageress for safe custody'. Owing to
the negligence of the hotel staff, a thief entered the room and stole
some of their property. The owner of the hotel was held liable since the notice formed no part of the contract
as it came to the knowledge of the plaintiff after the contract had been entered into.
Finally, we must note that even where adequate notice of the terms and conditions in a document has been given, the doctrine of fundamental breach and strict construction protects the contracting party from the unreasonable consequences of wide and sweeping exemption clauses. Thus a dry-cleaner's terms that he will pay only eight times the amount of cleaning charges, for any damage to or loss of garments has been held to be unreasonable (M. Siddalingappa vs T. Nataraj). 14 7.
An
offer should
not contain a term the non-compliance of which
would amount to acceptance.
Thus an offeror cannot say that if acceptance is not communicated
up to a certain date, the offer would be presumed to have been accepted. If the offeree does not reply, there is no contract, because no obligation to reply can be imposed on him, on the grounds of justice. 8.
An
offer can be made subject to any terms and conditions.
An
offeror may attach any terms and conditions to the offer he makes. He may even prescribe the mode of acceptance. The offeree will have to accept all the terms of the offer.
There is no contract, unless all the terms of the offer are complied with and accepted in the mode prescribed.
As regards mode of acceptance, it must be noted that in case of deviated acceptance, for example, if the offeror asks for sending the acceptance 'by telegram' and the offeree sends the acceptance 'by post', the offeror may decline to treat that acceptance as valid acceptance
provided he gives a notice to that effect to the offeree
within a reasonable time after the
acceptance is communicated to him. If he does not inform the offeree as to this effect, he is deemed to have accepted the
deviated acceptance (
Sec. 7). 9.
Two identical cross-offers do not make a contract.
When two parties make identical offers
to each other,
in ignorance of each other's offer,

the
offers are '
cross-offers'. '
Cross-offers' do not constitute acceptance of one's offer by
the other
and as such
there is no completed agreement. Illustration. On 15 October, 1989
A wrote to B offering to sell him 100 tons of iron at Rs 8,800 per ton. On the same day, B wrote to A offering to buy 100 tons
of iron at Rs 8,800 per ton. The letters 11 (1880), 6
Cal. 227. 12 (1930), 1 K.B. 41. 13 (1949), 1 K.B. 532. 14 (1970), A.I.R. Mys. 154.
Offer and Acceptance 22 Self-Instructional Material NOTES crossed in the post.
There is no concluded contract between A and B, because the
offers were simultaneous, each being made in ignorance of the other, and there is no acceptance of each other's offer.
2.2.2 Lapse and Revocation
of Offer An offer lapses and becomes invalid (i.e., comes to an end) in the following circumstances: 1. An offer lapses
after stipulated or reasonable time. An offer lapses if acceptance is not communicated
within the time prescribed in the offer,
or if no time is prescribed,
within
a reasonable time [
Sec. 6 (2)].
What is a
reasonable time
is a question of fact
depending upon the circumstances of each case.
For example, an offer made by telegram suggests that a reply is required urgently and if the offeree delays the
communication of his acceptance even by a day or two, the offer will be considered to have lapsed.
Illustration. In Ramsgate Victoria Hotel Co. vs Montefiore, 15 an application for allotment of shares was made on 8 June.
The applicant was informed on the 23 November that shares were allotted to him. He refused to accept them. It was
held that his offer had lapsed by reason of the delay of the company in notifying their acceptance, and that he was not
bound to accept the shares. 2.
An offer lapses by not being
accepted in the mode prescribed, or if no mode is prescribed, in some usual and reasonable manner.
But, according to Section 7, if the offeree does not accept the offer according to the mode prescribed, the offer does not
lapse automatically. It is for the offeror to insist that his proposal shall be accepted only
in the prescribed manner, and if he fails
to do so he
is deemed to have
accepted the
acceptance. 3. An offer lapses
by rejection. An offer lapses if it has been rejected by the offeree. The rejection
may be express
i.e., by words spoken or written, or implied.
Implied rejection is one: (a) where either
the offeree makes a counter offer, or (b) where the offeree gives a conditional acceptance.
Illustrations. (i) A
offered to sell his house to B for Rs 90,000. B offered Rs 80,000 for which price
A refused to sell. Subsequently B offered to purchase the house for Rs 90,000. A,
declined to adhere to his original offer. B filed a suit to obtain specific performance of the alleged contract. Dismissing
the suit, the court held that
A
was justified because no contract had come into existence, as
B, by offering Rs 80,000, had rejected the original offer. Subsequent willingness to pay Rs 90,000 could be no
acceptance of A's offer as there was no offer to accept. The original offer had already come to an end on account of
'counter offer' (Hyde vs Wrench). 16 (
ii)

A, offered to sell his motorcar to B for Rs 25,000. B said that he accepted the offer if he was appointed as General Manager of A's factory. B's acceptance is a 'conditional acceptance' which amounts to rejection of A's offer and there is no contract.

It is worth noting that a rejection is effective only when it comes to the knowledge of the offeror. For example, C makes an offer to D by letter. Immediately on receiving the letter D writes a letter rejecting the offer. Before the rejection reaches C, D changes his mind and telephones his acceptance. There would be a contract between C and D and the rejection shall not be effective. 4.

An offer lapses by the death or insanity of the offeror or the offeree before acceptance.

If the offeror dies or becomes insane before acceptance, the offer lapses provided that the fact of his death or insanity comes to the knowledge of the acceptor before acceptance [Sec. 6 (4)]. From the language of the Section, it may be inferred that an acceptance in ignorance of the death or insanity of the offeror, is a valid acceptance, and gives rise to a contract.

Thus the fact of death or insanity of the offeror would not put an end to the offer until it comes to the notice of the acceptor before acceptance.

An offeree's 15 (1866), L.R. 1 Ex. 109. 16 (1840), 3 Beav. 334.

Offer and Acceptance Self-Instructional Material 23 NOTES

death or insanity before accepting the offer puts an end to the offer and his heirs cannot accept for him (Reynolds vs Atherton). 17 5. An offer lapses by revocation. An offer is revoked when it is retracted back by the offeror. An offer may be revoked, at any time before acceptance, by the communication of notice of revocation by the offeror to the other party [Sec. 6 (1)]. For example, at an auction sale, A makes the highest bid. But he withdraws the bid before the fall of the hammer. There cannot be a concluded contract because the offer has been revoked before acceptance.

Further, an offer, agreed to be kept open for a definite period, may be revoked even before the expiry of that period, unless there is some consideration for so keeping it open. The effect of fixing a time for acceptance is merely to fix a time beyond which the offer cannot be accepted. Where no time limit is set, the offer cannot be accepted after a reasonable time. A promise to keep an offer open for a definite period, unsupported by consideration, is regarded as a 'bare pact,' and hence not binding on the promisor (Dickinson vs Dodds 18). A promise to keep an offer open, supported by consideration, is called an 'option'. An 'option' is in effect a separate contract making the promisor liable for breach if he revokes the offer before the expiry of agreed time. Illustration. M offers to sell his house to N for Rs 1,40,000. N says to M that if he agrees to keep the offer open for 10 days he (N) will pay him Rs 1,000, M agrees. M cannot revoke the offer before the expiry of 10 days, as N has obtained an option to purchase the house within 10 days. If M revokes the offer before the expiry of 10 days, he can be sued for breach of option contract. A revocation of an offer must be communicated or made known to the offeree, otherwise the revocation does not prevent acceptance.

Revocation of a 'general offer' must be made through the same channel by which the original offer was made.

Again, revocation

must always be express and must be communicated by the offeror himself or his duly authorised agent to the other party. Revocation of standing offer or tender. Where a person offers to another to supply specific goods, up to a stated quantity or in any quantity which may be required, at a certain rate, during a fixed period, he makes a standing offer or tender. A standing offer is in the nature of an open or continuing offer. An acceptance of such an offer merely amounts to an intimation that the offer will be considered to remain open during the period specified, and that it will be accepted from time to time by placing order for specified quantities. Each successive order given, while the offer remains in force, is an acceptance of the standing offer as to the quantity ordered, and creates a separate contract. In view of this legal position, the offeror is free to revoke the standing offer with regard to further supply, at any time, by giving a notice to the offeree, except where consideration is given for it. 6. Revocation by non-fulfilment of a condition precedent to acceptance. An offer stands revoked if the offeree fails to fulfil a condition precedent to acceptance [Sec. 6 (3)]. Thus, where A, offers to sell his scooter to B, for Rs 4,000, if B joins the Lions Club within a week, the offer stands revoked and cannot be accepted by B, if B fails to join the Lions Club. 7. An offer lapses by subsequent illegality or destruction of subject matter. An offer lapses if it becomes illegal after it is made, and before it is accepted. Thus, where an offer is made to sell 10 bags of wheat for Rs 6,500, and before it is accepted, a law prohibiting the sale of wheat by private individuals is enacted, the offer comes to an end. In the same manner, an offer may lapse if the thing, which is the subject matter of the offer, is destroyed or substantially impaired before acceptance. 17 (1921), 125 L.T. 690. 18 (1876), 2 Ch. D. 463.

Offer and Acceptance 24 Self-Instructional Material NOTES 2.3 THE ACCEPTANCE A contract, as already observed, emerges from the acceptance of an offer. Section 2(b) states that “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.” Thus, ‘ acceptance’ is the manifestation by the offeree of his assent to the terms of the offer. 2.3.1 Legal Rules Regarding a Valid Acceptance A valid acceptance must be in conformity with the following rules: 1. Acceptance must be given only by the person to whom the offer is made.

An
offer can be accepted only by the person
or persons to whom it is made
and with whom it imports an intention to contract;
it cannot be accepted by another person without the consent of
the offeror.
The rule of law is clear that "if you propose to make a contract with A,
then B can't substitute himself for A without your consent."
An offer made to a particular person can be validly accepted by him
alone.
Similarly
an offer made to a class of persons (i.e., teachers) can be accepted by any member
of that class.
An offer made to the world at large can be accepted by any person who has knowledge of the
existence of the offer.
Illustration. A sold his business to his manager B without disclosing the fact to his customers. C, a customer, who had a running account with A,
sent an order for the supply of goods to A by name. B received the order and executed the same.
C
refused to pay
the price.
It was held that there was no contract
between B and C
because C never made any offer to B
and as such C was not liable to pay the price to B (Boulton vs Jones 19). 2.
Acceptance must be absolute and unqualified [Sec. 7 (1)]. In order to be legally effective it
must be an absolute and unqualified acceptance of
all the terms of the offer.
Even the slightest deviation from the terms of the offer
makes the acceptance invalid. In effect a deviated acceptance is regarded as
a counter offer in law. Illustration. L offered to M his scooter for Rs 4,000. M accepted the, offer and tendered Rs 3,900 cash down, promising to pay the balance of Rs 100 by the evening. There is no contract, as the acceptance was not absolute and unqualified. 3.
Acceptance must be expressed
in some usual and reasonable manner,
unless the proposal prescribes the manner in which it is to be
accepted [
Sec. 7 (2)]. If the
offeror prescribes
no mode of acceptance, the acceptance must be communicated according to some usual and reasonable mode.
The usual modes of communication are by
word of mouth, by post and by conduct. When acceptance is given
by words spoken or written or by post or telegram, it is called an
express acceptance. When acceptance is given by conduct, it is called an implied
or tacit acceptance. Implied acceptance may be given either by doing some required act, for example, tracing the lost goods for the announced reward, or by accepting some benefit or service, for example, stepping in a public bus by a passenger.
If the offeror prescribes a mode of acceptance, the acceptance given accordingly will no doubt be a valid acceptance, even if the prescribed mode is funny. Thus, if an offeror prescribes lighting a match as a mode of acceptance and the offeree accordingly lights the match, the acceptance is effective and complete. But what happens if the offeree deviates from the prescribed mode? The answer to this query is given in Section 7(2) itself which states that in cases of deviated acceptances "
the proposer may, within a
reasonable time after the acceptance is communicated to him,
insist that his proposal shall be accepted in the prescribed manner,
and
not otherwise; but, if he fails to do so, he accepts the (

deviated) acceptance." 19 (I857). 157 E.R. 232.
Offer and Acceptance Self-Instructional Material 25 NOTES Illustration. If the offeror prescribes 'acceptance by telegram' and the offeree sends acceptance through a messenger, there is no acceptance of the offer, if the offeror informs the offeree
that the acceptance is not according to the mode prescribed.
But if the offeror fails to do so, it will be presumed that he has accepted the acceptance and a valid contract will arise. It should be noted that law does not allow an offeror to prescribe 'silence' as the mode of acceptance. Thus, a person cannot say that if within a certain time acceptance is not communicated the offer would be considered as accepted. Similarly, a trader who, of his own without receiving any order, sends goods to some person with a letter saying "If I do not hear from you by the next Monday, I shall presume that you have bought the goods," cannot impose a contract on the unwilling recipient. It is so because in the absence of such a rule the offerees will be at the mercy of offerors, unless they reply all such offers in negative which will certainly be causing a lot of inconvenience and financial burden to them.
Mental acceptance ineffectual. Mental acceptance or quiet assent not evidenced by words or conduct does not amount to a valid acceptance; and
this is so even where the offeror has said that
such a mode of acceptance will suffice. Acceptance must be communicated to the offeror, otherwise it has no effect. Thus, if an oral acceptance is spoken into a telephone after the telephone has gone dead, there is in effect no acceptance. This rule is based on the theory of consensus ad idem or of identity of minds. Unless the acceptance of the offer comes to the knowledge of the offeror, there is no identity of mind and therefore no contract. Illustrations. (a)
Felthouse offered by letter
to buy his nephew's horse for £ 30, 15
s.,
adding, "
If I hear no more about him I shall consider the horse mine at £ 30, 15
s."
The nephew
sent no reply
to this letter but told Bindley, an auctioneer, to keep the horse out of a sale
of his farm stock,
as he intended to reserve it for his uncle Felthouse. Bindley sold the horse by mistake, and Felthouse sued him for conversion
of his property. The Court held that as there was no communication of acceptance to Felthouse before the auction sale took place, there was no contract and therefore Felthouse had no right to complain of the sale. (Felthouse vs Bindley 20) (b)
A person received an offer by letter. In reply he wrote a letter of acceptance, put the letter in his drawer and forgot all about it. Held, this uncommunicated acceptance did not amount to acceptance and so did not complete the contract. (Brogden vs Metropolitan Rly. Co 21) 4.
Acceptance must be communicated by the acceptor. For an acceptance to be valid, it must
not only be made by the offeree
but must also be communicated by, or with the authority of, the offeree (or acceptor) to the offeror. Illustration. In Powell vs Lee 22 , P was a candidate
for the post of headmaster in a school. The managing committee
of the School passed a resolution selecting him
for the post. A member of the managing committee, acting in his individual capacity, informed P
that he had been selected, but P received no other intimation. Subsequently,
the resolution was cancelled, and P was not appointed to the post. P filed a suit against the Committee
for breach of contract.
The Court held that in the absence of
an authorised communication from the Committee there was no binding contract. 5.
Acceptance must be given within a reasonable time and before the offer lapses
and/or is revoked.
To be legally effective acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given
within a reasonable time because an offer cannot be kept open indefinitely (

Shree Jaya Mahal Cooperative Housing Society vs Zenith Chemical Works Pvt. Ltd.) 23 . Where M applied for certain shares in a company in June but the allotment was made in November and he refused to accept the allotted shares, it was held that the offeror M could refuse to take shares as the offer stood withdrawn and could not be accepted because the reasonable period during 20 (1863), 7
L.T. 835. 21 (1877), A.C. 666. 22 (1908), 99 L.T. 284. 23 AIR (1991) Born. 211.
Offer and Acceptance 26 Self-Instructional Material NOTES
which the offer could be accepted had elapsed (Ramsgate Victoria Hotel Co. vs Montefiore 24). Again, the acceptance must be given before the offer is revoked or lapses by reason of offeree's knowledge of the death or insanity of the offeror. 6.
Acceptance must succeed the offer. Acceptance must be given after receiving the offer. It should not precede the offer. In a company shares were allotted to a person who had not applied for them. Subsequently he applied for shares being unaware of the previous allotment.
It was held that the allotment of shares previous to the application was invalid. 7.
Rejected offers can be accepted only, if renewed.
Offer once rejected cannot be accepted again unless a fresh offer is made (
Hyde vs Wrench 25). 2.3.2
Communication of Offer, Acceptance and Revocation
When the contracting parties are face to face and negotiate in person,
there is instantaneous communication of offer and acceptance,
and a valid
contract comes into existence
the moment the offeree gives his absolute and unqualified acceptance to the proposal made by the
offeror.
The question of revocation of either offer or acceptance does not arise, for, in such cases a definite offer is made and accepted instantly at one and the same time. But where services of the post office are utilised for communicating among themselves by the contracting parties because they are at a
distance from one another, it is not always easy to ascertain the exact time at which an offer or/
and
an acceptance is made or revoked. In these cases the following rules, as laid down in Sections 4 and 5, will be applicable:
1.
Communication of an
offer.
The
communication of an offer is complete when it comes to the knowledge of the person
to whom it is made,
i.e., when the letter containing the offer reaches the
offeree. 2.
Communication of
an acceptance.
The
communication of an acceptance has two aspects, viz., as against the proposer and as against the acceptor.
The
communication of an
acceptance is complete (a) as against the proposer, when it is put in
a
course of transmission to
him, so as to be out of power of the acceptor,
and (b)
as against
the acceptor, when it comes to the knowledge of the
proposer
i.e., when the letter
of
acceptance is received by
the
proposer.
Illustrations. (i)

A
proposes, by letter, to sell a house to B
for Rs. 80,000. The letter is posted,
on 6
th instant. The letter
reaches B on 8th instant. The communication of the offer is complete when B, the offeree, receives the letter i.e., on 8
th. (
ii)
B accepts A's proposal, in the above case, by a letter sent by post on 9th instant. The letter reaches A on 11th instant.
The communication of the
acceptance is complete: as against A, when the letter is posted
i.e., on 9th,
and
as against B, when the letter is received by A.
i.e., on 11th. 3.
Communication of
a
revocation.
The communication of a
revocation is complete: (a) as against the person who makes it, when it is put into a course of transmission to the person
to whom it is made,
so
as to be out of
the
power of the
person
revoking, i.e., when
the letter of revocation
is posted,
and (b)
as against the person to whom it is made, when it comes to his knowledge,
i.e., when the letter
of revocation
is received by him.
Illustrations. (a) In the illustration (i) given above,
A revokes his offer by letter on 8th instant. The letter reaches B on 10th instant. The revocation is complete as against A
on 8th, when the letter of revocation is posted. It is complete as against B on 10th, when the letter of revocation is
received by him. (b) In the illustration (ii) given above, B revokes his acceptance
by letter on 10th instant. The letter reaches A on 12th instant. The revocation is complete as against
B on 10th, the date on which the letter of revocation is posted and as against A on 12th, the date on which the letter
reaches him. 24 (1866), L.R. 1 Ex. 109. 25 (1840), 3 Beav. 334.
Offer and Acceptance Self-Instructional Material 27 NOTES Time during which an offer or acceptance can be revoked. In
the illustrations (a) and (b) given above, there arises a question: whether the revocation of offer by A is operative or not,
or whether the revocation of acceptance by B is operative or not? For answering this question, it is necessary to know
the limit of time within which an offer or acceptance can be revoked. Section 5 deals with this question and provides as
follows: "
A proposal
may be revoked at
any time before the communication of its acceptance is complete as against the proposer,
but not afterwards.
An acceptance
may be revoked at any time before the communication of the acceptance is complete as against the
acceptor but not afterwards."
Applying Section 5 to our illustrations given above: A may revoke his offer
at any time before or at the moment when
B posts his letter of acceptance
i.e., 9th,

but not afterwards.
B may revoke his acceptance at any time before
or at the moment when he
letter
of acceptance reaches A i.e., 11th, but not afterwards.
While discussing the rule regarding 'communication of revocation', we have observed earlier
that the revocation of offer is complete as against B (the acceptor) on 10th, when the letter of revocation is
received by him. As B posts his
letter of acceptance on 9th and the communication of acceptance is complete as against A on
the day of posting itself i.e., 9th, A's revocation of his offer, which is complete as against B on 10th, is inoperative. B's acceptance is valid and there shall be a binding contract. For the sake of practice of the rules regarding communication of offer, acceptance and revocation discussed above, we take another illustration. Illustration. (i)
A offers, by letter, to sell his car to B
for
Rs 75,000 on 1st August. B receives the letter on 3rd August. (ii) B puts the letter of acceptance in post on 4th August, which reaches A on 6th. (iii) A writes a letter of revocation of his offer and posts it on 3rd August, which reaches B on 5th August. Rules applied. (i)
Communication of offer is complete on 3rd August i.e.,
when it comes to the knowledge of B. (ii)
Communication of acceptance is complete
as against the
proposer
i.e., A, when the letter of acceptance
is posted i.e., on 4th, and as against the acceptor i.e., B, when the letter of acceptance reaches the proposer i.e., on 6th August. (iii) Revocation of offer is complete as against A on 3rd August, when the letter of revocation is posted, and as against B on 5th August, when the letter of revocation is received by him. (iv) As B has put his acceptance into transmission on 4th August and revocation of offer is communicated to him on 5th August, his acceptance is valid and there shall be a binding contract. A, cannot revoke his offer after 4th August, when the communication of acceptance is complete as against him. Effect of delay or loss of letter of acceptance in postal transit. So far as the offeror is concerned, he is bound by the acceptance the moment the letter of acceptance is posted, although the letter is delayed or wholly lost through an accident of the post and the letter never in fact reaches him.
But in order to bind the offeror,
the letter of acceptance must be correctly addressed, properly stamped and
actually posted. If the letter
of acceptance is misdirected because it has not been addressed correctly, there would, in law, be no communication of the acceptance; but if the wrong address is furnished by the offeror himself, he will be bound.
So far as the acceptor is concerned, he is not bound by
the letter of acceptance till it reaches the offeror. Until the letter of acceptance reaches the offeror, the contract remains voidable at the instance of the acceptor. He can compel the offeror to enforce the contract or he may revoke his acceptance by communicating his revocation at any time before the letter reaches the offeror. Thus the acceptor is at an advantage if the letter is delayed or lost in transit.
Offer and Acceptance 28 Self-Instructional Material NOTES Accidental formation of contract. There remains yet another query: what happens if both
the 'letter of acceptance' and the 'telegram of revocation of acceptance' are delivered to the offeror at the same time? In such a situation the formation of contract 'will depend on a matter of chance.
If the offeror reads the letter of acceptance first and then the telegram, a binding contract will arise. But if the offeror reads the telegram of revocation of acceptance first and then the letter of acceptance, there will be no binding contract because the communication of revocation comes to the offeror's notice first than the communication of acceptance. It will be seen that the formation of contract in the aforesaid circumstance depends on a matter of chance and therefore such contracts are called 'accidental form of contracts'. 2.4 CONTRACTS OVER THE TELEPHONE In the case of contracts over the telephone, each contracting party is able to hear the voice of the other. There is instantaneous communication of offer and acceptance, rejection and counter offer. And therefore, the rule which applies to contracts negotiated orally by the parties in the physical presence of each other i.
e.,
the contract is complete only when the acceptance is received by the offeror
also applies to contracts made over the telephone. If the acceptance is not in fact communicated to the offeror because the telephone suddenly goes 'dead,' there will be no contract (Entores Ltd. vs Miles Far East Corporation). 26

The offeree, therefore, must make sure that his acceptance is received (heard and understood) by the offeror, otherwise there is no binding contract. The observation made by Denning, L.J, in Entores Case 27 is enlightening in this connection: "Now take a case where two people make a contract by telephone. Suppose for instance, that I make an offer to a man by telephone and in the middle of his reply, the line goes 'dead' so that I do not hear his words of acceptance. There is no contract at that moment. The other man may not know the precise moment when the line failed. But he will know that the telephonic conversation was abruptly broken off, because people usually say something to signify the end of the conversation. If he wishes to make a contract, he must, therefore, get through again so as to make sure that I heard.

Suppose next that the line does not go dead but it is nevertheless so indistinct that I do not catch what he says and I ask him to repeat it. He, then repeats it and I hear his acceptance.

The contract is made, not on the first time when I do not hear, but only the second time when I do hear. If he does not repeat it, there is no contract. The contract is only complete when I have his answer accepting the offer". In Kanhialal vs Dineshchandra 28 it has been so held in India as well that where a contract is effected by telephonic conversation, the contract is not complete till acceptance of the offer by the offeree is clearly heard and understood by the offeror. No question of revocation. When the parties negotiate a contract over telephone, no question of revocation can possibly arise, for in such instantaneous communication, a definite offer is made and accepted at one and the same time. An offer when accepted, explodes into a contract and cannot be revoked. In the words of Sir Anson: "Acceptance is to an offer what a lighted match is to a train of gunpowder. It produces something which cannot be recalled or undone." 29 26 (l955), 1 All. E.R. 493. 27 Ibid. 28 (1959), A.I.R., M.P. 234. 29 Anson's Law of Contract, 23rd Ed. p. 55.

Check Your Progress State whether the following are True or False: 1. A proposal when accepted always becomes a contract. 2. A quotation of price is an offer or proposal. 3. Acceptance can be made even without the knowledge of the offer. 4. If the offeree does not accept the offer according to the mode prescribed by the offeror, the offer does not lapse automatically. 5. An offer may be revoked by the offeror before the posting of the letter of acceptance by the acceptor.

Offer and Acceptance Self-Instructional Material 29 NOTES 2.5 TEST QUESTIONS 1. Define the term 'offer'. Explain the legal rules regarding a valid offer. 2. "An invitation to offer is not an offer." Elucidate the statement. 3. Discuss the circumstances under which an offer lapses and stands revoked. Give examples. 4. What do you understand by the term 'acceptance'? What are the essentials of a valid acceptance? 5. " A mere mental acceptance, not evidenced, by words or conduct is, in the eye of law, no acceptance." Explain by giving examples. 6. Discuss briefly the law relating to communication of offer, acceptance and revocation. Is there any limit of time after which offer and acceptance cannot be revoked? 7. Define offer and acceptance. When are offer and acceptance deemed to be complete if made through post? 8. " Acceptance is to an offer what a lighted match is to a train of gun powder. It produces something which cannot be recalled or undone" —

Anson. Comment on the statement and briefly discuss the essentials of a valid offer and acceptance. 2.6 PRACTICAL PROBLEMS Answer the following problems, giving reasons for your answers: 1. Harish says in conversation to Suresh that he will give Rs 10,000 to a person whosoever marries his daughter. Alok marries Harish's daughter and files a suit to recover Rs 10,000. Will he succeed? [Hint. No, Harish has expressed his wish only, and has never made an offer with a view to obtaining the assent of the other party.] 2. X sees a book displayed in a shelf of a book shop with a price tag of Rs 85. X tenders Rs 85 on the counter and asks for the book. The bookseller refuses to sell saying that the book has already been sold to someone else and he does not have another copy of that book in the stock. Is the bookseller bound to sell the book to X? [Hint. No, a display of goods with prices marked thereon is only an invitation for offer, and not an offer itself. Hence the bookseller is free to accept the offer or not.] 3. B offered to sell his car to A for Rs 95,000. A accepts to purchase it for Rs 94,500. B refused to sell the car for Rs 94,500. Subsequently A agrees to purchase the car for Rs 95,000 but B refused to sell the car. A sues B for the specific performance of the contract. Will he succeed? [Hint. No, B's offer comes to an end by the counter offer of A, and there was no offer available for acceptance subsequently.] 4. P sold his business to Q without disclosing this to his customers. M, an old customer sent an order for goods to P by name. Q, the new owner, executed the order. Is M bound to accept the goods? [Hint. No, M is not bound to accept the goods because a specific offer made to P can be accepted only by P and none else (Boulton vs Jones).] 5. B offered to sell his house to A for Rs 50,000.
A accepted the offer by post. On the next day A sent a telegram revoking the acceptance which reached B before the letter.
Offer and Acceptance 30 Self-Instructional Material NOTES
Is the revocation of acceptance valid? Would it make any difference if both the letter of acceptance and the telegram of revocation of acceptance reach B at the same time? [Hint. Yes, the revocation of acceptance is valid because the acceptor may revoke his acceptance at any time before the letter of acceptance reaches the offeror. If the letter of acceptance and the telegram of revocation of acceptance reach B at the same time, the formation of contract will depend on the fact that which of the two is opened first by B. If B reads the telegram first, revocation is valid but if he reads the letter first, revocation is not possible.]
Consideration Self-Instructional Material 31 NOTES UNIT 3 CONSIDERATION Structure 3.0 Introduction 3.1 Unit Objectives 3.2

Test Questions 3.6 Practical Problems 3.0 INTRODUCTION
Consideration is one of the essential elements of a valid contract (Sec. 10). It is an important element, for it imports in a measure the safeguard of deliberation. The fact of its existence serves to distinguish those promises by which the promisor intends to be legally bound from those which are not seriously meant. In the words of Blackstone: "A consideration of some sort or other is so necessary to the forming of a contract, that a nudum pactum, or agreement to do or pay something on one side, without any compensation on the other, will not at law support an action; and a man cannot be compelled to perform it... The law supplies no means nor affords any remedy to compel the performance of an agreement made without consideration. If I promise a man £ 100 for nothing, he neither doing nor promising anything in return or to compensate me for my money, my promise has no force in law."

The breach of a gratuitous promise cannot be redressed by legal remedies. It is only when a promise is made in return of 'something' from the promisee, that such promise can be enforced by law against the promisor. This 'something' in return is the consideration for the promise. In the language of purchase and sale Pollock has observed: "
Consideration
is the price for which the promise of the other is bought." 1
Thus consideration
is
the
very foundation of a contract. "Subject to certain exceptions, 2
agreements without consideration are void" (Sec. 25). 3.1 UNIT OBJECTIVES ? Understand the concept of consideration and its importance for the validity of a contract. ? Clearly understand the essentials of valid consideration. ? Be aware of the rule that consideration may move from a third party but a stranger to a contract cannot sue. ? Learn about the circumstances when a contract is valid even without consideration. 3.2
DEFINITION
Section 2(d) of the Indian
Contract
Act
defines consideration
as
follows: "
When at the
desire of the promisor,
the
promisee or any other person has done or abstained from
doing, 1
Pollock on Contracts, 13th edn., p. 113. 2 These exceptions have been discussed later in the present unit under the heading: Exceptions to the Rule, "No Consideration, No Contract".

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."
An analysis of the above definition will show that it consists of the following
four components: (a)
the act or abstinence or promise which forms
the consideration for the promise, must
be done
at
the desire of the promisor; (
b) it must be done by the promisee or any other person; (
c) it may
have been already executed or is
in the process of being done or may be still executory; (d) it
must be something to which the law attaches a value. Illustrations. (i)
A
agrees to sell his house to B for
Rs 10,000. Here B's promise to
pay
the
sum of
Rs 10,000 is the
consideration
for A's promise to sell
the house,

and
A's
promise
to
sell the
house is the consideration for B's promise to pay
the sum of
Rs 10,000. 3 (ii) A promises
to maintain B's child
and B promises to pay A Rs 1,000 yearly for the purpose.
Here
the promise of each party is the consideration for the promise of the other
party. 3 (
iii) A promises to pay B Rs 1,000 at the end of six months, if C, who owes that sum to B, fails to pay it. B promises to grant time to C accordingly.
Here
the promise of each party is the consideration for the promise of the other
party. 3 (
iv)
A promises his debtor B
not to file a suit against him for one year on
B'
s agreeing to pay him Rs 100 more.
The abstinence of A
is the consideration for B's
promise to pay. (
v) A promises to
type the manuscript of B's book, and in return B promises to teach A's son for a month. The promise to each party is the consideration for the promise of the other
party. (
vi) A person had a daughter to marry and in order to raise funds for her marriage he intended to sell a property. His son promised that if the father would forbear to sell, he would pay the father Rs. 50,000. The father accordingly forbore. The abstinence of the father is the consideration for son's promise to pay. 3.3 ESSENTIALS OF VALID CONSIDERATION The four component parts of the definition of consideration (given above) may well be described as the essentials of valid consideration. We shall now discuss these essentials one by one
in detail. 1. Consideration must move
at the desire of the promisor.
In order to constitute legal consideration,
the act or abstinence forming the consideration for the promise
must be done at the desire or request of the promisor.
Thus acts done or services rendered voluntarily, or at the desire of third party, will not amount to valid consideration so as to support a contract.
The logic for this may be found in the worry and expense to which every one might be subjected, if he were obliged to pay for services, which he does not need or require. Illustrations. (a)
A sees B's house on fire and helps in extinguishing it.
He cannot demand payment for his services because B never asked him to come for help. (b) D had built,
at his own expense,
a market
at the request of the Collector of the District. The
shopkeepers in the market promised to pay
D a commission on
the articles sold by them in the market.
When D sued the shopkeepers for the
commission, it was held that the promise
to pay commission did not amount to a contract
for want of consideration, because D (the promisee) had constructed the market not at the desire of the shopkeepers (the promisors) but at the desire of the Collector

to please him (
Durga Prasad vs Baldeo). 4 It must be noted that this essential does not require that the consideration must confer 'some benefit' on the promisor. It would be enough if the act or forbearance or promise 3 Illustration appended to Section 23. 4 (188l), 3 All. 221.
Consideration Self-Instructional Material 33 NOTES constituting the consideration was done or given at the promisor's request, the benefit may accrue to a third party.
Illustrations. (a)
B
requests A to sell and deliver to him goods on credit. A agrees to do so,
provided C
will guarantee the
payment of the price of the goods. C promises to
guarantee the payment.
The contract between A and C is a 'contract of guarantee' and is perfectly valid though the benefit which A confers in return of C's guarantee is conferred not on C but on B (in the shape of sale of goods on credit).
A's promise to deliver the goods is the consideration for C's promise
of guarantee. (Illustration appended to Section 127). (b)
A, who owed Rs 20,000 to B, persuaded C to pass
a promissory note for the amount in favour of B.
C promised B that he would pay the amount (by passing on a promissory note), and B credited the amount to A's Account in his books. The discharge
of A'
s Account was consideration for C's promise (though C the promisor had received no benefit) (National Bank of Upper India vs Bansidhar 5). 2.
Consideration may move from the promisee or any other person.
The
second
essential of valid consideration, as contained in the definition of consideration in Section 2 (d), is that
consideration need not move from the promisee alone but may proceed from a third
person. Thus,
as long as there is a
consideration for a promise, it is immaterial who has furnished it.
It
may move from the promisee or from
any other person.
This means that even a stranger to the
consideration can sue on a contract, provided he is a party to the contract.
This is sometimes called as 'Doctrine of Constructive Consideration'.
The leading case of Chinayya vs Ramayya 6 provides a good illustration on the point: Illustration. In the above
case A,
an old lady,
by a deed
of gift, made over certain property to her daughter
R, with a direction that the daughter should pay
an annuity to A's
brother C, as
has been done by A. Accordingly,
on the same day R, the daughter, executed a writing in favour of
her maternal uncle C
agreeing to pay the annuity. Afterwards she declined to fulfil her promise saying that no consideration had moved from her
maternal uncle i.e., the promisee. It was
held that
the words "the promisee or any other person" in Section 2 (d) clearly show that
a stranger to consideration may maintain a suit.

Hence the maternal uncle, though a stranger to the consideration (as the consideration indirectly moved from his sister) was entitled to maintain the suit. In the above case, it will be observed, that although C, the maternal uncle, was a stranger to the consideration, he was not a stranger to the contract as there was a separate contract between him and R, the daughter. The maternal uncle could not have sued on the basis of 'gift deed' executed by A in favour of R because he was not a party to it.

A stranger to a contract cannot sue. A person may be a stranger to the consideration but he should not be a stranger to the contract because 'privity of contract' is essential for enforcing any of the rights arising out of the contract. It being a fundamental principle of the law of contracts that ' a stranger to a contract cannot sue, only a person who is a party to a contract can sue on it.'

Thus, where A mortgages his property to B in consideration of B's promise to A to pay A's debt to C, C cannot file a suit against B to enforce his promise, C being no party to the contract between A and B (Iswaram Pillai vs Sonnivaveru 7).

Exceptions.

The above rule that 'a stranger to a contract cannot sue' is subject to the following exceptions: (

i) Where an express or implied trust is created. In case of a trust, the beneficiary can sue in his own right to enforce his rights under the trust, though he was not a party to the contract between the settler and the trustees.

Illustrations. (a) A transfers certain properties to B to be held by B in trust for the benefit of M. M can enforce the agreement i.e., trust (

M.K. Rapai vs John 8). 5 (1930), 5 Luck. 1 (P.C.). 6 (1881), 4 Mad. 137. 7 (1915), 38 Mad. 753. 8 l965), A.I.R. Ker. 203.

Consideration 34 Self-Instructional Material NOTES (b) An addressee of an insured article is entitled to sue the Post Office in case of loss, as on receipt of such article, the Post Office becomes in law a constructive trustee for the addressee (Amir Ullah vs Central Govt. 9). (ii) Family settlement.

Where a provision is made in a partition or family arrangement for maintenance or marriage expenses of female members; such members, though not parties to the agreement, can sue on the footing of the arrangement.

Illustration. A daughter along with her husband entered into a contract with her father whereby it was agreed that she will maintain her mother and the property of the father will be conveyed to them. The daughter subsequently refused to maintain the mother. On a suit it was held that the mother was entitled to require her daughter to maintain her, though she was a stranger to the contract (Veeramma vs Appayya). 10 (iii) When the defendant constitutes himself, as the agent of the third party. Thus if A receives some money from B to be paid over to C and he admits of this receipt to C, then C can recover this amount from A who shall be regarded as the agent of C (Surjan vs Nanat). 11 (iv) In case of agency. Where a contract is entered into by an agent, the principal can sue on it. (v) In case of assignment of rights under a contract in favour of a third party either voluntarily or by operation of law, the assignee can enforce the benefits of the contract, e.g., the assignee of an insurance policy or the official assignee on the insolvency of a person can sue on the contract even though originally they were not parties to

it. 3.
Consideration may be past, present or future.
The words, "
has done
or abstained from doing; or does or abstains from doing; or promises to do or to abstain from doing,"
used in the definition of consideration
clearly indicate that the
consideration may consist of
either something done or not done in the past, or done or not done in the present, or promised to
be
done or not done in the future.
To put it briefly, consideration may consist of a past, present or a future act or abstinence.
Consideration may consist of
an act or abstinence. Consideration may consist of either a positive act or an abstinence i.e., a negative act.
Thus, an agreement between B and A, under which B; on failing to pay the debt amount on the due date to A;
promises to raise the rate of interest from 9 per cent to 12 per cent in consideration of A
promising not to file a suit against him for another one year, is a valid contract; A's abstinence being the consideration for B's promise.
Past
consideration. When something is done or suffered before the date of the agreement, at the desire of the promisor, it is called 'past consideration.' It must be noted that past consideration is good consideration only if it is given by the promisee, 'at the desire of the promisor.' Illustrations. (a) A teaches the son of
B at B's request in the month of January, and in February B promises to pay A
a sum of Rs 200 for his services. The services of A will be
past consideration. (
b) A lawyer, gave up his practice and served as manager of a landlord at the latter's request in lieu of which the landlord subsequently promised a pension. It was held that there was good past consideration. (
Shiv Saran vs Kesho Prasad) 12
Present
consideration. Consideration which moves simultaneously with the promise, is called 'present
consideration'
or 'executed consideration'.
For example, A sells and delivers a book to B, upon B's promise to pay for it at a future date. The consideration moving from A is present
or executed
consideration since A has done his act of delivering the
book 9 (1959), All. L.J. 271. 10 (1957), A.I.R. AP 965. 11 (1940), A.I.R. Lah. 471. 12 42 .IC. 122.
Consideration Self-Instructional Material 35 NOTES simultaneously with the promise of B. It should, however, be noted that it
is said to be 'present consideration' when at the time of the agreement it is executed on one side and executory on the other.
If both parties have done their part under the contract, e.g., where A sells a book to B and B pays its price immediately, it is a case of executed contract (where nothing remains to be done) and not of executed or
present consideration.
Future consideration. When the consideration on both sides is to move at
a
future date, it is called "future
consideration'
or 'executory consideration'.
It consists of an exchange of promises and each promise is a consideration for the other.
For
example, X promises to sell and deliver 10 bags of wheat to Y for Rs 6,500 after a week,
upon Y's promise to pay the agreed price at the time of delivery. The promise of X is supported by promise of Y and the consideration is executory on both sides.
It is to be observed that

in an 'executed consideration', the liability is outstanding against only one side whereas in an 'executory consideration' it is outstanding on both sides. 4. Consideration must be 'something of value'. The fourth and last essential of valid consideration is that it must be '
something' to which the law attaches a
value. The consideration
need not be adequate to the promise
for the validity of an agreement.
The Law only insists on the presence of consideration and not on the adequacy of it. It leaves the people free to make their own bargains. Thus, where A agrees to sell his motorcar worth Rs 20,000 for Rs 1,000 only and his consent is free, the agreement is a valid contract, notwithstanding the inadequacy of the consideration.
However, if the consideration be grossly or shockingly inadequate, and if one of the parties to the contract alleges that his consent was obtained by fraud, coercion or undue influence, the court will treat inadequacy of consideration as an evidence in support of such allegation and will declare the contract void. 13 Inadequacy of consideration being no bar to a valid contract, unless it is an evidence of unfree consent, it has been correctly observed that "in many cases, the doctrine of consideration is a mere technicality irreconcilable either with business expediency or common sense."
Consideration must be real. Though
consideration need not be adequate, it
must be
of some value in the eye of law,
i.e., it must be real
and competent.
Where
consideration is physically impossible, illegal, uncertain or illusory, it is not real and therefore shall not be a valid consideration. (
i) Physically impossible. A promise to do something which is physically impossible, e.g., to make a dead man alive or to run at a speed of 100 kilometres per hour, does not form valid consideration. (ii) Legally impossible. A promise to do something which is illegal, e.g., a promise for illegal cohabitation, does not amount to good consideration. 14 (iii) Uncertain consideration. A promise to do something which is too vague and uncertain, e.g., a promise to pay such remuneration "as shall be deemed right," is no consideration in the eye of law. (iv) Illusory consideration. Again, an illusory or deceptive consideration does not amount to a valid consideration. Consideration is illusory if it consists in a promise to perform a public duty, or to perform a contract already made with the promisor. Illustrations. (a) C (the plaintiff) received a subpoena (a kind of summon) to appear at a trial as a witness on behalf of G (the defendant). G promised him a sum of money for his trouble. On default 13 "
An agreement to which the consent of the promisor is freely given is not void merely because the consideration
is
inadequate;
but the inadequacy of
the consideration may be taken into account
by the Court in determining the question whether the consent of the promisor was freely given." (
Explanation 2, to Section 25). 14
The topic of 'Unlawful Consideration' has been discussed in detail, later in the unit on 'Legality of the Object and Consideration'.
Consideration 36 Self-Instructional Material NOTES by G, C filed the suit for the recovery of the promised sum. It was held that C being under a public duty to attend and give evidence, there was no consideration for the promise and hence the promise is unenforceable. (Collins vs Godefroy 15) (b)
Two of the crew of a ship deserted it
half way

while the ship was on a voyage from London to the Baltic and back. The captain, being unable to supply their place, promised the rest of the crew that, if they would work the vessel home, the wages of the two deserters should be equally divided amongst them. The agreement was held to be void for want of consideration because it was the contractual duty of the mariners who remained with the ship to exert themselves utmost in any emergency of the voyage to bring the ship in safety to her destined port... The desertion of a part of the crew is to be considered an emergency of the voyage as much as their death. (Stilk vs Myrick) 16 However, in the following cases consideration has been regarded as real and valid: (i) Forbearance to sue. Forbearance to sue, at the instance of the debtor, is sufficient consideration. A, has a right to sue his debtor B for Rs 5,000, but infact forbears as B agreed to pay Rs 100 more. Such forbearance is a valuable consideration for the promise, being in the nature of abstinence, and A can later on sue B for Rs 5,100. But in order that the forbearance should be a consideration, there must be existing and lawful liability. (ii) Compromise of a pending suit. The compromise of a disputed or doubtful claim is a good consideration for the fresh agreement of compromise. (Sunder Singh vs Haro) 17 3.4
EXCEPTIONS TO THE RULE, "NO CONSIDERATION, NO
CONTRACT"
Consideration being
one of the essential elements of a valid
contract,
the
general rule is that "
an agreement made without consideration is void."
But there are
a few exceptions to the rule, where an agreement without consideration will be perfectly valid and binding.
These exceptions are as follows: 1.
Agreement made on account of natural love and affection [Sec. 25 (1)].
An agreement
made
without consideration is enforceable if,
it is (i) expressed in writing,
and (
ii)
registered under the law for the time being
in force
for
the registration of documents, and is (
iii)
made on account of natural love and affection, (iv)
between parties standing in
a near relation to each other.
Thus there are four essential requirements which must be complied with to enforce an agreement made without consideration, as per Section 25 (1). Illustrations. (a)
A promises, for no consideration, to give to B Rs 1,000. This is a void agreement. 18 (b)
A
for
natural love and affection, promises to give his son
B,
Rs 1,000. A
puts his promise to B into writing and registers it. This
is a contract. 18 (
c) A registered agreement,
whereby
an elder brother, on account of natural love and affection, promised to pay the debts of his younger brother,
was held to
be valid and binding and the younger brother could sue the elder brother in the event of his not carrying out the agreement. (Venkatasamy vs Rangasami 19) It should, however, be noted that
mere existence of a
near relation between the parties
does not necessarily import natural love and affection.

Thus where a Hindu husband,
after referring to quarrels and disagreement between him and his wife,
executed a registered document in favour of his wife, agreeing to pay for
separate residence
and maintenance,
it 15 (1831), I.B. & Ad. 950. 16 (1809), 2 Camp. 317. 17 (1929), 116 IC 719. 18 Illustration appended to Section 25. 19 6 Mad. 71.
Consideration Self-Instructional Material 37 NOTES was
held
that the agreement was void for want of consideration because
it was not made out of natural love and affection. (
Rajlakhi Devi vs Bhootnath) 20 2.
Agreement to compensate for past voluntary service [Sec. 25 (2)].
A promise
made without consideration is
also
valid,
if it is
a promise to compensate, wholly or in part,
a person who has already voluntarily done something for the promisor,
or
done something which the promisor was legally compellable to do. Illustrations. (
a)
A finds B's purse and
gives it to him. B promises to give
A
Rs 50.
This is a
contract. 21 (
b) A supports B's infant son. B promises
to
pay A's expenses in so doing. This is a contract. 21 (
Note that B was legally bound to support his infant son). (c) A rescued B from drowning in the river, and B, appreciating the service that has been rendered, promises to pay Rs 1,000 to A. There is a contract between A and B.
In order to attract this exception, the following points should be noted: (i) The service should have been rendered voluntarily for the promisor. If it is not voluntary but
rendered at the desire of the promisor, then it is covered
under 'past consideration' [as per Sec. 2(d)] and not under this exception. (ii)
The promisor must be in existence at the time the service was
rendered. Thus where services were rendered
by a promoter for a company not then in existence, a subsequent promise by the company to pay for them could not be brought within the exception. (Ahmedabad Jubilee Spinning Co. vs Chhotalal 22). (iii) The promise must be
to compensate a person who has himself done something for the promisor
and not to a person who has done nothing for the promisor. Thus, where B treated A during his illness but refused to accept payment from A; they being friends; and A in gratitude promises to pay Rs 1,000 to B's son D, the agreement between A and D is void for want of consideration as it is not covered under the exception. (iv) The intention of the promisor ought to be to compensate the promisee. A promise given for any motive other than the desire to compensate the promisee would not fall within the exception. (Abdulla Khan vs Parshottam 23 (v) The promisor to whom the service has been rendered
need
not be competent
to contract at the time the service was rendered. Thus a promise made after attaining majority to
pay for goods supplied voluntarily to the promisor during his minority has been held valid and the promisee could enforce it (Karam Chand vs Basant Kaur 24). The
court in that case observed that they failed to see how an agreement made by a person of full age
to compensate wholly or in part
a promisee, who had already voluntarily done something for the

promisor,
even at a time when the promisor was
a minor, did not fall within the purview of Sec. 25(2) of the Contract Act. The reasoning of the court is, that at the time the thing was done the minor was unable to contract, and therefore the person who did it for the minor must in law be taken to have done it voluntarily. In their opinion the provisions of Sec. 25(2) applied equally to a contract by a major, as well as by a minor, to pay for past services. In this connection it is important to note that this exception does not cover a promise by a person on attaining majority to repay the money borrowed during his minority because such a promise cannot be said a promise to compensate a person who has already voluntarily (without any promise of compensation) done something for the promisor. 'Advancing money 20 (1900), 4, C.W.N. 488. 21 Illustration appended to Section 25. 22 (1908), 10 Bom. L.R. 141. 23 (1948), A.I.R. Bom. 265. 24 (1911), 31 Punj. Rep. 1911. See also Ram Ratan vs Basant Rai, (1921), 2 Lah. 263.
Consideration 38 Self-Instructional Material NOTES as a loan' necessarily implies a promise to compensate (i.e., a promise to repay the loan) on the part of the borrower. Thus
a promise made by a minor after attaining majority to repay money advanced during his minority has been held invalid and beyond the purview of Section 25(2) of the Contract Act (
Indran Ramaswami vs Anthappa 25). (vi)
The service rendered must also be legal. Thus past cohabitation will not make a promise to pay for it enforceable under this exception (Sabava vs Yamanappa 26). 3. Agreement
to pay a time-barred debt [Sec. 25 (3)]. Where there is an agreement,
made in writing and signed by the debtor or by his
authorised agent,
to pay
wholly or in part
a debt barred by the law of limitation,
the agreement is valid even though it is not supported by any consideration.
A time barred debt cannot be recovered and therefore a promise to repay such
a debt is without consideration, hence the importance of the present exception.
But before the exception can apply, it is necessary that: (i)
the debt must be such of
which the creditor might have enforced payment but for
the law
for the limitation of suits; 27 (
ii) the promisor himself must be liable for the debt. So a promissory note executed by a widow in her personal capacity in payment of time-barred debt of her husband cannot be brought within the exception (Pestonji vs Maherbai 28); (iii) there must be an 'express promise to pay' a time barred debt as distinguished from a mere "acknowledgment of a liability' in respect of a debt. Thus a debtor's letter to his creditor, "I owe you Rs 1,000 on account of my time-barred promissory note" is not a contract. There must be a distinct promise, to pay; and (iv)
the
promise must be in writing and signed by the debtor or his agent.
An oral promise
to pay a time-barred debt
is unenforceable.
The logic behind this exception is that by lapse of time the debt is not destroyed but only the remedy is lost. The remedy is revived by a new promise under
the exception. Illustration.
A
owes B Rs 1,000, but the debt is barred by
the
Limitation Act. A
signs a written promise to pay B
Rs 500 on account of
the debt. This is a contract (
Appended to Sec. 25). 4.
Completed gift.
A gift (which is not an agreement) does not require consideration in order to be valid. "As between the donor and the donee, any gift actually made will be valid and binding even though without consideration" [Explanation 1, to Section 25].

In order to attract this exception there need not be natural love and affection or nearness of relationship between the donor and donee. The gift must, however, be complete. 5. Contract of agency.
Section 185 of the Contract Act lays down that no consideration is necessary to create an agency. 6. Remission by the promisee, of performance of the promise (Sec. 63). For compromising a due debt, i.e., agreeing to accept less than what is due, no consideration is necessary. In other words, a creditor can agree to give up a part of his claim and there need be no consideration for such an agreement. Similarly, an agreement to extend time for performance of a contract need not be supported by consideration (Sec. 63). 7. Contribution to charity. A promise to contribute to charity, though gratuitous, would be enforceable, if on the faith of the promised subscription, the promisee takes definite steps in furtherance of the object and undertakes a liability, to the extent of liability incurred, not exceeding the promised amount of subscription. In Kedar Nath vs Gorie Mohammad, 29 25 (1906), 16 Mad. L.J. 422. See also Suraj Narain vs Sukhu Ahir, (1929), 51 All. 164 (f.B.). 26 35 Bom. L.R. 345. see also Hussenally vs Dinbai, 26 Bom. L.R. 252. 27 Section 25 (3). 28 (1928), Bom. L.R. 1407. 29 (1886), I.L.R. 14 Cal. 64. Also see Perumal Mudaliar vs Sendanatha Mudaliar (1918), A.I.R. Mad. 311.
Check Your Progress State whether the following are True or False: 1. An act constituting consideration for the promise must be done at the desire of the promisor or any other person. 2. Past consideration is no consideration. 3. A stranger to a contract cannot sue thereon. 4. Consideration need not be adequate to the promise for the validity of an agreement. 5. No consideration is necessary to create an agency.
Consideration Self-Instructional Material 39 NOTES
the defendant had agreed to subscribe Rs 100 towards the construction of a Town Hall at Howarh. The plaintiff (secretary of the Town Hall) on the faith of the promise entrusted the work to a contractor and undertook liability to pay him. The defendant was held liable. But where the promisee had done nothing on the faith on the promise, a promised subscription is not legally recoverable. Accordingly, in Abdul Aziz vs Masum Ali, 30 the defendant promised to subscribe Rs 500 to a fund started for rebuilding a Mosque but no steps had been taken to carry out the repairs. The defendant was held not liable and the suit was dismissed. It may thus be noted that consideration need not always be something in return. It may even take the form of some risk, loss or responsibility suffered or undertaken by one party (Currie vs Misa 31). 3.5 TEST QUESTIONS 1. Define consideration. How far is it necessary for the validity of a contract. Critically discuss the essential elements of consideration. 2. Explain the term consideration and state the exceptions to the rule — 'No consideration, no contract.' 3. " Insufficiency of consideration is immaterial; but an agreement without consideration is void". Explain. 4. " A stranger to a contract cannot sue." Discuss. Are there any exceptions to this rule? 5. " A stranger to the consideration can sue but a stranger to contract cannot sue." Explain. 6. " Consideration need not be adequate but it must have some value in the eye of law." Explain. 7. "No consideration, no contract." Explain. 3.6 PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. M offered a reward to anyone who would rescue his wife dead or alive from a burning building. A fireman

risking his life brought out the wife's dead body. Is he entitled to recovery of the reward? [Hint. Yes. In the instant case the fireman took an extra risk of endangering his life, which does not fall in his normal duties in connection with rescue operations. As such the consideration is not illusory and the fireman is entitled to reward.] 2.
A and B are friends, B treats A during A's illness. B does not accept payment from A for the treatment and A promises B's son. X, to pay him Rs 1,000. A being in poor circumstances, is unable to pay. X sues A for
the money. Can X recover? [Hint. No. X cannot recover the money from A. The agreement between X and A is not a contract in the absence of consideration. In this case X's father, B, voluntarily treats A during his illness. Apparently it is not a valid consideration because it is voluntary, whereas
consideration to be valid must be given at the desire of the promisor—
vide Section 2(d). The question now is whether this case is covered by the exception given in Section 25(2) which inter-alia provides: "
If it is
a promise to compensate a person who has already voluntarily done something for the
promisor..."
Thus as per the exception
the promise must be
to compensate a person who has himself done something for the promisor
and not to a person who has done nothing for the promisor. As B's 30 (1914), A.
I.R. All. 22. Also see Gopal vs Trimbak, (1953), A.I.R. Nag. 195. 31 (1875), LR 10 Ex. l53.
Consideration 40 Self-Instructional Material NOTES son. X, to whom the promise was made, did nothing for A, so A's promise is not enforceable even under the exception.] 3. X, a social reformer, promised Y
a reward of Rs 1,000 if he refrained from smoking for two years. Y does so. Is he entitled to the reward? [Hint. Yes. Y is entitled to the reward
from X. In the instant case, Y at the desire of X refrained from smoking for two years. This is a valid consideration in the form of an act of abstinence—vide Section 2(d).] 4. A writes to B, "
at the risk of your own life, you saved me from a serious motor accident. I promise to pay you
Rs 1,000." A does not pay.
Advise B as to his legal rights. [Hint. B is advised to file a suit for recovery for Rs 1,000. Under Section 25(2) of the Contract Act,
a promise to compensate for voluntary acts done in the past is valid
even though without consideration. As the instant case is fully covered by the above Section, A cannot avoid his liability later on.]
Capacity of Parties Self-Instructional Material 41 NOTES UNIT 4 CAPACITY OF PARTIES Structure 4.0 Introduction 4.1 Unit Objectives 4.2 Minor 4.3 Persons of Unsound Mind 4.4 Disqualified Persons 4.5 Test Questions 4.6 Practical Problems 4.0 INTRODUCTION An
essential ingredient
of a valid contract is that the contracting parties must be 'competent
to
contract' (Sec. 10). Section 11 lays down
that "
Every person is
competent
to contract who
is of the age of majority according to the law to
which
he is subject, and
who
is of sound mind,
and
is not
disqualified from contracting
by
any law
to which he is subject."
Thus
the
Section 1 declares that a person

is incompetent to contract under the following circumstances: 1. if he is a minor, according to the law to which he is subject, 2. if he is of unsound mind, and 3. if he is disqualified from contracting by any law to which he is subject. 4.1

UNIT OBJECTIVES ? Note the circumstances under which a person is incompetent to contract. ? Be clear about the law regarding minor's agreements. ? Understand the effects of agreements made by persons of unsound mind and by persons disqualified from contracting under any law. 4.2

MINOR According to Section 3 of the Majority Act 1875, as amended by the Majority (Amendment) Act, 1999, a person, domiciled in India, who is under 18 years of age is a minor. Accordingly every person who has completed the age of 18 years becomes a major.

Section 11 expressly provides that the age of majority of a person is to be determined "according to the law to which he is subject." The Courts of Law used to decide the age of majority (competency to contract) by the law of domicile and not by the law of the place where the contract is entered into (Kashiba vs Shripat 2). But the later trend of law for determining the age of majority is: (a) in the case of contracts relating to ordinary mercantile transactions, the age of majority is to be determined by the law of the place where the 1

Section 11. 2 (1894), 19 Bom. 697.

 NOTES contract is made, and (b) in the case of contracts relating to land, the age of majority is to be determined by the law of the place where the land is situated (T.N.S. Firm vs Mohd. Hussain 3). Thus, where a person aged 18 years, domiciled in India, endorsed certain negotiable instrument in Ceylon, by the laws of which he was a minor, 4 he was held not to be liable as an endorser. 4.2.1

Minor's Agreements

The law regarding minor's agreements may be summed up as under: 1. An agreement by a minor is absolutely void and inoperative as against him.

Law acts as the guardian of minors and protects their rights, because their mental faculties are not mature—they don't possess the capacity to judge what is good and what is bad for them.

Accordingly, where a minor is charged with obligations and the other contracting party seeks to enforce those obligations against minor, the agreement is deemed as void ab- initio.

In the leading case of Mohori Bibi vs Dharmo Das Ghosh, 5 a minor executed a mortgage for Rs 20,000 and received Rs 8,000 from the mortgagee. The mortgagee filed a suit for the recovery of his mortgage money and for sale of the property in case of default. The Privy Council held that an agreement by a minor was absolutely void as against him and therefore the mortgagee could not recover the mortgage money nor could he have the minor's property sold under his mortgage. No restitution except in certain cases. A minor cannot be ordered to make compensation for a benefit obtained under a void agreement, because Sections 64 and 65 of the Contract Act, which deal with restitution, apply only to contracts between competent parties and are not applicable to a case where there is not and could not have been any contract at all (Kanta Prasad vs Sheo Gopal La1). 6 The court may, however, in certain cases, while ordering for the cancellation of an instrument, at the instance of a minor, require the minor plaintiff to make compensation to the other party to the instrument. This is so as per Section 33 7 of the Specific Relief Act, 1963, which states as follows: "

On adjudging the cancellation of an instrument, the Court may require the party to whom such relief is granted, to restore, so far as may be, any benefit which he may have received from the other party and to make any compensation to him which justice may require."
Thus, the Court will compel restitution by a minor when he is a plaintiff. For example, if a minor sells a house for Rs 50,000 and later on files a suit to set aside the sale on the ground of minority, he may be directed by the Court to refund the purchase money received by him before he can recover possession of the property sold (Jager Nath Singh vs Lalta Prasad 8). It may be emphasised that Section 33 of the Specific Relief Act, 1963, is framed so as to afford relief only in a case where the minor himself as plaintiff seeks the assistance of Court and the Section is inapplicable if he happens to be merely a defendant in a suit by the person who dealt with him when he was a minor. This Section is based on the well known principle that "he who seeks equity must do equity." 2. Beneficial agreements are valid contracts. As observed earlier, the court protects the rights of minors. Accordingly,
any agreement which is of some benefit to the minor and under which he is required to bear no obligation, is valid.
In other words, a minor can be a beneficiary e.g., a payee, an endorsee or a promisee under a contract (Goekda Latcharao 3 (1933), A.I.R. Mad. 756. 4 The majority age is 21 years in Ceylon. 5 (1903), I.L.R. 30 Cal. 539. Also see Bhim Mondal vs Magaram, (1961), A.I.R. Pat. 21: 6 (1904), 26 All. 342. 7 Formerly Section 41 of the Specific Relief Act, 1877. 8 (1909), 31 All. 21.
Capacity of Parties Self-Instructional Material 43 NOTES vs Vishwanadham Bhomayya 9). Thus money advanced by a minor can be recovered by him by a suit because he can take benefit under a contract. The Hindu Minority and Guardianship Act, 1956, also provides to the same effect, namely,
a natural guardian is empowered to enter into a
contract
on behalf of the minor and the contract would be binding
and enforceable if the contract is for the benefit of the minor.
Illustrations. (a)
A duly executed transfer by way of sale or
mortgage in favour of a minor, who has paid
the whole of
the consideration money, is enforceable by him or by any other person on his behalf (
Raghava Chariar vs Srinivasa 10). (b) Where a minor purchaser of immovable property was, subsequent to his purchase, dispossessed by a third party, it was held that the minor could recover from his vendor the sum which he has paid as purchase money (Walidad Khan vs Janak Singh). 11 (c) A minor purchaser of immovable property was held entitled to recover possession of property purchased from his vendor, when refused by vendor (Collector of Meerut vs Hardian). 12 (d) A promissory note executed in favour of a minor is valid and can be enforced in a court (Sharaft All vs Noor Mohd.) 13 (e) Where a minor had performed his part of the agreement and delivered the goods,
he was held entitled to maintain a suit for the recovery of
their price (Abdul Gafar vs Piare Lal 14). Contracts of apprenticeship and service by a minor. A contract of apprenticeship stands on a different footing than an agreement of service by
a minor. A contract of apprenticeship
is valid and binding upon a minor because such a contract is protected by the Apprentices Act, 1961, provided the case falls within the terms of that Act. The
Act, inter alia, provides that the minor must not be less than fourteen
years of age and the contract must be entered into on behalf of the minor by his guardian.
The Act was passed with a view to enabling children to learn trades, crafts and employments, by which,
when they come to full age, they may gain a livelihood.
So far as an agreement of service by a minor is concerned, it is
void because a minor's promise to serve would supply no consideration for the promise of the defendant to pay him/her a salary (
Raj Rani vs Prem Adib 15). In that case the court said that the
contract of apprenticeship entered into by the guardian
is protected by the Apprentices Act provided the
case falls within the terms of that Act,
but no such exception is made in the case of contracts of service ... Of course, where a minor has already served under a contract of service, he is entitled to enforce the contract not by virtue of the contract but by reason of the relationship resembling those created by the contract (i.e., by reason of a quasi-contract) under Section 70 of the Contract Act. 3. No ratification on attaining the age of majority. Ratification means
the subsequent adoption and acceptance of an act or agreement.
A minor's agreement being a nullity and

void ab-initio has no existence in the eye of law. It cannot be ratified by the minor on attaining the age of majority, for, an agreement void ab-initio cannot be made valid by subsequent ratification (Mohendra vs Kailash). 16 Thus, if an advance is made to a minor during his minority, a promise to pay for such amount after he attains majority would not be enforceable. "The consideration which passed under the earlier contract cannot be implied into the contract into which the minor enters on attaining majority" (Nazir Ahmed vs Jiwan Dass). 17 In Arumugam Chetti vs Duraisinga Tevar, 18 it was held that there can 9 (1956), 33 All. 667. 10 (1917), 40 Mad. 308 (F.B.). 11 (1913), 85 All. 370. 12 (1945), A.I.R. All. 156. 13 (1924), A.I.R. Rang. 136. 14 (1935), 16 Lah. 1. 15 (1948), 51 Bom. L.R. 256. 16 (1927), 555 Cal. 841. 17 (1938), A.I.R. Lah. 159. 18 (1914), 37 Mad. 38.

be no ratification of a transaction which is void owing to the promisor possessing no contractual capacity at the time. Nor can a void deed form a good consideration for a fresh contract made by the minor on attaining majority. Similarly, in Suraj Narain vs Sukhu Ahir, 19 where a minor borrowed a sum of money by executing a promissory note, and after attaining majority executed a second bond in respect of the original loan, the court held that a suit upon the second bond was not maintainable as that bond was without consideration.

Since ratification relates back to the date when the contract was originally made, it is necessary for a valid ratification that the person who purports to ratify must be competent to contract at the time of the contract. But if services are rendered or an advance is made to a minor during his minority and the services are continued or a further advance is made after he attains majority, a promise to pay for such services or amount as a whole would be valid and enforceable (Sindha vs Abraham 20). 4. The rule of estoppel does not apply to a minor. Section 115 of the Indian Evidence Act explains "Estoppel" as follows: " Where one person has, by his declaration, act or omission, intentionally caused or permitted another person to believe a thing to be true and to act upon such belief, neither he nor his representatives shall be allowed, in any suit or proceeding between himself and such person or his representative, to deny the truth of that thing." In the words of Lord Halsbury: " Estoppel arises when you are precluded from denying the truth of anything, which you have represented as a fact, although it is not a fact." The rule of estoppel does not apply to a minor i.e., a minor is not estopped from pleading his infancy in order to avoid a contract, even if he has entered into an agreement by falsely representing that he was of full age (Sadiq Ali Khan vs Jai Kishore 21). In other words, where an infant represents fraudulently or otherwise that he is of full age and thereby induces another to enter into a contract with him, then in an action founded on the contract, the infant is not estopped from setting up infancy.

But if any thing is traceable in the hands of minor, out of the proceeds of the contract made by fraudulently representing that he was of full age, the court may direct the minor to restore that thing to the other party, on equitable considerations, for 'minors can have no privilege to cheat man' (Khan Gul vs Lakha Singh 22). "... Whenever the infant is still in possession of any property in specie which he has obtained by his fraud, he will be made to restore it to its former owner. But I think that it is incorrect to say that he can be made to repay money which he has spent, merely because he received it under a contract induced by his fraud" (

Lawrence J., in Leslie vs Sheill 23). Similarly, the infant will be made to restore to the person deceived, any property purchased out of, or money received as a result of, sale proceeds of the goods obtained by his fraud (Stocks vs Wilson 24). Thus, if a minor obtains a loan by fraudulent representation and purchases a motorcar out of that, although the loan transaction is invalid, the court may direct the minor to restore the motorcar to the lender. But once the identity of the property or money has been lost because it has been spent wastefully, it is no longer possible to invoke the aid of the 'equitable doctrine of restitution'. Again, it may be noted that restoration is allowed only when a minor commits fraud by misrepresenting his age because Section 65 expressly prohibits restoration in cases which are known to be void. 5. Minor's
liability for necessaries. The case of necessaries supplied to
a minor
is governed by
Section 68 of the Contract Act
which provides that "
if
a person, incapable of entering into a contract, or
any one
whom he is legally
bound
to support,
is supplied by another
person with necessaries suited
to his condition in life, the
person who
has
furnished such supplies is entitled to
be reimbursed from the property of
such
incapable person." 19 (1928),
I.L.R. 51 All. 164. Also see Bindeshri Bakhsh Singh vs Chandika Prasad, (1927), 49 All. 137. 20 (1895), 20 Bom. 755. 21 (1928), 30 Bom. L.R. 1342 (P.O.). 22 (1928), 9 Lah. 701. 23 (1914), 3 K.B. 607. 24 (1913), 2 K.B. 235.
Capacity of Parties Self-Instructional Material 45 NOTES Illustrations. (
a)
A supplies
B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's
property. 25 (
b)
A supplies the wife and children of
B, a lunatic, with necessaries suitable to their condition in life.
A is entitled to be reimbursed from
B's
property. 25
Thus, Section 68 confers a quasi-contractual right on the supplier
of "necessaries" to
a person incapable of entering into a contract, or
to any one whom he is legally bound to support.
But
a minor is not personally liable, it is his property only which
is liable. Therefore
if a minor owns no property, the supplier will lose the price of necessaries.
Even where a minor owns property, the supplier will get a reasonable price and not the price agreed to by the minor. "What is a necessary article," is to be determined with reference to the status and circumstances of the particular minor. Objects of mere luxury are not necessaries, nor are objects, which though of real use, are excessively costly. Food and clothing may be taken as simple examples of necessaries. The necessaries would also include the infant's lodging expense, medical attendance, cost of defending a minor in civil and criminal proceedings. Loans taken by a minor to obtain necessaries also bind him. But where a minor is engaged in trade, contracts entered into by him for trading purposes are not for necessaries and are not binding on him. 6.
Specific performance.

Specific performance means the actual carrying out of the contract as agreed. Since an agreement by a minor is absolutely void, the court will never direct 'specific performance' 26 of such an agreement by him. But a contract entered into, on behalf of a minor, by his guardian or by the manager of his estate, is binding on the minor and can be specifically enforced by or against the minor, provided: (a) the contract is within the authority of the guardian or manager; and (b) it is for the benefit of the minor. Thus it was held in Gujoba Tulsiram vs Nilkanth, 27 that a contract of sale of immovable property by the guardian of minor, for the minor benefit, may be specifically enforced by either party to the contract. Similarly, in Rumalingam vs Babanambal, 28 it was held that a Hindu minor is bound by a contract entered into by his mother as his guardian for sale of his property. However, a guardian has no power to bind the minor: (i) by a contract, for the purchase of immovable property (Mir Sarwarjan vs Fakruddin 29), and (ii) by a contract of service on his behalf (Raj Rani vs Prem Adib 30), and therefore such contracts cannot be specifically enforced by or against the minor. 7. Minor partner. A minor being incompetent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the 'benefits of partnership' with the consent of all the partners by an agreement executed through his lawful guardian with the other partners. Such a minor will have a right to such share of the property or profits of the firm as may be agreed upon and he would have access to and inspect and copy any of the accounts of the firm. The minor cannot participate in the management of the business and shall not share losses except when liability to third parties has arisen but then too upto his share in the partnership assets. He cannot be made personally liable for any obligations of the firm, although he may after attaining majority accept those obligations if he thinks fit to do so. 25 Appended to Section 68. 26 Where for a breach of contract, damages are inadequate remedy, the guilty party may, if the court so likes, be ordered 'specific performance' i.e., to perform the contract specifically (to do as agreed). 27 (1958), A.I.R. Bom. 202. 28 (1951), A.I.R. Mad. 431. 29 (1912), 39 Cal. 232. 30 (1948), 51 Bom. L.R. 256.

 NOTES 8. Minor agent. A minor can be an agent (Sec. 184). He shall bind the

principal
by his acts done in the course of such an agency, but he
cannot be held personally liable for negligence or breach of duty.
Thus in appointing a minor as an agent, the principal runs a great risk. 9. Minor and insolvency. A minor cannot be adjudicated an insolvent, for, he
is incapable of contracting debts. Even for necessaries supplied to him, he is not personally liable, only his property is liable (
Sec. 68). 10.
Contract by minor and adult jointly. Where a minor and an adult jointly enter into an agreement with another person, the minor has no liability but the contract as a whole can be enforced against the adult (Jamna Bai vs Vasanta Rao 31).
In Sain Das vs Ram Chand, 32 where there was a joint purchase by two vendees, one of whom was a minor, it was held that the vendor could enforce the contract against the major vendee. 11.
Surety for a minor. Where in a contract of guarantee, an adult stands surety for a minor, the
adult is liable under the contract, although the minor is not (as for there is a direct contract between the surety and the third party) (Kashiba vs Shripat 33). Infact in such a case there cannot be a contract of guarantee in the true sense. The Bombay High Court considered the question in Manju Mahadeo vs Shivappa Manju 34 , and held that "... if a minor could not default, the liability of the guarantor being secondary, does not arise at all". Similar decision has been given by Madras High Court in Edvavan Nambiar vs Moolaki Raman 35 . 12.
Position of minor's
parents. The parents of a minor are not liable for agreements made by
a minor,
whether the agreement is for the purchase of necessaries or not. The parents can be held liable only when the child is contracting as an agent for the parents. 13. Minor shareholder. A minor, being incompetent to contract, cannot be a shareholder of the company. A company can also refuse to register transfer or transmission of shares
in favour of a minor unless the shares are fully paid.
It follows from it that a minor, acting through his lawful guardian, may become a shareholder of the company, in case of transfer or transmission of fully paid shares to him. Logically also, if a minor could legally hold property in his name, it would be wrong to debar him from holding fully paid up shares in his own name. 14.
Minor's liability in tort. A 'tort' 36 is a civil wrong (
not having its genesis in contractual or equitable relationship) for which the ordinary remedy is damages. A minor is liable for his tort, unless the tort is in reality a breach of contract. Thus, where a minor hired a horse for riding and injured it by over-riding, he was not held liable (Jennings vs Rundall) 37 . The court observed in that case, "if an infant
in the course of doing what he is entitled to do under the contract is guilty of negligence, he cannot be made liable in tort if he is not liable on the contract."
But if the wrongful action is of a kind not
contemplated by the contract, the minor may be held liable for tort. Thus, where a minor hired a horse for riding
under express instructions not to jump,
he was held liable when he lent the horse to one of his friends who jumped
it, whereby it was injured and ultimately died. The court observed, "... it was a bare trespass, not within the object and purpose of the hiring, for which the defendant was liable" (Burnard vs Haggis 38). 31 (1916), 39 Mad. 409 (P.C.). [Also see Section 43 of the Contract Act.] 32 (1923), 4 Lah. 334. 33 (1894), 19, Bom. 697. 34 (1918), 42, 42, Bom. 444. 35 A.I.R. (1957) Mad. 36 "Tort" is, in itself, a very wide field, embracing such diverse conduct as assault, conversion (wrongful use of another's property), defamation, false imprisonment, negligence, malicious prosecution, trespass over immovable property, nuisance and so on. 37 (1799), 8 T.R. 335. 38 (1863), 14 C.B. 45.
Capacity of Parties Self-Instructional Material 47 NOTES 4.3 PERSONS OF UNSOUND MIND As stated earlier,
as per Section 11 of the Contract Act,
for a valid contract, it is necessary that each party to it must have a 'sound mind'.
What is
a 'sound mind'?
Section 12
of the Contract Act defines the term 'sound mind'
as follows: "
A person is
said to be
of
sound mind
for the purpose of making a contract, if, at the time when he makes it, he is capable of

understanding it and
of forming a rational judgment as to its effects upon
his interests."
According to this Section, therefore, the person entering into the contract must be a person who understands what he is doing and is able to form a rational judgment
as to whether what he is about to do is to his interest or not. The
Section further states
that: (i) "
A person who is usually of unsound mind, but occasionally, of sound mind, may make a contract when he is of sound mind."
Thus
a
patient in a lunatic asylum, who is at intervals
of sound mind, may contract during those intervals. 39 (
ii) "
A
person who is
usually of sound mind, but occasionally of unsound mind, may not
make a contract when he is of unsound mind."
Thus,
a
sane man, who is
delirious from fever, or
who is so drunk that he cannot understand the terms of a
contract, or form a rational judgment as to its effect on his
interest,
cannot contract whilst such delirium or drunkenness lasts. 40
In Halsbury's Laws of England, 41 it is stated: "The general theory of the law in regard to acts done, contracts made by parties affecting their rights and interests, is that in all cases there must be a free and full consent to bind the parties. Consent is an act of reason accompanied by deliberation, and it is upon the ground that there is a want of rational and deliberate consent that the conveyance and contracts of unsound mind are generally deemed to be invalid; or in other words, (subject to exceptions), there cannot be a contract by a person of unsound mind." Unsoundness of mind may arise from: (a) Idiocy—It is God given and permanent, with no intervals of saneness. The mental powers of an idiot are completely absent because of
lack of development of the brain; (b) Lunacy or Insanity— It is a disease of the brain. A lunatic
loses the use of his reason due to some mental strain or disease. Of course he may have lucid intervals of sanity; (c) Drunkenness—It produces temporary incapacity, till the drunkard is under the effect of intoxication, provided it is so excessive as to suspend the reason for a time and create impotence of mind; (d) Hypnotism—It also produces temporary incapacity, till the person is under the impact of artificially induced sleep; (e) Mental decay on account of old age, etc. In cases where the contract is sought to be avoided on any of the above grounds, the burden of proof lies on the party who sets up such a disability; but if unsoundness of mind is once established, the burden of proving a lucid interval is on him, who sets it up (Mohanlal vs Vinayak). 42
Effects
of agreements made by persons of unsound mind.
An agreement entered into by a person of unsound mind
is treated on the same footing as that of minor's, and therefore an agreement by a person of unsound mind is absolutely void and inoperative as, against him but he can derive benefit under it (
Jugal Kishore vs Cheddu 43). The property of
a person of unsound mind is, however, always
liable
for necessaries supplied to him
or to any one whom he is legally bound to support,
under Section 68 of the Act. 44 39 Illustration (a) to Section 12. 40 Illustration (b) to Section 12. 41 2nd. ed., V. 21, pp. 279–80. 42 (1941), A.I.R. Nag. 251. 43 (1903), 1 All. L.J. 43. 44 For a detailed study, refer to the heading 'Minor's Agreements' already discussed in the present
unit.
Check Your Progress

State whether the following are True or False: 1.
A
minor is
a person who has not completed
the age of 21
years. 2.
An agreement conferring some benefit upon the minor is a valid contract. 3. A minor cannot be adjudged insolvent. 4.
A minor is personally liable for necessaries supplied to him. 5.
A person who is usually of unsound mind may enter into a contract when he is of sound
mind.
Capacity of Parties 48 Self-Instructional Material NOTES 4.4 DISQUALIFIED PERSONS The third type of incompetent persons, as per Section 11,
are those
who
are "
disqualified from contracting by any law to which they are subject."
Thus: (a)
Alien enemies. An alien (citizen of a foreign country) living in India can enter into contracts with citizens of India during peace time only, and that too subject to any restrictions imposed by the Government in that respect. On the declaration of a war between his country and India, he becomes an alien enemy and cannot enter into contracts. "Alien friend can contract but an alien enemy can't contract." Contracts entered into before the declaration of the war stand suspended and cannot be performed during
the course of war, of course, they can be
revived after the war is over provided they have not already become time-barred. (
b) Foreign sovereigns and ambassadors. One has to be cautious while entering into contracts with foreign sovereigns and ambassadors, because whereas
they can sue others to enforce the contracts entered upon with them,
they cannot be sued without obtaining the prior sanction of the Central Government.
Thus they are in a privileged position and are ordinarily considered
incompetent to contract. (c) Convict. A convict is one who is found guilty and is imprisoned.
During the period of imprisonment, a convict is incompetent (a) to enter into contracts, and (b) to sue on contracts made before conviction. On the expiry of the sentence, he is at liberty to institute a suit and
the Law of Limitation is held in abeyance during the period of his sentence. (
d) Married women. Married women are competent to enter into contracts with respect to their separate properties (Stridhan) provided they are major and are of sound mind. They cannot enter into contracts with respect to their husbands' properties. A married woman can, however, act as an agent of her husband and
bind her husband's property for necessaries supplied to her,
if he fails to provide her with these. (e) Insolvent. An adjudged insolvent (before an 'order of discharge') is competent to enter into certain types of contracts i.e., he can incur debts, purchase property or be an employee but he cannot sell his property which vests in the Official Receiver. Before 'discharge' he also suffers from certain disqualifications e.g., can't be a magistrate or a director of a company or a member of local body but he has the contractual capacity except with respect to his property. After the 'order of discharge,' he is just like an ordinary citizen. (f) Joint-stock company and corporation incorporated under a special Act (like L.I.C., U.T.I.). A Company/Corporation is an artificial person created by law. It cannot enter into contracts outside the powers conferred upon it by its Memorandum of Association or by the provisions of its special Act, as the case may be. Again, being an artificial person (and not a natural person)
it cannot enter into contracts of a strictly personal nature
e.g., marriage. 4.5 TEST QUESTIONS 1.
What do you understand by 'capacity to contract'?
What is the effect of agreements made by persons
of unsound mind? 2.
Discuss in detail the provisions of law relating to minor's agreements. 3. (a) Is a minor bound on his agreement for necessaries? Is he liable upon a bill of exchange which he has accepted in payment for necessaries? (b) Can a promise by a person on attaining majority to repay money lent and advanced to him during his minority be enforced?
Capacity of Parties Self-Instructional Material 49 NOTES 4.
Discuss with suitable illustrations the law relating to validity of contracts by minors. 5. "
Apart from minority and unsoundness of mind, the capacity of a person may be affected by virtue of any special law to which he is subject." Comment on the statement. 4.6

PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A, an infant, obtains a loan from B. Can A be asked to repay the money? [Hint. No, A cannot be asked to repay the money. A minor's agreement is void ab- initio as against him (Mohori Bibi vs Dharmodas Ghosh).] 2. A, a minor lends Rs 1,000 against a Promissory Note executed in his favour. Is the borrower liable to repay the money? [Hint. Yes, the borrower is liable to repay the money to the minor, because the law protects the rights of minors i.e., a minor can take benefit under a contract e.g., he can be a payee or a promisee.] 3. A minor fraudulently represented to a moneylender that he was of full age, and obtained a loan of Rs 500. Has the moneylender any right of action against the minor for the money lent, or for damages for fraudulent misrepresentation? [Hint. No, the moneylender does not have any right of action against the minor on either of the grounds, because the 'Rule of Estoppel' does not apply to a minor. Of course, if any thing is traceable in the hands of the minor out of the amount of loan so obtained, the court may direct the minor to restore that thing to the other party, on equitable consideration, for, 'minors can have no privilege to cheat man.'] 4. A, an infant, borrows Rs 2.000 from B and executes a promissory note for the amount in favour of B. On his attaining majority, the minor executes another promissory note in lieu of the first which is then cancelled. Is the second promissory note valid? [Hint. The second promissory note is invalid, for a minor's agreement, being void ab- initio, cannot be made valid by subsequent ratification (Mohindra vs Kailash).] 5. A renders some service to B during his minority at the request of B. B, on attaining majority, enters into an agreement with A to compensate A for services rendered during B's minority. Is the agreement valid? [Hint. Yes, the agreement is valid and the promisee could enforce it, as it is covered within the purview of the exception to 'consideration' as given in Section 25(2) (Karam Chand vs Basant Kaur).

MODULE - 2

Free Consent Self-Instructional Material 53 NOTES UNIT 5 FREE CONSENT Structure 5.0 Introduction 5.1 Unit Objectives 5.2 Coercion 5.3 Undue Influence 5.4 Misrepresentation 5.5 Fraud 5.6 Mistake 5.7 Test Questions 5.8 Practical Problems

5.0 INTRODUCTION It has already been pointed out that, according to Section 10, ' free consent' of all the parties to an agreement is one of the essential elements of a valid contract. ' Consent' defined. Section 13 of the Contract Act defines the term 'consent' and lays down that " Two or more persons are said to consent when they agree upon the same thing in the same sense." Thus, consent involves identity of minds or consensus ad-idem i.e., agreeing upon the same thing in the same sense. If, for whatever reason, there is no consensus ad-idem among the contracting parties, there is no real consent and hence no valid contract. 'Free Consent' defined. Section 14 lays down that " Consent is said to be free' when it is not caused by — 1. coercion, as defined in Section 15, or 2. undue influence, as defined in Section 16, or 3. misrepresentation, as defined in Section 18, or 4. fraud, as defined in Section 17, or 5. mistake,

subject to the provisions of
Sections, 20, 21 and 22." "
Consent is said to be
so caused when it would not have been given but for the existence of such coercion, undue influence,
misrepresentation, fraud or mistake" (
Sec. 14). This means that in order to bring a case within this Section, the party, who alleges that his consent has been caused by any of the above elements which vitiate consent, must show that, but for the vitiating circumstance the agreement would not have been entered into. To put it differently, in order to prove that his consent is 'not free', the complainant must prove that if he had known the truth, or had not been forced to agree, he would not have entered into the contract. In the absence of free consent', the contract may turn out to be either voidable or void depending upon the nature of the flaw in
consent.
When consent to an agreement is caused by coercion, undue influence,
misrepresentation
or
fraud, there is 'no free consent' and
the
contract
is
voidable
at the option of the party whose consent
was
so
caused (
Secs. 19 and 19A).
But when consent is caused by 'bilateral
mistake' 1 as to
a
matter of fact essential to the agreement,
the agreement
is void (
Sec. 20).
In
such a case
there is 'no consent' at all. 1 For a detailed discussion, refer to the heading 'Mistake' dealt later in this unit.
Free Consent 54 Self-Instructional Material NOTES 5.1 UNIT OBJECTIVES ? Be clear about the concept of ' consensus ad-idem', i.e. parties agreeing upon the same thing in the same sense. ?
To grasp the essential features of different elements which vitiate consent and be aware of their effect on the validity of the contract. ? Understand the concept of 'mistake' and how does it effect the validity of the contract. 5.2
COERCION 5.2.1 Definition
Section 15 of the Contract Act defines 'Coercion' as follows: "
Coercion is
the
committing or
threatening to commit, any act forbidden by
the
Indian Penal Code, or
the
unlawful
detaining or threatening to detain, any property,
to
the prejudice
of any person whatever,
with the intention of causing any person to enter into
an agreement."
The
Explanation to the Section further adds that "

it is immaterial
whether the Indian Penal Code is or is not in force in
the place where the coercion is employed."
The above definition
can be analysed as follows: 1.
Coercion implies (
a)
committing or
threatening to commit any act forbidden by
the
Indian Penal Code; 2 or (
b) unlawful
detaining
or threatening to detain any property, with the
intention of causing any person to enter into
an agreement.
Illustrations. (i)
A
Madrasi gentleman died leaving a young widow. The relatives of the deceased threatened the widow to adopt a boy otherwise they would not allow her to remove the dead body of her husband for cremation.
The widow adopted the boy and subsequently applied for cancellation of the adoption. It was held that
her consent was not free but induced by coercion,
as any person who obstructed a dead body from being removed
for cremation, would be guilty of an offence under Section 297 of the I.P.C. The adoption was set aside
(Ranganayakamma vs Alwar Setti 3). (ii) L threatens
to shoot M, if he does not let out
his house to him. M agrees to let out his house to L. The consent of M has been
induced by coercion. (
iii)
An agent refused to hand over the account books of
the business to the new agent sent in his place,
unless the Principal released him from all liabilities. The Principal had to give a release deed as demanded. Held,
that the release deed was voidable at the instance of the Principal
who was made to execute the release deed under coercion (Muthia vs Karuppan 4). (iv)
The Government gave a threat of attachment against the property
of A,
for the recovery of a fine due from
B, the son of A. A, paid the fine. Held, the payment of fine was induced by coercion and
therefore
A was entitled to recover the moneys paid to remove wrongful attachment (Bansraj vs The Secy. of State 5). 2.
The act constituting coercion, may be directed at any person, and not necessarily at the other
party to the agreement.
Likewise it may proceed even from a stranger to the contract. 2
Threat to shoot,
murder, intimidation, threat to cause hurt, rape, defamation, giving wrong evidence, instigating to commit crime, theft, attempt to commit suicide, are a few examples of acts forbidden by Indian Penal Code. 3 (1889), 13 Mad. 214. 4 (1927), 50 Mad. 786. 5 (1939), A.W.R. 247.
Free Consent Self-Instructional Material 55 NOTES Illustrations. (a) A, threatens to shoot B, a friend of C if C does not let out his house to him. C agrees to do so.
The agreement has been brought about by coercion. (b)
A, threatens to shoot B if he does not
let out his house to C. B agrees to let out his house to C. B's consent has been caused by
coercion. 3.
It does not matter
whether the Indian Penal Code is or is not in force in
the
place where the coercion is employed.

If the suit is
filed in India,
the above provision (i.e., Sec. 15) will apply. Illustration (Appended to Sec. 15).
A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the
Indian Penal Code.
A, afterwards sues B for breach of contract at Calcutta. A, has employed coercion, although his act is not an offence by the law of England and although
Section 506 of
the Indian Penal Code was not in force,
at the time when, or place where, the act was
done. Threat to
file a suit. To threaten a criminal or civil prosecution does not constitute coercion because it
is not an act
forbidden by the Indian Penal Code.
But a threat to file a
suit on
a false charge constitutes coercion, for such an act is forbidden by the I.P.C. (Askari Mirza vs Bibi Jai Kishori 6) Threat to commit suicide. Neither 'suicide' nor 'threat to commit suicide' is punishable under
the Indian Penal Code; only 'an attempt to commit suicide' is punishable
under it. In Chikkam Ammiraju vs Chikkam Seshamma, 7 there arose a question as to whether 'a threat to commit suicide' amounts to coercion, and their Lordships of the Madras High Court answered the question in the affirmative holding that this amounts to coercion.
In that case a person, by a threat
to commit
suicide, induced his wife and son to
execute a release
deed
in favour of his brother in respect of certain
properties
which they claimed as their own. The
transaction was set aside on the grounds of coercion. It was stated by the majority of judges
that though 'a threat to commit suicide' was
not punishable under the Indian Penal Code, it
must be deemed to be forbidden by that Code, as 'an attempt to commit suicide'
was punishable under Section 309 of that Code. Their Lordships
observed: "
The term 'any act forbidden by the Indian Penal Code' is wider than the term 'punishable by the Indian Penal Code.' Simply because a man escapes punishment, it does not follow that the act is not forbidden by
the
Penal code. For example, a lunatic or a minor may not be punished. This does not show that
their criminal acts are not forbidden by the Penal Code." Duress. The term 'duress' is used in English Law to denote illegal imprisonment or either actual or threatened violence over the person (body) of another party or his wife or children with a view to obtain the consent of that party to the agreement. In short, for 'duress' the act or threat must be aimed at the life or liberty of the other party to the contract or the members of his family.
A threat to destroy or detain property will not amount to 'duress.' Thus the scope of the term 'coercion,' as defined in Section 15, is wider, because it includes threats over property also. 5.2.2
Effect of Coercion
A contract
brought about
by coercion
is
voidable
at the option of the party whose consent
was
so
caused (

Sec. 19).
This means
that
the aggrieved party
may either exercise the option to affirm the transaction and hold the other party bound by it, or repudiate the transaction by exercising
a right of rescission. 8 As per Section 64, if the aggrieved party opts to rescind a voidable contract, he must
restore any benefit received by him under the contract to the other party from whom
received.
The burden of proof that coercion was used lies on the party who wants to set aside the contract
on the
plea of coercion. 6 (1912), 16.
I.C. 344. 7 (1918), 41 Mad. 33. 8 The power to rescind the contract is lost in certain cases. For details refer to the heading 'Loss of Right of Rescission' discussed later in this unit.
Free Consent 56 Self-Instructional Material NOTES 5.3 UNDUE INFLUENCE 5.3.1 Definition Section 16(1) defines the term
'
Undue influence' as follows: "
A contract is said to be induced by undue influence
where, (
i) 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 (
ii) he uses
the
position to obtain an unfair advantage over the other."
The phrase "
in a position to dominate the will of
the other"
is
clarified by the same Section under subsection (2), thus:
Section 16(2).
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,
e.g.,
the relationship
between master and
the servant, police officer and the accused;
or (
b)
where he stands in a fiduciary relation to the other.
Fiduciary relation means a
relation of mutual trust and confidence.
Such a relationship is supposed to
exist in the following cases: father and son,
guardian and ward, solicitor and client, doctor and patient,
Guru (spiritual adviser) and disciple, trustee and beneficiary, etc.;
or (
c)
where
he

makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress, e.g., old illiterate persons. It is to be observed that for proving the use of undue-influence both the elements mentioned above, namely, (i) the other party was in a position to dominate his will, and (ii) the transaction was an unfair one, must be established. 5.3.2 Presumption of Undue Influence Undue influence is presumed to exist under the circumstances mentioned above in sub- clauses (a), (b) and (c). In other words, for example, where the relationship between the contracting parties is that of master and servant, father and son, doctor and patient, solicitor and client, etc., or where one of the parties to the contract is an old illiterate person, there is no need of proving the use of undue influence by the party whose consent was so caused. Merely status of parties is enough to prove the existence of undue influence in these cases. Presumption of undue influence is also there, in case of a contract by or with a 'pardanashin woman'. 9 There is, however, no presumption of undue influence in the following cases: (i) Husband and wife (In case of persons engaged to marry, the presumption of undue influence will arise). 10 (ii) Mother and daughter. 11 (iii) Grandson and grandfather. 12 (iv) Landlord and tenant. 13 (v) Creditor and debtor. 14 9 Also see the heading 'pardanashin woman' dealt later in this unit. 10 Sar Farazali vs Ahmad Kamil, A.I.R. (1944), All. 104. 11 Ismail vs Hafiz Boo, (1906), 33 Cal. 773. 12 Lakshmi Amma vs Telengana Narayana, A.I.R. (1970), S.C. 1367. 13 Promoda Nath vs Kinoo Mollai, (1908), 8 Cal. L.J. 135. 14 For details refer to the heading 'Unconscionable Transactions' dealt later in this unit.

 In these cases, undue influence shall have to be proved by the party alleging that undue influence existed. Burden of proof and rebutting the presumption. In cases where there is a presumption of undue influence the burden of proving that the person who was in a position to dominate the will of another, did not use his position to obtain an unfair advantage, will lie upon the person who was in a position to dominate the will of the other [Sec. 16 (3)]. He can rebut or oppose the presumption by arguing (i) that full disclosure of facts was made, (ii) that the price was adequate, (iii) that the other party was in receipt of competent independent advice and his consent was free. Illustrations. (a) A, having advanced money to his son B, obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance.

A employs undue influence.

As undue influence is presumed to exist if the relationship between contracting parties is that of father and son, the burden of proof lies on A, the father. It will be for A to prove that he did not employ undue influence, on a suit by B alleging undue influence. (b) 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 professional services. B employs undue influence. 15

On a petition by A alleging undue influence, it lies on B, the doctor,
to prove that the contract was not induced by undue influence. (
c)
An old
illiterate woman made a gift of almost the whole of her property to her nephew, who
was managing her estate. On a petition by the old lady for setting aside the gift deed on the ground of undue influence,
the onus lies on the nephew to prove that the transaction is bona fide, well understood and free from undue influence,
because undue influence is presumed in such a case. 5.3.3
Effect of Undue Influence "
When consent to an agreement is causer by undue influence,
the agreement
is
a
contract
voidable at the option of the party whose consent was
so
caused.
Any such contract may be set aside either absolutely or, if the party who was entitled to avoid
it
has received any benefit thereunder, upon such terms and conditions as the court may seem just." (
Sec. 19-A)
Illustrations. (Appended to Sec. 19-A). (
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. (
b)
A, a money lender, 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
the Rs 100 with such interest as may seem just. Thus, it will be noticed that Section 19-A also declares
a contract brought about by undue influence voidable at the option of the
aggrieved party, just as Section 19 so declares in case of a contract brought about by coercion, misrepresentation or fraud. The special feature of Section 19-A is that while in the case of rescission of a contract procured by coercion, misrepresentation or fraud, any benefit received by the aggrieved party has to be restored under Section 64 of the Contract Act; under Section 19-A,
if a contract procured by undue influence is set aside, 16
the Court has discretion to direct the aggrieved party for refunding the benefit whether in whole or in part or set aside the contract without any direction
for refund of benefit.
The following points must also be noted in this connection: (i) Lack of judgment, lack of knowledge of facts or absence of foresight are generally not by themselves sufficient reasons for setting aside a contract on the ground of undue influence. Persuation and argument are also not in themselves undue influence. 15 Illustration appended to Section 16. 16 The power to set aside the contract is, however, lost in certain cases. For details refer to the heading — 'Loss of Right of Rescission' discussed later in this unit.
Free Consent 58 Self-Instructional Material NOTES Undue influence implies mental and moral coercion so as to make
the consent of one of the parties to the contract
unfree. (
ii) Undue influence
by
a person, who is not a party to the contract,
may make the contract voidable. In other words,
it is not necessary that
the person
in a position to dominate the will of the other

party must himself be benefited. It is sufficient if the third person in whom he is interested is benefited (Chinnamma vs Devenga Sangha 17). 5.3.4 Unconscionable Transactions Unfair or unreasonable bargains belong to the category of 'unconscionable transactions.' These are such transactions where as between two contracting parties, one is in a dominant position and makes an exorbitant profit of the other's distress. High rate of interest. Unconscionable bargains take place mostly in moneylending transactions where moneylenders charge high rates of interest from needy borrowers. The presumption of undue influence on the ground of high rate of interest is raised only when the following two things
are proved: 1. that
the moneylender
was
in a position to dominate the will of the
borrower, and 2.
that
the
bargain is unreasonable i.e., rate of interest is excessive without any valid reason. In such cases the law presumes that consent must have been obtained by undue influence and
the burden of proving that there was no undue influence lies on the creditor.
It must be noted that both the above conditions must be proved for giving rise to a presumption of undue influence. There will be no presumption of
undue influence and a transaction will not be set aside on ground of undue influence, merely because the rate of interest is high
if both
the parties are on equal footing (i.e., none
of the parties
is in a position to dominate the will of
the other
party) or if there exists valid reason (like tight money market conditions) for charging high rate of interest. Illustrations. (a) A, being in debt to B, the
moneylender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence [
Illustration (c) to
Section 16]. (b) A poor Hindu widow borrowed Rs 1,500 from a moneylender at 100 per cent per annum rate of interest for the purpose of enabling her to establish her right to maintenance. It lies on the moneylender to prove that there was no undue influence (Rannee Annapurni vs Swaminatha 18). (c) A, applies to a banker for a loan at the
time when there is
stringency in the money market. The banker declines to make
the
loan
except at an unusually high
rate of interest. A, accepts the loan on these terms.
This
is
a
transaction in the ordinary course of business, and the contract is not induced by undue influence [
Illustration (d) to
Section 16]. Now-a-days, however, drastic legislation in almost every State (fixing maximum rates of interest etc.) has proved greater protection to debtors. High prices. As regards exorbitant price charged by the trader, it is never considered a case of undue influence. 5.3.5 Pardanashin Woman As observed earlier,
there is a presumption of undue influence in case of a contract by or with a 'pardanashin woman'.
She can avoid
any
contract entered by her on the plea of undue influence and it is for the other party to prove that no undue influence was used. For proving the absence of undue influence, the other party will have to satisfy the Court (i) 17 (1973), A.I.R. Mys. 338. 18 (1910), 34 Mad. 7.

that
the terms of the contract were fully explained to her, (ii)

that she understood their implications,
and was free to have independent advice in the matter, and (iii) that she freely consented to the contract. It may be noted that
the term 'pardanashin' here refers to a woman who observes complete seclusion (parda) from contact with people outside her own family, because of
the custom of her community, and one
does not become 'pardanashin' simply because she lives in some degree of seclusion (Shaik Ismail vs Amir Bibi 19).
Further, note that the protection granted to pardanashin woman is also extended to illiterate and ignorant ladies, who are equally exposed to the danger and risk of an unfair deal (Sonia Parshini vs S.M. Baksha 20). 5.3.6 Distinction
between Coercion and Undue Influence Both, coercion and
undue influence, vitiate consent and make
the consent of one of the parties
to the contract
unfree. But the following are the points of distinction between the
five: 1. In coercion, the consent
of the aggrieved party is obtained
by
committing
or threatening to commit an act forbidden by Indian Penal Code or
detaining or threatening to detain
some property
unlawfully. While in undue influence, the consent of the aggrieved party is affected
from the domination of the will of one person over another. 2.
Coercion is mainly of a physical character involving mostly use of physical or violent force.
Whereas
undue influence is of moral character involving use of moral force or mental pressure. 3.
There
is no presumption of coercion by law under any circumstance.
The burden of proof that coercion was used lies on the party
whose consent was so caused. In the case of undue-influence, however, there is presumption as to the same in the case of certain relationships. In these cases there is no need of proving the use of undue-influence by the party whose consent was so caused. 4. While in the case of rescission of a contract procured by coercion, any benefit received by the aggrieved party has to be restored under Section 64 of the Contract Act; in the case of rescission of a contract procured by undue influence, as per Section 19-A,
the Court has discretion to direct the aggrieved party for restoring the benefit whether in whole or in part or set aside the contract without any direction
for refund of benefit. 5.
The party exercising coercion exposes himself to criminal liability under the Indian Penal Code, besides an action on contract.
There is no criminal liability in case of undue- influence. 5.4
MISREPRESENTATION A
representation means
a statement of fact made by one party to the other,
either before or at the time of
contract, relating to some matter essential
to the formation
of
the contract,
with an intention
to induce the other party to enter into
the
contract.
It may be expressed by words spoken or written or implied from the acts
or conducts of the
parties (e.g., by any half statement of truth).
A representation when wrongly made, either innocently or intentionally, is

termed as a misrepresentation. To put in differently, misrepresentation may be either innocent or intentional or deliberate with an intent to deceive the other party.
In law, for the former kind, the term 'Misrepresentation' and for the latter the term 'Fraud' is used. 19 (1920), 4 Bom. L.R. 146. 20 (1950), A.I.R. Cal. 17.
Free Consent 60 Self-Instructional Material NOTES 5.4.1 Definition
According to Section 18 '
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;
or (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 any one claiming under him;
or (
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.
Thus, as per
Section 18, there is misrepresentation in the following three cases: (a)
Positive assertion of unwarranted statements of material facts believing them to be true.
If
a person makes
an explicit statement of fact not warranted by his information (i.e., without any reasonable ground),
under an honest belief as to its truth though it is not true, there is misrepresentation. Illustration.
A says to B who intends to purchase his land, "My land produces 10 quintals of wheat per acre." A, believes the statement to be true, although he did not have sufficient
grounds for the belief. Later on, it transpires that the land produces only 7 quintals of
wheat per acre. This is a misrepresentation. It may be noted that a mere expression of opinion or words of commendation, for example, in a sale of land a mere general statement that the land is fertile, cannot be held to amount to a positive assertion. (b)
Breach of duty which brings an advantage to the person committing it by misleading
the other to his prejudice.
This clause covers those cases where a statement when made was true but subsequently before it was acted upon, it became false to the knowledge of the person making it.
In such a case, the person making the statement comes under an obligation to disclose the change in circumstances to the other party,
otherwise he will be guilty of misrepresentation. Illustration. A, before signing a contract with B for the sale of business, correctly states that the monthly sales are Rs 50,000. Negotiations lasted for five months, when the contract of sale was signed. During this period the sales dwindled to Rs 5,000 a month. A, unintentionally keeps quite. It was held that there was misrepresentation and B was entitled to rescind the contract (With vs O'Flanagan 21). Note, that a partial non-disclosure may also constitute a misrepresentation, for instance, where a vendor of land told a purchaser that all the farms on the land were fully let, but inadvertently omitted to inform him that the tenants had given notice to quit, he was held guilty of misrepresentation (Dimmock vs Hallett 22). (c) Causing
mistake about subject-matter innocently.

If one of the parties
induces the other, though innocently, to commit a mistake
as to the quality or nature of the thing bargained, there is misrepresentation.
Illustration. In a contract of sale of 500 bags of wheat, the seller made
a representation that no sulphur has been used in the cultivation of wheat. Sulphur,
however, had been used in 5 out of 200 acres of land. The buyer would not have purchased the wheat
but for the representation. There is a misrepresentation.
Essentials of misrepresentation. From the foregoing discussion, it follows that for alleging misrepresentation, the
following four things are necessary: 21 (1936), Ch. 575. 22 (1866), 2 Ch. App. 21.
Free Consent Self-Instructional Material 61 NOTES (i) There should be a representation,
made innocently, with an honest belief as to its truth
and without any desire to deceive the other party, either expressly or impliedly. (ii) The representation must relate to facts
material to the contract and not to mere opinion or hearsay. (iii) The representation must be, or must have become
untrue. (iv) The representation must have been instrumental in inducing the other party to enter into a contract (As per
the Explanation to Section 19). 5.4.2 Effects of Misrepresentation
In case of misrepresentation, the aggrieved party has two alternative courses
open to him— (i) he can rescind 23 the contract, treating the contract
as voidable; or (ii)
he may affirm
the contract and insist that he shall be put in the position in which he would have been, if the representation made had
been true (
Sec. 19).
Misrepresentation does not entitle the aggrieved party to claim damages by way of interest or otherwise for expenses
incurred. Illustration. A, innocently in good faith
tells B that his T.V. set is made in Japan. B, thereupon buys the
T.V. set. However, it comes
out to be an Indian make. A, is guilty of misrepresentation.
B, may either avoid the contract or may insist on its being carried out.
In the latter case, B may either ask for replacing the set by a Japanese make set or may keep the Indian make set and
claim the difference in price
between that set and a Japanese make set. Exception. The above remedy is lost,
if
the party whose consent was caused by misrepresentation,
had the means of discovering the truth
with ordinary diligence.
Illustration.
A, by
a misrepresentation, leads B erroneously to believe that 500 maunds of indigo are made annually at
A's
factory.
B
examines the accounts of the factory, which
show that only 400
maunds of indigo
have
been made. After this B buys the factory. The contract
is not voidable on account of A's misrepresentation (
Illustration (b) to Section 19]. 5.5
FRAUD
The term 'fraud' includes
all acts committed by a person with an intention to deceive another person. 5.5.1
Definition
According to
Section 17, '
fraud means and includes
any of the following acts committed by a party to a
contract,' or with

his connivance, or by his agent, with intent to deceive or to induce another party thereto or his agent, to enter into the contract: 1. The suggestion that a fact is true when it is not true by one who does not believe it to be true.

Thus a false statement intentionally made is fraud.

An absence of honest belief in the truth of the statement made is essential to constitute fraud. If a representor honestly believes his statement to be true, he cannot be liable in deceit no matter how ill-advised, stupid, or even negligent he may have been. In order to be called fraudulent representation the false statement must be made intentionally. Lord Herschell gave the definition of fraud in Derry vs Peek 24 as, "

a false statement made knowingly, or without belief in its truth, or recklessly careless whether it be true or false." 2. The active concealment of a fact by a person who has knowledge or belief of the fact.

Active concealment of a material fact is taken as much a fraud as if the existence of such fact was expressly denied or the reverse of it expressly stated. Mere non-disclosure 23 The power to rescind the contract is, however, lost in certain cases. For details refer to the heading — 'Loss of Right of Rescission' dealt later in this unit. 24 (1889), 14 A.C. 337.

is not fraud, where there is no duty to disclose. Caveat Emptor or '

Buyer Beware' is the principle in all contracts of sale of goods.

As a rule the seller is not bound to disclose to the buyer the faults in the goods he is selling. Illustrations. (a)

A, a horse dealer, sells a mare to B. A knows that the mare has a cracked hoof which he fills up in such a way as to defy detection or on enquiry from

B, A affirms that the mare is sound. The defect is subsequently discovered by B. There is 'fraud' on the part of A and the agreement can be avoided by B as his consent has been obtained by fraud. (b)

A, sells by auction, to B a horse, which he knows to be unsound.

A says nothing to B about the horse's unsoundness. This is not 'fraud' because A is under no duty to disclose the fact to B, the general rule of law being 'let the buyer beware' [Illustration (a) to Section 17]. 3. A promise made without any intention of performing it. If a man while entering into a contract has no intention to perform his promise, there is fraud on his part.

Illustrations. (a) X purchases certain goods from Y on credit without any intention of paying for them as he was in insolvent circumstances. It is

a clear case of fraud from X's side. Note that mere failure to pay, where there was no original dishonest intention, is not fraud. (b) Where a man and
a woman went through a ceremony of marriage without any intention on the part of the husband to regard it as a real marriage, it was held that the consent of the wife was obtained by fraud and
that the marriage was mere pretence (Shireen Mal vs John J. Taylor 25). 4. Any other act fitted to deceive. 'The fertility of man's invention in devising new schemes of fraud is so great that it would be difficult, if not impossible, to confine fraud within the limits of any exhaustive definition. All surprise, trick, cunning, dissembling and other unfair way that is used to cheat anyone is considered fraud and subsection (4) is obviously intended to cover all those cases of fraud which cannot appropriately be covered by the other subsections. 26 5.
Any such act or omission as the law specially declares to
be fraudulent.
This subsection refers to
the
provisions in certain Acts which make it obligatory to disclose relevant facts.
Thus,
for instance, under Section 55
of
the Transfer of Property Act, the seller of immovable property
is bound to
disclose to the buyer all material defects
in the property (
e.g., the roof has a crack) or in the seller's title (e.g., the property is mortgaged).
An omission to make such a disclosure amounts to fraud. Thus, in order to allege fraud, the act complained of must be brought within the scope of the acts enumerated above. A mere expression of opinion or commendatoy expression is not fraud. "The land is very fertile" is simply a statement of opinion or "our products are the best in the market" is merely a commendatory expression. Such statements do not ordinarily amount to fraud. 5.5.2 Can Silence be Fraudulent? The Explanation to Section 17 deals with cases as to when 'silence is fraudulent' or what is sometimes called 'constructive fraud.'
The explanation declares that "
mere
silence as to facts likely to affect the willingness of
a person to enter into
a
contract is not fraud,
unless— (i)
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 (ii) silence is,
in itself, equivalent to speech."
It therefore
follows that — 1. As a rule mere silence is not fraud because there is no duty cast by law on
a party to a contract to make a disclosure to the other party, of material facts within his knowledge. 25 (1952),
A.I.R. Punj. 277. 26 Cf. Desai T.R. 'The Contract Act,' 18th Edn., p. 1 16.
Free Consent Self-Instructional Material 63 NOTES Illustration.
A and B, being traders, enter upon a
contract. A has private information of a change in prices which would affect
B's willingness to proceed with the contract. A is not bound to inform B [
Illustration (d) to
Section 17]. 2.
Silence is fraudulent, if
the circumstances of the case are such that 'it is the duty of the person keeping silence to speak'.
In other words, silence is
fraudulent
in contracts of 'utmost good faith' i.e., contracts 'uberrimae fidei.' These are contracts in which the law imposes a duty

of abundant disclosure on one of the parties thereto, due to peculiar relationship of the parties or due to the fact that one of the parties has peculiar means of knowledge which are not accessible to the other. The following contracts come within the class of 'uberrimae fidei' contracts: (a) Fiduciary relationship. When the parties stand in a fiduciary relation to each other, the person in whom confidence is reposed is under a duty to act with utmost good faith and to make a full disclosure of all material facts concerning the transaction known to him. Examples of a fiduciary relationship include those of principal and agent, solicitor and client, guardian and ward, and trustee and beneficiary. Illustrations. (i) Where a broker who was employed to buy shares for the client, sold
his own shares to the client, without disclosing this fact
to him and without obtaining his consent therefore, it was held that the sale can be avoided by the client (Regier vs Campbell-Stuart 27). (ii) Where solicitor purchased certain property from his client nominally for his brother, but really for himself, it was held that the sale can be avoided by the client, even if the transaction was perfectly proper one (Macpherson vs Watt 28). (b) Contracts of insurance. In contracts of marine, fire and life insurance, the insurer contracts on the basis that all material facts have been communicated to him; and it is an implied condition of the contract that full disclosure shall be made, and that if there has been non-disclosure he shall be entitled to avoid the contract.
The assured, therefore must disclose to the insurer all material facts concerning the risk to be undertaken
e.g., disease etc., in case of life insurance. A concealment or misstatement of a material fact will render the contract void (Ratan Lal vs Metropolitan Co. 29). (c) Contract of marriage engagement. Every material fact must be disclosed by both parties to a contract of marriage otherwise the other party is justified in breaking off the engagement (Haji Ahmed vs Abdul Gani 30). (d) Contracts of family settlements. Contracts of family settlements and arrangements also require full disclosure of all material facts within the knowledge of the parties to such contracts. Such a contract is not binding if either party has been misled by the concealment of material facts. (e) Share allotment contracts. Promoters and directors, who issue the 'prospectus' of a company to invite the public to subscribe for shares and debentures, possess information which is not available to general public and as such they are required to disclose all information regarding the company with strict and scrupulous accuracy. 3.
Silence is
fraudulent where the circumstances are such that "
silence is, in
itself, equivalent to speech."
Where, for example,
B says to A — "If you do not deny it, I shall assume that the
horse is sound."
A
says nothing. Hence
A'
s silence is equivalent to speech.
If
the horse is unsound A's
silence is fraudulent [
Illustration (c) to Section 17]. 5.5.3
Effect of Fraud A party who has been induced to enter into
a contract by fraud, has the following remedies open to him: 27 (1939),
Ch. 766. 28 3 A.C. 254. 29 (1959), Pat. 413. 30 (1937), Nag. 299.
Free Consent 64 Self-Instructional Material NOTES 1.
He can rescind 31 the contract i.e., he can avoid the performance of the contract; being voidable at his option (Sec. 19).
2. He can ask for restitution and
insist that the contract shall be performed,
and
that he shall
be put in the position in which he would have been, if the representation made had been true (
Sec. 19).
Illustration. A, fraudulently informs B that A's
estate
is free from encumbrance. B thereupon buys the estate. The estate is subject to a mortgage.
B may either avoid the contract, or
may insist on its being carried out and
the
mortgage debt redeemed. [

Illustration (c) to Section 19]. 3.
The aggrieved party can also sue for damages, if
any. Fraud is a 'civil wrong' hence compensation is payable.
For instance, if the
party suffers injury because of unsound horse, which was not disclosed despite enquiry, compensation can be demanded.
Similarly, where a man was fraudulently induced to buy a house, he was allowed to recover the expense involved in moving into the house as damages (in addition to rescission of the contract) (Doyle vs Olby (Ironmongers) Ltd. 32].
Special points. For giving rise to an action for deceit, the following points deserve special attention: (i)
Fraud by a stranger to the contract does not affect
contract. It may be recalled that 'coercion' as well as 'undue influence' by a stranger to a contract affect the contract. (ii) Fraudulent representation must have been instrumental in inducing the other party to enter into the contract i.e., but for this, the aggrieved party would not have entered into the contract. (iii) The plantiff must have been actually deceived by fraudulent statement. A deceit which does not deceive gives no ground for action. (iv) The plaintiff must be thereby damnified. Unless the plaintiff has sustained a damage or injury, no action will lie. It is a common saying that "there is no fraud without damages." (v) In cases of fraudulent
silence,
the contract is not voidable,
if
the party whose consent was so caused
had the means of discovering the truth
with ordinary diligence (
Exception to
Sec. 19 given in the Act). Note that in other cases of fraud, this is no defence i.e., the contract is voidable even if the fraud could be discovered with ordinary diligence. 5.5.4
Distinction between Fraud and Misrepresentation The following are the points of distinction between the
three: 1. Fraud implies an intention to deceive, it is deliberate or wilful; whereas misrepresentation is innocent without any intention to deceive. 2.
Fraud is a civil wrong which entitles a party to claim damages in addition to the right of rescinding the contract.
Misrepresentation gives only the right to avoid the contract and there can be no suit for damages. 3.
In case of misrepresentation,
the fact that
the aggrieved party had the means to discover the truth with ordinary diligence
will prevent the party from avoiding the contract. But
in case of fraud,
excepting fraud by silence,
the contract is voidable even though the party defrauded
had the means of discovering the truth with ordinary diligence. 31
The
power to rescind is, however, lost in certain cases. For details refer to the heading — 'Loss of Right of Rescission' later in this unit. 32 (1969), 2 W.L.R. 673.
Free Consent Self-Instructional Material 65 NOTES 5.5.5 Loss of Right of Rescission 33 We have observed earlier that a contract brought about
by coercion, undue influence, misrepresentation or
fraud
is
voidable
at the option of the party whose consent
was
so
caused.
He has the
option either to recind the contract or to

affirm it. But his right of rescission is lost in the following cases: 1. Affirmation. If after becoming aware of his right to rescind, the aggrieved party affirms the transaction either by express words or by an act which shows an intention to affirm it, the right of rescission is lost. So, for example, if a person, who has purchased shares on the faith of a misleading prospectus, subsequently becomes aware of its falsity, but accepts dividends paid to him, he will not be permitted to avoid the contract. Paying for the goods purchased (if not paid so far), attempting to sell the goods are some other examples of implied affirmation. 2. Restitution not possible. If the party seeking rescission
is not in a position to restore the benefits he may have obtained under the contract,
e.g., where the subject-matter of the contract has been consumed or
destroyed,
the right to rescind the contract
cannot be exercised. 3. Lapse of time. It may be treated as evidence of affirmation where the party misled fails to exercise his rights promptly on discovering the representation to be untrue or on becoming aware of the fraud or coercion. As such the right of rescission may also be lost by too long- a-delay. 4. Rights of third parties. Since the contract is valid until rescinded, being a voidable contract, if before the contract is rescinded third parties, bona fide for value, acquire rights in the subject matter of the contract, those rights are valid against the party misled, and the right to rescind will no longer be available. 34 Thus where a person obtains goods by fraud and, before the seller rescinds the contract, disposes them off to a bona fide party, the seller cannot then rescind (Phillips vs Brooks Ltd. 35). 5.6
MISTAKE
Mistake may be defined as an erroneous belief concerning something.
It
may be
of
two kinds: 1.
Mistake of law. 2. Mistake of
fact. 5.6.1
Mistake of Law
Mistake of law
may be of two types: 1. Mistake of law of the country; 2.
Mistake of foreign law. 1. Mistake of
law
of the
country
or Mistake of
law. Every one is deemed to be
conversant with
the law of his country, and hence the maxim "
ignorance of law is no excuse." Mistake of law, therefore, is
no excuse and it does not give right to the parties to avoid the contract.
Stating the effect of mistake as to
law,
Section 21
declares
that "
a contract is not voidable because it was caused by a mistake as to
any law in force in India."
Accordingly, no relief can be granted on the ground of mistake of law of the
country.
Illustration (to Sec. 21).
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 (
i.e., the contract is valid). 33 This heading is common to all 'defects of consent' discussed so far. 34 Section 29 of the Sale of Goods Act. 35 (1919), 2 K.B. 243.
 However, if one of the parties makes
a 'mistake of law' through the inducement, whether innocent or otherwise,

of the other party, the contract may be avoided. 2.
Mistake of foreign law. Mistake of foreign law stands on the same footing as the 'mistake of fact'.
Here the agreement is void
in case of 'bilateral mistake' only, as explained under the subsequent heading. 5.6.2
Mistake of Fact Mistake of fact may be of two types: 1. Bilateral mistake; 2. Unilateral mistake. 1. Bilateral mistake.
Where the parties to an agreement
misunderstood each other and are at cross purposes,
there is a bilateral mistake.
Here there is no real correspondence of offer and acceptance, each party obviously understanding the contract in a different way. In
fact in such cases, there is no agreement at all, there being entire absence of consent.
This has been termed by Salmond as 'error in consensus'
as distinguished from 'error in causa' (i.e., where consent
is not free and is caused by coercion, undue influence, misrepresentation or fraud).
In case of bilateral mistake of essential fact, the agreement is void ab-initio.
Section 20 provides that "
where
both
the parties to an agreement are under a mistake as to
a
matter of fact
essential to the
agreement,
the agreement is void."
Thus for
declaring an agreement
void ab-into under this Section, the following three conditions must be
fulfilled: (i)
Both the parties must be
under a mistake
i.e.,
the mistake must be mutual.
Both the parties should misunderstand each other
so as to nullify consent. Illustration. M, having two houses A and B, offers to sell house A,
and N
not knowing that M has two houses, thinks of house B and agrees to buy it. Here there is no real consent and the agreement is void. (
ii) Mistake must
relate to some
fact and not to judgement or opinion etc.
An erroneous opinion
as to the value of the thing which forms the subject-matter of the
agreement
is not
to be deemed a mistake as to a matter of fact (
Explanation to Section 20). Illustration. If A buys a
motorcar, thinking that it is
worth Rs 80,000, and pays Rs. 80,000 for it, when
it is only worth Rs 40,000, the contract remains good. A has to blame himself for his ignorance of
the true value of the
motorcar and he cannot avoid the contract on the ground of mistake. (iii) The fact must be essential to the agreement
i.e., the fact must be such which goes to the very root of the agreement. On the basis of judicial decisions, the mistakes which may be covered under this condition may broadly be put into the following heads: (
a)
Mistake
as to the existence of
the subject-matter of the agreement.

If at the time of the agreement and unknown to parties, the subject-matter of the agreement has ceased to exist, or if it has never been in existence, then the agreement is void (Bell vs Lever Bros. 36). Illustrations (to Sec. 20). (a) A, agrees to sell to B a specific cargo of goods supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain, the ship conveying the cargo had been cast away, and the goods lost. Neither party was aware of these facts. The agreement is void. (b) A, agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void. (c) Mistake as to the identity of the subject-matter. Where both parties are working under a mistake as to the identity of the subject-matter i.e., one party had one thing in mind and the other party had another, the agreement is void for want of consensus-ad-idem. 36 (1932), A.C. 161. Free Consent Self-Instructional Material 67 NOTES Illustration. Where there was a contract for the sale of a certain quantity of cotton arriving per 'ex ship Peerless,' and there were two ships of that name sailing, and the parties had in mind different ships at the time of entering into the contract, held there was no contract. The Court observed: "the defendant meant one Peerless and the Plaintiff another. That being so, there was no consensus- ad-idem and therefore no binding contract." (Reffles vs Wichelaus) 37 (d) Mistake as to the title of the subject-matter. Normally a mistake as to 'title of the seller' does not affect the validity of the contract because Section 14 of the Sale of Goods Act, 1930, imposes an implied 'condition' as to the title of the seller in a contract of sale, unless otherwise agreed. Accordingly, a seller is taken to warrant his title to the property sold and he may be made liable in damages for breach of the condition, even though both the parties contract under a mistaken belief as to the title of the seller. It is only in a very special circumstance, where a person agrees to purchase property or goods which unknown to himself and the seller, is his own already, that the agreement is void ab-initio and none of the parties can be made liable in damages. Illustration. A agreed to take a lease of fishery from B, though contrary to the belief of both parties at the time A was tenant for life by inheritance of the fishery and B had no title at all. It was held that the lease agreement was void (Copper vs Phibbs 38). (e) Mistake as to the quantity of the subject-matter. If both the parties are working under a mistake as to the quantity of the subject-matter, the agreement is void. Illustration. P enquired about the price of rifles from H stating that he may buy

as many as 50. H quoted the price. P telegraphed "Send three rifles." The telegraph clerk transcribed the message as "Send the rifles." H sent 50 rifles.
P accepted
only three and returned 47. H filed a suit
for damages for non-acceptance of 47 rifles. It was held that there was no contract
as there was no consent and it made no difference
even if
the mistake was caused by the negligence of a third party.
Ofcourse P must pay the price of three rifles accepted by him (Henkel vs Pope 39). (f)
Mistake as to the quality of the subject-matter. If
there is a mutual mistake
of both the parties
as to
the quality of the subject-
matter
i.e., if the subject-matter is something essentially different, from what the parties
believed it to be, the agreement is void.
Illustrations. (a) A set of table-linen was
sold at an auction by a description 'with the crest of Charles I and the authentic property of that monarch.' In fact
the
linen was Georgian and there was a mutual mistake of both parties as to the quality of subject-matter. Held, the agreement was void (Nicholson & Venn. vs Smith Marriott 40). (b) A, contracts to sell B a particular horse, which is believed by both the parties to be a race horse. But later on it turn out to be a cart horse. The agreement is void. Strictly speaking it is the mistake as to 'substance' of the subject-matter going to the very root of the agreement and affecting the whole consideration which makes it void and not the mistake as to 'quality'. For, the principle of caveat emptor (let the buyer beware) clearly states
that
there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale
and the
buyer must be held to have taken the risk that the goods sold might prove defective or might in some way be different from that which the parties believed it to be, in the absence of any misrepresentation or guarantee by the seller.
Illustration. A sold certain seeds to B. Both parties honestly believed that the seeds were two years old. Actually the seeds proved to be only one year eleven months old. The contract cannot be avoided as the mistake does not affect the substance of the transaction. (g) Mistaken assumption going to the root of agreement. Thus, where a man and woman entered into an agreement for separation on the erroneous assumption that their marriage 37 (1864), 2 H. & C. 906. 38 (1867), L.R. 2HL 149. 39 (1870), L.R. 6 Ex. 7. 40 (1947), 177 L.T. 189.
Free Consent 68 Self-Instructional Material NOTES was valid, the agreement was held void as the parties entered into the contract under a false and fundamental assumption that they were lawfully married. (Galloway vs Galloway 41). 2.
Unilateral mistake. Where only one of the contracting parties is mistaken as to a matter of fact, the
mistake is a unilateral mistake.
Regarding the effect of unilateral mistake on the validity of a contract.
Section 22 provides
that "
a
contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to
a matter of fact."
Accordingly, in case of unilateral mistake
a contract remains valid unless the mistake is
caused by misrepresentation or
fraud, in which case
the contract is voidable at the option of
aggrieved party. On the
basis of judicial decisions, however, in certain exceptional cases even an unilateral mistake, whether caused by fraud, misrepresentation, etc., or otherwise, may make an agreement void ab-initio. With a view to elucidating the above mentioned various possibilities regarding the validity of a contract under unilateral mistake, we shall now discuss them in some detail. Contract valid.

If a man
due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must blame himself and cannot avoid the contract. Thus, as a rule, an
unilateral mistake is not allowed as a defence in avoiding a contract
i.e., it has no effect on the contract and the contract remains valid. Illustrations. (a) Where
the government sold by auction the right of fishery and the plaintiff offered the highest bid thinking that the right was sold for three years, when in fact it was for one year only,
he
could not
avoid the contract because it was his
unilateral mistake caused by his own negligence. He ought to have ascertained the tenure of fishery before bidding at the auction (
A.A. Singh vs Union of India 42). (b)
X buys rice from Y, by sample under the impression that the rice is old. The rice is, however, new, X cannot avoid the contract.
The rule of caveat emptor (let the buyer beware) of the Sale of Goods Act is generally applicable
in such cases of unilateral mistake as to quality of subject- matter of a contract,
and despite the mistake the contract remains valid. Contract voidable. If the unilateral mistake is caused by fraud or misrepresentation, etc., on the part of the other party, the contract is voidable and can be avoided by the injured party. Illustration. A, has a horse with a hole in the hoof. A, so fills it up that the defect cannot be discovered on a reasonable examination. B, purchases the horse under the impression that 'the horse is sound'. Here A, is guilty of fraud and as such on discovery of the defect B can avoid the contract because his unilateral mistake has been caused by A's fraud.
Agreement void ab-initio. In the following two
cases, where the consent is given by a party under a mistake which is so fundamental as goes to the root of the agreement and has the effect of nullifying consent, no contract will arise even though there is a unilateral mistake only: 1. Mistake as to the identity of person contracted with,
where such identity is important. The rule of law is that a contract apparently made between A and C is a complete nullity, if the inference from the facts is that to the knowledge of C, it was the intention of A to contract only with B, for, there can be no real formation of an agreement by proposal and acceptance unless
a proposal is accepted by the person to whom it is made.
Thus, whenever the identity of the person with whom one intends to contract is important element of the contract, a mistake with regard to the person contracted with destroys his consent and consequently annuls the contract. Identity of person contracted with is important either when there is a credit deal or when one party has a set-off against the other party. It is important to note that in case of mistake as to identity of person contracted with, even if the mistake is committed because of fraud or misrepresentation of another party, the contract is not merely voidable but is absolutely void. 41 (1914), 30 T.L.R. 531. 42 (1970), A.I.R. Mani. 16.
Free Consent Self-Instructional Material 69 NOTES Illustrations. (a) In Boulton vs Jones: 43 Boulton had taken over the business of one Brocklehurst, with whom the defendant, Jones, had been accustomed to deal, and against whom he had a set- off. Jones sent an order for goods to Brocklehurst, which Boulton supplied without informing him that the business has changed hands. Jones consumed the goods in the belief that they had been supplied by Brocklehurst. When Boulton demanded the payment for the goods supplied, Jones refused to pay, alleging that he had intended to contract with Brocklehurst personally, since he had a set-off which he wished to enforce against him. Boulton, therefore, sued Jones for the price. It was held that Jones was not liable to pay for the goods. Pollock C.B. observed, "
it is a rule of law that if a person intends to contract with A, B cannot give himself any
right under it." (b) In Said vs Butt: 44 Butt, the managing director of a
theatrical company, gave instructions that no ticket was to be sold to Said, who was a very bad critic of all the plays of the company. Said,
knowing this, asked
a friend to buy a ticket for him. With this ticket Said went to the theatre but was refused admission. Said
filed a suit
for damages for breach of contract.
Held that
there was no contract
because the theatrical company never intended to contract with
Said. (

Notice that in the given circumstances the identity of the plaintiff was a material element in the formation of the contract.) (c) In Cundy vs Lindsay: 45 A fraudulent person named Blenkarn, taking advantage of the similarity of his name with that of a big company named Blenkiron & Co., in the same town, placed an order with Lindsey & Co., for supply of certain goods on credit and signed the order in such a way as to look like that of Blenkiron & Co. Lindsay & Co., mistook his order for that of Blenkiron & Co., and despatched the goods. Blenkarn took delivery of the goods and sold them to Cundy & Co., a bona fide purchaser for value, and did not pay Lindsay & Co., for them. On coming to know the true facts, Lindsay & Co., filed a suit on Cundy & Co., for recovery of goods. The Court of Appeal held that owing to mistake as to identity of contracting party caused by Blenkarn, the rogue, there was no consensus of mind which could lead to any agreement whatever between Blenkarn and Lindsay & Co., and hence the agreement was void ab-initio and Blenkarn got no title to the goods which he could pass to Cundy & Co. As Cundy & Co., obtained no title to the goods, it must return them or pay their price to Lindsay & Co. Notice that in the above case if the contract between Blenkarn and Lindsay & Co., would have been merely voidable for fraud, Cundy & Co., would have been entitled to retain the goods as it had taken them in good faith for value, because
in case of a voidable contract before it is repudiated, one
can pass a good title to a bonafide purchaser for value.
Hence the speciality of a mistake as to the identity of person contracted with becomes clear that in such a case, even if the mistake is committed because of misrepresentation or fraud of another party, the contract is absolutely void to the prejudice of third parties who later deal in good faith with the fraudulent person. Further, “mistake as to the identity” of a party is to be distinguished from “mistake as to the attributes” of the other party. Mistake as to attributes, for example, as to the solvency or social status of that person, cannot negative the consent. It can only vitiate consent. It, therefore, makes the contract merely voidable for fraud. Thus where X enters into a contract with Y, falsely representing himself to be a richman, the contract is only voidable at the option of Y. Again where the identity of the party contracted with is immaterial, mistake as to identity will not avoid a contract. Thus if X enters a shop, introduces himself as Y and purchases some goods for cash, the contract is valid. 2.
Mistake as to the nature and character of a written document.
The second circumstance in which even an unilateral mistake may make a contract absolutely void
is where the consent is given by a party under a mistake as to the nature and character of a written document.
The rule of law is that where
the mind of the signer did not accompany the signature;
i.e., he did not intend to sign; in contemplation of law, he never did sign the contract to which his name is appended and the agreement is void ab-initio. 43 (1857), 2 H. & N. 564. 44 (1920), 3 K.B. 497. 45 (1878), 3 A.C. 459.
Check Your Progress
State whether the following are True or False: 1.
In the absence of
free consent,
the contract is voidable at the option of either party. 2.
A threat to commit suicide amounts to coercion. 3. There is no presumption of undue influence between husband and wife. 4.
Silence as to facts likely to affect the willingness of a person to enter into
a contract is fraud. 5.
Where
both
the parties to an agreement are under a mistake as to
a
matter of fact
essential to the
agreement,
the agreement
is void.
Free Consent 70 Self-Instructional Material NOTES Illustrations. (
a) An old illiterate woman executed a deed under the impression that she was executing a power of attorney authorising her nephew to manage her estate,
while
in fact it was a deed of gift in favour of
her nephew. The
evidence showed that
the woman never intended to execute such a deed of gift nor was the deed read or explained to her. The document was

held to be void,
as her mind did not go with her signature (Bala Devi vs Santi Mazumdar 46). (b) A blind man signed what he thought was a compromise petition, but was in fact a release, on the fraudulent representation of another, the document was held to be void (Hem Singh vs Bhagwat 47). (c) M, an old man with
feeble sight, signed a bill of exchange for £ 3,000 thinking it was a guarantee.
It was held that M was not liable (Foster vs Mackinnon 48). In this case Byles J., 49 made a very interesting observation: "It was as if he had written his name ... in a lady's album, or on an order for admission to the Temple Church, or in the fly-leaf of a book, and there had already been without his knowledge, a bill of exchange ... on the other side of the paper." It should be borne in mind that in the aforesaid type of mistake, even if one party's consent is induced by misrepresentation of another, the contract is not merely voidable but is entirely void and the third party would acquire no rights (Ningawwa vs Byrappa 50). 5.7 TEST QUESTIONS 1. "For giving rise to a valid contract, there must be consensus ad-idem among the contracting parties." Explain this statement and discuss the meaning of 'free consent.' 2.
When is consent said to be given under coercion? What is
the liability of a person to whom money has been paid or goods have been delivered under coercion? How coercion differs from undue influence? 3. "It is an essential condition for challenging a contract
on the basis of undue influence
that one of
the parties should
be
in a position to dominate the will of the other."
Examine this
statement and explain the effect of undue influence on the validity or otherwise of a contract. 4. Define the term 'misrepresentation.'
What is its effect on the validity of a contract?
Distinguish it from fraud. 5.
Define fraud and point out its effects on the validity of a contract.
Give suitable examples to illustrate your answer. 6. "
Mere silence as to facts is not fraud." Explain with
illustrations. 7. What are contracts Uberrimae Fidei? Give at least four examples of such contracts. 8. Distinguish clearly between (a) coercion and undue influence, and (b) misrepresentation and fraud. 9. Discuss the remedies available for coercion, undue influence, misrepresentation and fraud. 10.
Discuss the law relating to the effect of 'mistake' on contracts. 11. "
A contract caused by unilateral mistake may be valid, voidable or void." Explain. 12.
Write notes on: (a) Unconscionable transactions. (b) Pardanashin women. 46 (1956), A.I.R. Cal. 575. 47 (1925), Pat. 140. 48 (1869), L.R. 4 C.P. 704. For an Indian case see: Chimanram vs Divan Chand, (1932), 56 Bom. 180. 49 At p. 712. 50 (1968), A.I.R. S.C. 956.
Free Consent Self-Instructional Material 71 NOTES 5.8
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A,
sells a horse to B knowing fully well that the horse is vicious. A does not disclose the nature of the horse to B. Is the sale valid? [Hint. Yes, the sale
is valid,
because A is under no duty to disclose the fault to B,
the general rule of law being "let the buyer beware."] 2. A,
who is trying to sell an unsound horse, forges a veterinary surgeon's certificate, stating that the horse is sound and pins it on the stable door. B comes to examine the horse but the certificate goes unnoticed by him. He buys the horse and finds later on the horse to be unsound. He wants to avoid the agreement under the plea that he has been defrauded. Will he succeed? [Hint. B will not succeed because he bought the horse after his examination and not on the basis of the Certificate. B has not therefore been deceived by the Certificate actually and a deceit which does not deceive is not fraud.] 3. X
offers to sell Y a painting which X knows is a
copy of a well known masterpiece. Y, thinking that the painting is an original one
and that X must be unaware of this, immediately accepts X's offer. Does this result in a contract? [Hint. Yes,
there
is a contract. The rule of Caveat Emptor applies in case
of unilateral mistake as
to quality of subject-matter of a contract,
and despite the mistake the contract remains valid.] 4.

X buys from Y a painting which both believe to be the work of an old master and for which X pays a high price. The painting turns out to be only a modern copy.
Discuss the validity of the contract? [Hint. The contract is absolutely void as there is a mutual mistake of both the parties as to the substance or quality of the subject-matter going to the very root of the contract. In case of bilateral mistake of essential fact, the agreement is void ab-initio, as per Section 20.] 5. X, falsely representing herself as the wife of a millionaire takes a ring from a jeweller's shop for the approval of her husband. She pledges it with a pawn broker who in good faith and without notice of the fraud pays her Rs. 1,000. Can the jeweller recover the ring from the pawn broker? [Hint. The ring cannot be recovered from the pawn broker. The jeweller intended to contract with the person present before him. He was not mistaken about his identity but only about his attributes. His intention was to sell to the person present i.e., there was consent, but it was vitiated by fraud. Hence the contract is voidable and not void.
In case of a voidable contract, before it is repudiated, one can pass a good title to the pledgee or purchaser in good faith. Thus, in the instant case, the pledge is valid (Phillips vs Brooks, 1919, 2 K.B. 243). It may be noted that in the given case if X would have falsely represented herself as the wife of a certain well known millionaire, it would have been a case of mistake as to the identity of person contracted with, rendering the agreement void ab-initio, thereby enabling the jeweller to recover the ring from the pawn broker.] 6. M, an old man of poor sight endorsed a bill of exchange for Rs 3,000 thinking that it was a guarantee.
Is M liable to pay the amount? [Hint. M is not liable to pay the amount. The instant case belongs to the category of unilateral mistake as to the nature and character of a written document. In such cases the rule of law is that if the mind of the signer did not accompany the signature, in the eye of law, he never did sign and the agreement is void ab-initio.]
Legality of Object and Consideration Self-Instructional Material 73 NOTES UNIT 6 LEGALITY OF OBJECT AND UNIT 6 CONSIDERATION Structure 6.0 Introduction 6.1 Unit Objectives 6.2 What Considerations and Objects Are Unlawful? 6.3 Object or Consideration Unlawful in Part 6.4 Effect of Illegal Agreements on Collateral Transactions 6.5 Test Questions 6.6 Practical Problems 6.0 INTRODUCTION
The object or consideration of an agreement must be lawful, in order to make the agreement a valid contract, for, Section 10 lays down that all agreements are contracts if made for lawful consideration and with a lawful object. Section 23 declares what kinds of considerations and objects are not lawful. If the object or consideration is unlawful for one or the other of the reasons mentioned in Section 23, the agreement is 'illegal' and therefore void (Sec. 23). The use of the word 'illegal' is somewhat misnomering here. It usually connotes a punishable offence, but the parties to a so called "illegal agreement," unless it is expressly punishable by law or amounts to a criminal conspiracy, are not liable to punishment. They have committed no offence. They have merely concluded a transaction that will be spurned by the courts. 1 The words 'object' and 'consideration' used in Section 23 are not synonymous. The word 'object' here means 'purpose or design.' Thus, where a person, while in insolvent circumstances, transferred his property to one of his creditors with the object of defrauding his other creditors, it was held that the agreement was void and the transfer was inoperative (Jaffar Meher Ali vs Budge Budge Jute Mills Co. 2) The court observed that although the consideration of the contract was lawful but the object was unlawful because the purpose of the parties was to defeat the provisions of the Insolvency Law. 6.1 UNIT OBJECTIVES ?
Understand the circumstances when consideration and object become unlawful. ? Be clear about the legal consequences of illegal agreements. ? Be aware of the agreements opposed to public policy. 1 Adapted from Chesire & Fifoot, The Law of Contract, IV Ed., p. 272. 2 (1906), 33 Cal. 702.
Legality of Object and Consideration 74 Self-Instructional Material NOTES 6.2 WHAT CONSIDERATIONS AND OBJECTS ARE 6.2 UNLAWFUL? According to Section 23, every agreement of which the object or consideration is unlawful is void, and the consideration or the object of an agreement is unlawful in the following cases: 1. If it

is forbidden by law.
This clause refers to agreements which are declared illegal
by law. If the consideration or object for a promise is such as is
forbidden by law,
the agreement is void.
An act or an undertaking is forbidden by law: (
a)
when it is punishable by the criminal law of the country, or (
b)
when it is prohibited by special legislation
or
regulations made by
a competent authority under powers derived from the legislature. 3 Illustrations. (a)
Agreements for sale or purchase above the standard price fixed by the relevant law (e.g., Essential Commodities Act. 1955) with regard to a controlled article are illegal and hence void (Sita Ram vs Kunj Lal 4). (b) An agreement to pay consideration to a tenant to induce him to vacate premises governed by the Rent Restriction Act is illegal and cannot be enforced because such an act
is forbidden by the said Act (Mohanchana vs Manindra 5). 2.
If
it
is of such a
nature that, if permitted, it would defeat the provisions of
any
law.
This clause refers to
cases
where
the object or consideration of an agreement is
of such a nature that,
though not directly forbidden by law, it would
indirectly lend to
a violation of law, whether enacted or otherwise (e.g., Hindu and Mohammedan Laws). Such an agreement is also void. Illustrations. (a) A loan granted under a promissory note
to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act was held illegal and
could not be recovered back (
Chandra Shrinivisa Rao vs Korrapati Raja Rama Mohana Rao 6). It will be seen that the purpose of borrowing in this case is of such a
nature that if permitted it would defeat the provisions of
Child Marriage Restraint Act of 1929, 7 for the money was lent to enable the guardian to celebrate the marriage contrary to the provisions of the said Act. (b) An agreement by the debtor not to rise the plea of limitation, should a suit have to be filed, is void as tending to limit the provisions of the Limitation Act (Rama Murthy vs Gopayya 8). (c)
An agreement between husband and wife to live separately is invalid as being opposed to
Hindu Law (
A.E. Thimmal Naidu vs Rajammal 9). 3. If it is fraudulent. An agreement whose object or consideration is to defraud others, is unlawful and hence void. Illustrations. (
a)
A, promises to pay Rs 200 to B, if B would commit fraud on C. B agrees. B's agreeing to defraud is unlawful consideration for A's promise to pay. Hence
the agreement is illegal and
void. (
b)
A, B and C enter into an agreement for the division among them of gains acquired, or to be acquired, by them by fraud. The agreement is void, as its object is unlawful. [
Illustration (e) to

Section 23] 3 Cf. Pollock and Mulla, Indian Contract Act, p. 138. 4 A.I.R. (1963), All, 206. 5 A.I.R. (1955), Cal. 442. 6 (1951), 2 Mad. L.J. 264. 7 This Act has been repealed by the Child Marriage Restraint Act, 1978. The new Act raises the marriage age limit to 18 and 21 years for girls and boys respectively with effect from 2 October 1978. 8 (1917), 40 Mad.701. 9 (1968), A.I.R. Mad. 201.

Legality of Object and Consideration Self-Instructional Material 75 NOTES (c)

A, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for B a lease of land belonging to

his principal. The agreement between A and B is void as

it implies a fraud by concealment by A on his principal. [

Illustration (g) to Section 23] 4.

If

it

involves

or implies injury

to the person or property of another.

If

the

object

or consideration

of an agreement is injury to the person or property of another,

it is

void,

being an unlawful agreement. Illustrations. (a)

An agreement to commit an assault or to beat a man has been held unlawful and void (

Alien vs Rescous 10). (b) An agreement to put certain property to fire is unlawful and void under this clause. (c) An agreement involving the publication of a libel (defamatory article against someone) has been held unlawful and void (Clay vs Yates 11). (d)

An agreement by which a debtor, who borrowed Rs 100, promised to do manual labour without pay for the creditor, so long as the debt was not repaid in full has been held to be void, as it

involved injury to the person of the debtor (

Ram Sarup vs Bansi Mandar 12). 5.

If the court regards it as

immoral. An agreement whose object or consideration is immoral,

is

illegal and therefore void.

The scope of the word 'immoral' here extends to the following: (i) Sexual immorality e.g., illicit cohabitation or concubinage or prostitution. Illustrations. (a)

A, agrees to let her daughter to B for concubinage. The agreement is

void, because it is immoral,

though the letting may not be punishable under the Indian Penal Code. [Illustration (k) to

Section 23] (b) A gift deed executed in consideration of illicit intercourse has been held void as its object was immoral (Ghumma vs Ram Chandra 13)…. It may be noted that an agreement to pay for 'past' or 'future' illicit cohabitation is also void, as being immoral. Consideration

which is immoral at the time when it passes cannot become innocent by passage of time

and therefore, the consideration for past cohabitation is unlawful as being immoral (Hussenali vs Dinbai 14). Similarly, a promise to pay for the purpose of future cohabitation, which comprised the consideration, was held illegal and void (Lakshminarayana vs Subhadri 15). (ii) Furtherance of sexual immorality. Illustrations. (a) A prostitute was sued for the hire money of a carriage in which she used to go every evening in order to make a display of her beauty and thus to attract customers. The suit was dismissed on the ground that the plaintiff contributed towards the performance of an immoral and illegal act and hence he was liable to suffer (Pearce vs Brooks 16). (b) A man who knowingly lets out his house for prostitution cannot recover the rent, it being an act for furtherance of sexual immorality (Choga Lal vs Piyasi 17). The landlord may, however, recover if he did not know the purpose. (iii) Interference with marital relations. Illustrations. (a) Money advanced to a married woman to enable her to procure a divorce and to marry the plaintiff could not be recovered back as the object of the agreement was held immoral (Bai Vijli vs Nansa Nagar 18). 10 2 Lev. 174. 11 I.H. & N. 73. 12 (1915), 42 Cal. 742. 13 (1926), 47 All. 619. 14 (1924), 25 Bom. L.R. 252. 15 (1903), 13 Mad. L.J. 7. 16 (1866), L.R.I Ex. 213. 17 (1909), 31 All. 58. 18 (1885), 10 Bom. 152.

Legality of Object and Consideration 76 Self-Instructional Material NOTES (b) An agreement for future separation between a husband and wife is void ab-initio, it being immoral in the eye of law. (iv) Such acts which are against good public morals. Illustrations. (a) An agreement for future marriage, after the death of First wife is against good morals and hence would be void (Wilson vs Cornley 19). (b)
A, who is B's mukhtar, promises to exercise his influence, as such with B in favour of C
and C
promises to pay
Rs 1,000
to A. The agreement is void,
because it is immoral. [
Illustration (j) to
Section 23] 6.
If the court regards it as 'opposed
to
public policy.'
An agreement
is
unlawful
if the court regards it as 'opposed to public policy.'
It is not possible to give a precise or exact definition of the term 'public policy.' It is
rather
an elastic term and its connotation may vary with the social structure of a State.
Public policy is that principle of law which holds that no citizen can lawfully do that which
is injurious to the public or is against the interests of the society or the State.
Broadly speaking, an
agreement which tends to promote corruption or injustice or immorality
is said to be opposed to public policy.
It is interesting, to
note that 'opposed to public policy' and 'immoral,' both are very much similar in nature because what is 'immoral' must be 'opposed to public policy' and reverse is also true in most cases. Public policy is an illusive concept. It has been described as an 'untrustworthy guide,' 'unruly horse,' etc., and therefore, the doctrine of public policy is generally governed by precedents. In Gherulal vs Mahadeodas 20 the Supreme Court observed, "...
though the heads (of public policy) are not closed and though theoretically it may be permissible to evolve a new head under exceptional circumstances of a changing world, it is advisable in the interest of stability of society not to make any attempt to discover new heads in these days."
The courts, thus, are generally disinclined to invent new heads of public policy.
On the basis of decided cases on the subject the following agreements have been held to be against public policy: (i) Trading with an alien enemy.
It is now fully established that trading with an alien enemy (i.e., a citizen of the other country at war with the State) is against public policy in so far as it tends to aid the economy of the enemy country. Such agreements are therefore illegal, unless made with the special permission of Government. It is
to be noted that
an agreement to promote hostile action in a friendly State is also illegal and void as being opposed to public policy. (ii) Agreements interfering with the course
of justice.
An agreement the object of which is to interfere with the course of justice,
e.g., an agreement not to disclose misconduct to the other interested party or an agreement to influence a judge to induce him to decide the case in a party's favour, is obviously opposed to public policy and
is void. But an agreement to refer present or future disputes to arbitration is
a valid agreement. (iii) Agreements for stifling criminal
prosecution. It is well settled law that if a person has committed a crime, he must be
punished. Hence
any agreement which seeks to prevent the prosecution of a guilty party is opposed to public policy and is void,
for "no one can be allowed to make a trade of a felony." In Sudhindra Kumar vs Ganesh Chandra, 21 Mukherjee, J., has observed: "
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."

Where, therefore,
A promises B to drop a
prosecution which he has
instituted against B for robbery,
and
B promises to restore the value of the thing taken, the agreement is void, as
its 19 (1908), 1
K.B. 729. 20 (1959), A.I.R. S.C. 781. 21 (1939), 1 Cal. 241.
Legality of Object and Consideration Self-Instructional Material 77 NOTES object is unlawful. 22 Similarly, the compromise of a public offence is illegal. It is obvious that if such a course is allowed to be adopted and agreements made between the parties based solely on the consideration of stifling criminal prosecutions are sustained, the basic purpose of Criminal Law would be defeated. However, under the Indian Criminal Procedure Code there are certain compoundable offences (e.g., assault) which can be compromised and agreements for the compromise of such offences are valid (Ramachandra vs Bhauwari Bai 23). (iv) Maintenance and Champerty. 'Maintenance' may be defined as an agreement whereby a stranger promises to help another person by money or otherwise in litigation in which that third person has himself no legal interest. 'Champerty' is an agreement whereby a person agrees to assist
another in litigation in exchange of a promise to hand over a portion of the proceeds of the
action. Thus, in both cases financial or professional assistance is provided with a view to assisting another person in litigation but in case of Champerty the party helping in litigation also shares in the gains of the litigation in addition to interest on money advanced or fees for professional services. Under
the English Law such agreements are absolutely void. The Indian Law, however, does not make them absolutely void because of the peculiar position of Indian litigants many of whom are too poor to afford expensive litigation. "The uncertainties of litigation are proverbial; and if the financier must need risk losing his money he may well be allowed some chances of exceptional advantage" (Ram Sarup vs Court of Wards 24). The rules applied in India are as follows: 1. An agreement for supplying funds by way of 'maintenance' or 'Champerty' is valid, unless: (a) it is unreasonable so as to be unjust to the other party, or (b) it is made by a malicious motive like that of gambling in litigation or oppressing other party by encouraging unrighteous suits, and
not with the bona fide object of assisting a claim believed to be just (
Bhagwat Dayal Singh vs Debi Dayal Sahu). 25 2. An agreement for providing professional services is valid if it is made by way of 'maintenance' and with a
bona fide object of assisting a claim believed to be just
and obtaining a reasonable recompense therefor. But if it is made by way of 'Champerty', i.e., making the remuneration dependent to any extent whatsoever upon the result of the suit, it is void (Kothi Jairam vs Vishvanath 26). Illustrations. (a) Where 75 paise in a rupee was agreed as the share of the financier, out of the property recovered, it was held that the agreement was unreasonable and hence void. However, the plaintiff (financier) was awarded the expenses legitimately incurred by him with interest (Nuthaki Venkataswami vs Katta Nagi Reddy 27). (b)
An agreement by a client to pay his lawyer according to the result of the case
was held opposed to public policy and void, it being against the professional code of conduct (Kothi Jairam vs Vishvanath 28). (v) Traffic
in public offices. Agreements for sale or transfer of public offices or for
appointments to public offices in consideration of money
are illegal, being opposed to public policy. Such agreements, if enforced, would lead to inefficiency and corruption in public life. 22
Illustration (h) to Section 23. 23 (1973). A.I.R. Raj. 260. 24 (1940), 67 I.A. 50. 25 (1908), 35 Cal. 420. 26 (1925), A.I.R. Bom. 470. 27 A.I.R. (1962) A.P. 457. 28 A.I.R. (1925) Bom. 470.
Legality of Object and Consideration 78 Self-Instructional Material NOTES Illustrations. (
a)
A,
promises to
obtain for B
an employment
in the
public
service, and B promises to pay
Rs 1,000
to A. The
agreement is void as the consideration for it is unlawful [

Illustration (f) to
Section 23]. (b) So also a promise
to pay money to a public servant to induce him to retire and make way for the appointment of the promisor
is void (Saminatha vs Muthusami 29). (vi) Agreements creating an interest opposed to duty. An agreement which tends to create a conflict between interest and duty is illegal and void on the ground that it is opposed to public policy.
Illustrations. (a) A, agrees to pay B, the lieutenant colonel in the army. Rs 50,000 if he will assist her brother to desert the army. The object of the agreement is opposed to public policy and hence the agreement is void and illegal. (b) An agreement by an agent with a third party whereby he would be enabled to make secret profits is illegal and void as it tends to create a conflict between interest and duty. (vii) Agreements unduly restraining personal liberty. Agreements which unduly restrict personal freedom have been held to be void and illegal as being against public policy. Illustration.
A, borrowed money from B, a moneylender, and agreed that he would not, without the written consent of B,
leave his
job, borrow money, dispose of
his property or change his residence.
It was held that
the agreement was illegal as it unduly restricted the liberty of A (Harwood vs Miller's Timber and Trading Co. 30). (
viii) Agreements interfering with
parental duties. A father, and in his absence the mother, is the legal guardian of his/her minor child.
The authority of a guardian is to be exercised in the best interest of the child, in accordance with good public morals. If, therefore, the right of guardianship is bartered away by any agreement which is inconsistent with the duties arising out of such custody, such an agreement shall be void on the ground of public policy. Illustration. For monetary consideration, A agrees to place his daughter at the disposal of B to be married as B likes. The agreement is illegal and void as it would interfere with A's parental duty to select a husband in the best interests of the girl (Atma Ram vs Banku Mal 31). (ix) Marriage brokerage agreements. These are agreements for the payment of money in consideration of procuring for another in marriage a husband or a wife.
Such agreements are illegal and void as being contrary to public policy.
Thus, when
a 'Profit' was promised Rs 200 in consideration of procuring a wife for the defendant, the agreement was held invalid and the money could not be recovered (Pitamber vs Jagjiwan 32). Further, an agreement
of dowry 33 i.e., to give money or property to the parents of the bride or the bridegroom in connection of their agreeing to the contract of marriage is also illegal and cannot be enforced. But such an agreement is illegal in respect of payment only,
the validity of marriage is not affected. So, once the marriage is solemnised, money if actually paid cannot be recovered back, and if not paid, a suit therefore would not lie, because the agreement to pay is illegal. Of course the money can be recovered when the marriage is not 29 (1907), 30 Mad. 530. 30 (1917), 1 K.B. 305. 31 (1930), Lah. 561. 32 13 Bom. 131. 33 The Dowry Prohibition Act, 1961 had defined dowry as property given directly or indirectly by one party to another, by parents of one party to either party at or before or after the marriage in consideration of marriage. The Dowry Prohibition (Amendment) Act, 1984 has changed the definition of dowry slightly. The new Act has defined dowry as property given in connection (not consideration) with marriage. The Amendment Act, however, clarifies that presents given to the bride or the bridegroom at the time of marriages, voluntarily, without a demand being made, will not be treated as dowry. But these presents will have to be carefully listed in accordance with the rules of the Amendment Act.
Legality of Object and Consideration Self-Instructional Material 79 NOTES performed (Dharnidhar vs Kanhji Sahay 34). Similarly, clothes and ornaments or their value can be recovered if the marriage does not take place (Girdhari Singh vs Neeladhar Singh 35). (x) Miscellaneous cases.
The following agreements have also been held to be against public policy: (
a) Agreements "tending to create monopolies" are illegal and void (Kameshwar Singh vs Yasin Khan 36). (b) Agreements to defraud revenue authorities are void and illegal. For example, an agreement by which an employee was to get, in addition to salary,
an expense allowance grossly in excess of the expenses actually incurred by him,
was held illegal because the provision as to expenses was contrary to public policy being merely a device to defraud the income-tax authorities (Napeier vs National Business Agency Ltd. 37). (c) Agreements whereby money is given to induce persons to give evidences in a civil court are void because every one is expected to perform his legal duty (Adhiraja Shatty vs Vittil Bhatta 38). 6.3 OBJECT OR CONSIDERATION UNLAWFUL IN 6.3 PART Section 23 (already discussed) deals with cases in which object or/and consideration is wholly illegal. But what is the position
if the same agreement contains both legal and illegal terms, i.e., it is partly legal and partly illegal?
Sections 24, 57 and 58 of the Contract Act provide for such cases. Accordingly, if the object or consideration is partially unlawful, the following rules will apply: 1. When an agreement contains several distinct

promises to do things legal and also other things illegal,
and the legal part cannot be separated from the illegal part (i.e., the consideration for different promises is a single sum of money), the whole agreement is illegal and void (Sec. 24). Illustrations. (a)
A, promises to superintend, on behalf of B, a
legal manufacture of indigo and an illegal traffic in other articles. B promises to pay to A a salary of Rs. 10,000 a year. The agreement is void
and unlawful. Here a part of the object is legal and a part is illegal which are not severable because the consideration for both promises is a single sum of money (Illustration to Section 24). (b) A, agrees to serve B as his housekeeper and also to live in adultery with him at a fixed salary. The whole agreement is unlawful and void. A cannot sue even for service rendered as housekeeper because it cannot be ascertained as to what was due on account of adulterous intercourse and what was due for housekeeping (Alice Hill vs William Clarke 39). 2. Where there is
reciprocal promise to do things legal and also other things illegal,
and the legal part can be separated from the illegal part (i.e., there is a separate consideration for different promises), the legal part
is a contract and the illegal part
is a void agreement (Sec. 57). Illustration.
A and B agree that A shall sell B a house for Rs 10,000, but
that, if B uses it
is
as a gambling house, he shall pay A Rs 50,000
for it. The first set of reciprocal promises, namely, to sell the house and
to
pay Rs 10,000 for it, is
a
contract.
The second set is for an unlawful object, namely, that B may use the house as a gambling house, and is a void and illegal agreement. 34 A.I.R, (1949), Pat. 250. 35 (1912), 16 I.C. 1004. 36 (1938), Pat. 473. 37 (1951), 2 All. E.R. 264. 38 A.I.R (1914), Mad. 366. 39 (1905), 27 All. 266.
Check Your Progress State
whether the following are True or False: 1.
If the consideration or object
for a promise is such as is forbidden by law, the agreement is
illegal and void. 2. If the agreement is such whose object or consider- ation is to defraud others, the contract is voidable. 3.
An agreement by a client to pay his lawyer according to the result of the case is not void. 4.
An immoral agreement is unlawful and hence void. 5.
The collateral transactions to an illegal agreement are not affected.
Legality of Object and Consideration 80 Self-Instructional Material NOTES (Illustration to Section 57). Here it is to be noted that the two promises are distinct and severable with a separate consideration for each such promise. The promises are thus independent of each other except that they form part of the same contract. 3.
In the
case of an alternative promise, one branch of which is
legal and the other illegal, the legal branch alone can be enforced (
Sec. 58).
Illustration. A and B agree that A shall pay B Rs 1,000
for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice and a void and unlawful agreement as to
opium (
Illustration to

Section 58). 6.4 EFFECT OF ILLEGAL AGREEMENTS ON 6.4 COLLATERAL TRANSACTIONS An 'illegal agreement' like the 'void agreement' is unenforceable as between the immediate parties. But an 'illegal agreement' has this further effect that other transactions which are incidental or collateral to it are also tainted with illegality and, therefore, are not enforceable, provided the parties to the collateral transaction had the knowledge of the illegal or immoral design of the main or primary agreement (a void agreement does not invalidate collateral transaction 40). Illustrations. (a) A enters into a smuggling of goods agreement with B and borrows Rs 1,000 from C for giving an advance to B. C cannot recover the money lent if he knew the illegal purpose, because his loan agreement was a collateral transaction to an illegal agreement. Of course if C did not know the purpose of the loan, he can recover even though A had used the money for an illegal object. (b) A bets on a horse race with B and borrows Rs 500 from C for this purpose. C can always recover the money lent, whether he knew the purpose of loan or not, because his loan agreement was collateral to a void (wagering) agreement only. No restitution is allowed. Parties to an illegal agreement cannot get any help from a court of law, for, " no polluted hand shall touch the pure fountain of justice."
So, nothing can be recovered under an illegal agreement and if something has been paid it cannot be recovered back, whether the illegal object has been carried out or has not been carried out, is immaterial. The rule of law is that " no action is allowed on an illegal agreement" and "
in case of equal guilt, the position of the defendant is better than that of the
plaintiff."
Illustration. X promises Y to pay Rs 10,000 if he murders Z. If Y commits the murder,
he cannot recover the amount from X. If X has already paid the amount and
Y fails in murdering Z, X cannot recover the amount
back. 6.5 TEST QUESTIONS 1. In what cases the object and consideration of an agreement are said to be unlawful under the Contract Act? Illustrate with examples. 2. What do you understand by an illegal agreement? What is the effect of illegal agreements on collateral transactions? 3. "An agreement is illegal and shall not be enforced if the court regards it as immoral." Comment. 4. Discuss the doctrine of public policy. Name the various types of agreements which are considered to be opposed to public policy. Are the categories of public policy closed? 5. Examine the validity of agreements with consideration and object unlawful in part. 40 'Illegal' and 'Void' agreements have been distinguished in detail earlier under the heading "Illegal and Void Agreements Distinguished."
Legality of Object and Consideration Self-Instructional Material 81 NOTES 6.6
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A
promises to pay a certain sum of money
to B, who is an intended witness in a suit against A, in consideration of B's absenting himself at the trial. B absents but fails to get the money. Can he recover? [Hint.
B cannot recover the money because an agreement which tends to create a conflict between interest and duty is illegal and void being opposed to public policy.] 2. In a suit by A against B for the recovery of Rs 5,000, A is in need of money. C agrees to provide funds to A in consideration of sharing one-fourth of the money recovered from B. Decide the validity of the agreement between C and A. [Hint. The agreement between C and A is valid. It is a champertous agreement which is valid provided its terms are fair and reasonable and is made with a bona fide object of assisting a just claim.] 3.
A, while his wife B was alive, promised to marry C in the event of B's death. Subsequently B died but A refused to marry. C sues A for damages for breach of promise. Decide. [Hint.
C will not succeed because an agreement for future marriage, after the death of first wife is against good public morals and hence illegal and void (Wilson vs Carnley, 1908, 1 K.B.729)]. 4. A, entered into an agreement with B and engaged B for the purpose of performing puja (prayer) for A's success in a suit which he had before the court and promised to pay Rs 2,000 in the event of success. A succeeded in the suit. B sued A for the amount agreed upon. Will B succeed? [Hint. No, B will not succeed as the object of the agreement is to interfere with the course of justice, making the agreement illegal and void. It has been held that where the object of an agreement is to exercise some extraneous influence, unauthorised by law, on the mind of the court, the agreement is contrary to public policy and hence void [Bhagwan Datt Shastri vs Raja Ram, (1927) All. 406]. However, in Balasundara Mudaliar vs Mahomed Usman, A.I.R. (1929) Mad. 812, a promise of reward by a Muslim litigant to a Hindu devotee in consideration of offering prayers for the success of his suit has been held not against public policy. Thus accordingly the agreement between A and B is valid and B must succeed.]
Void Agreements Self-Instructional Material 83 NOTES UNIT 7 VOID AGREEMENTS Structure 7.0 Introduction 7.1 Unit Objectives 7.2 Expressly Declared Void Agreements 7.3 Test Questions 7.4 Practical Problems 7.0 INTRODUCTION "
An
agreement not enforceable by law is said to be void" [
Sec. 2(g)].
Thus a void
agreement does
not

give rise to any legal consequences and is void
ab-initio.
In the eye of law such an agreement is no agreement at all from its very inception. We have already dealt with the following types of void agreements in the preceding units, and will not therefore discuss them here again: 1. Agreements by a minor or a person of unsound mind (Sec. 11). 2.
Agreements made under a bilateral mistake of fact material to the agreement (Sec. 20). 3. Agreements of which the consideration or object is unlawful (Sec. 23). 4. Agreements of which the
consideration or object is unlawful in part
and the illegal part cannot be separated from the legal part (Sec. 24). 5. Agreements made without consideration (Sec. 25). 7.1
UNIT OBJECTIVE Be familiar with
the various
agreements which have been 'expressly declared' void by the Indian Contract Act. 7.2
EXPRESSLY DECLARED VOID AGREEMENTS The last essential of a valid contract as declared by Section 10 is that it must not be one which is 'expressly declared' to be void by the Act. Thus, there arises a question, as to what are 'expressly declared'
void agreements? The
following
agreements have been '
expressly declared', to be
void by the
Indian Contract Act: 1.
Agreements
in restraint of marriage (
Sec. 26). 2. Agreements
in restraint of trade (Sec. 27). 3. Agreements
in restraint of legal proceedings (
Sec. 28). 4.
Agreements
the meaning of which
is
uncertain (Sec. 29). 5.
Agreements by way
of wager (Sec. 30). 6. Agreements
contingent on impossible events (Sec. 36). 7. Agreements to do impossible
acts (Sec. 56).
At the very outset, it may be borne in mind that the law declares these agreements void ab- initio and not illegal, and therefore transactions collateral to such agreements are not made
Void Agreements 84 Self-Instructional Material NOTES void. In fact it is for this reason that these agreements have not been discussed in the preceding unit dealing with "unlawful or illegal agreements," because otherwise, in effect, these agreements are also 'unlawful agreements' as they are expressly declared void by the Contract Act. It may be recalled that in the case of illegal agreements, transactions collateral to them are also tainted with illegality and hence void. 1.
Agreements
in Restraint of Marriage: Every individual enjoys the freedom to marry and so
according to
Section 26 of the Contract
Act "
every agreement in restraint of the marriage of any person,
other than a minor, is void."
The
restraint may be general or
partial but the
agreement is void, and therefore, an agreement agreeing not to marry
at all, or a certain person, or a class of persons, or for a fixed period, is void.
However, an agreement restraining the marriage of a minor is valid
under the Section. It is interesting to note that a promise to marry a particular person does not imply any restraint of marriage, and is, therefore, a valid contract. Illustrations. (a)

A agrees with B for good consideration that she will not marry C. It is a void agreement. (
b) A agrees with B that
she will marry him only. It is a valid contract
of marriage. 2. Agreements in Restraint of Trade: The Constitution of India guarantees the freedom of trade and commerce to every citizen and therefore
Section 27 declares "
every agreement by which any one
is restrained from exercising a lawful profession, trade or business of any kind, is to that extent
void."
Thus
no person is
at liberty to deprive himself of
the fruit of his labour, skill or talent, by any contracts that he enters into.
It
is to be noted that whether restraint is reasonable or not, if it is in the nature of restraint of trade, the agreement is void always, subject to certain exceptions provided for statutorily. Illustration. An agreement whereby one of the parties agrees to close his business in consideration of the promise by the other party to pay a certain sum of money, is void, being an agreement is restraint of trade, and the amount is not recoverable, if the other party fails to pay the promised sum of money (
Madhub Chander vs Raj Kumar 1).
But agreements merely restraining freedom of action necessary for the carrying on of business are not void, for the law does not intend to take away the right of a trader to regulate his business according to his own discretion and choice. Illustration. An agreement
to sell all produce to a certain party, with a stipulation that the purchaser was bound to accept the whole quantity, was held valid because it aimed to promote business and did not restrain it (Mackenzie vs Striramiah 2). But where in a similar agreement the purchaser was free to reject the goods (i.e., was not bound to accept the whole quantity tendered) it was held that the agreement was void as being in restraint of trade (Sheikh Kalu vs Ram Saran 3). Exceptions.
An agreement in restraint of trade is valid in the following cases: (i) Sale of goodwill.
The seller of
the '
goodwill' of a business can be restrained
from carrying on a
similar business,
within specified local limits,
so long as the buyer,
or any person deriving title to the goodwill from him, carries on a like business
therein, provided
the restraint is reasonable in point of time and space (Exception to Sec. 27). Illustrations. (
a) A, after selling the goodwill of his business to B promises not to carry on similar business "
anywhere in the world." As the restraint is unreasonable the agreement is void. (
b) C,
a seller of imitation jewellery in London sells
his business to D and promises that for a period of two years he would not deal: (
a)
in imitation jewellery in England, (b) in real jewellery in
England, and (c) in real or imitation jewellery in
certain foreign countries. The first promise alone 1 (1874), 14 B.L.R. 76. 2 (1890), 13 Mad. 472. 3 (1909), 13 Cal. W.N. 388.
Void Agreements Self-Instructional Material 85 NOTES was held lawful. The other two promises, namely (b) and (c), were held void as the restraint was unreasonable in point of space and the nature of business (Goldsoll vs Goldman 4). (ii) Partners' agreements.
An agreement in restraint of trade among the partners or between any partner and the buyer of firm's goodwill is valid if the
restraint comes within any of
the following cases: (a)
An agreement among the
partners
that

a partner shall not carry on
any business other than that of the firm while he is a partner [
Section 11(2)
of the
Partnership Act]. (
b)
An
agreement by a partner with his other partners that on retiring from the partnership
he
will not carry on any business similar to that of the firm within a specified period or within specified local limits,
provided the restrictions imposed are reasonable [
Section 36(2)
of the
Partnership Act]. (
c)
An agreement among
the
partners, upon or in anticipation of the
dissolution of the firm, that some or all of them will not carry on a
business
similar to that of the firm within a specified period or within specified
local limits,
provided the restrictions imposed are reasonable (
Section 54
of the
Partnership Act). (
d)
An agreement between any partner and
the buyer of the firm's
goodwill
that such
partner will not carry on any business similar to that of the firm within a specified period or within specified local limits,
provided the restrictions imposed are reasonable [
Section 55(3)
of the
Partnership Act]. (
iii) Trade combinations.
As pointed out earlier, an agreement,
the primary object of which is to regulate business and not to restrain it, is valid.
Thus, an agreement in the nature of a business combination
between traders or manufacturers e.g., not to sell their goods below a certain price,
to pool profits
or output and
to divide the same in an agreed proportion, does not amount to
a restraint of trade and is perfectly valid (Fraser & Co. vs Bombay Ice Company 5). Similarly, an agreement amongst the traders of a
particular locality with the object of keeping the trade in their own
hands is not void merely because it hurts a rival in trade (Bhola Nath vs Lachmi Narain 6) But if an agreement attempts to create a monopoly, it would be void (Kameshwar Singh vs Yasin Khan 7) Agreements tending to create monopolies are now also governed by the provisions of the Monopolies and Restrictive Trade Practices Act, 1969, which forbids certain types of trade agreements. (iv) Negative stipulations in
service agreements. An agreement of service by
which a person binds himself during the term of the agreement, not to take
service with
anyone else,
is not in restraint of lawful profession and is valid.
Thus a

chartered accountant employed in a company may be debarred from private practice or from serving elsewhere during the continuance of service (Maganlal vs Ambica Mills Ltd. 8) But an agreement of service which seeks to restrict the freedom of occupation for some period, after the termination of service, is void. Thus, where S, who was an employee of Brahmputra Tea Co. Assam, agreed not to employ himself or to engage himself in any similar business within 40 miles from Assam, for a period of five years from the date of the termination of his service, it was held that the agreement is in restraint of lawful profession and hence void (Brahamputra Tea Co. vs Scarth 9). 3. Agreements in Restraint of Legal Proceedings: Section 28, as amended by the Indian Contract (Amendment) Act, 1996, declares the following three kinds of agreements void: 4 (1915), 1 Ch. 292. 5 (1905), 29 Bom. 107. 6 (1931), 53 All. 316. 7 (1938), Pat. 473. 8 A.I.R. (1964) Guj. 216. 9 (1885), 11 Cal. 545.

 NOTES (a) An agreement by which a party is restricted absolutely from taking usual legal proceedings, in respect of any rights arising from a contract. (b) An agreement which limits the time within which one may enforce his contract rights, without regard to the time allowed by the Limitation Act. (c) An agreement which provides for forfeiture of any rights arising from a contract, if suit is not brought within a specified period, without regard to the time allowed by the Limitation Act. Restriction on Legal proceedings. As stated above Section 28 renders every agreement in restraint of legal proceedings void. This is in furtherance of what we studied under the definition of a 'contract', namely, agreement plus enforceability at law is a contract. Thus if an agreement inter-alia provides that no party shall go to a court of law, in case of breach, there is no contract and the agreement is void ab-initio. In this connection the following points must also be borne in mind: (a) The Section 'applies only to rights arising from a contract. It does not apply to cases 10 of civil or criminal wrongs or torts. (b) This Section does not affect the law relating to arbitration e.g., if the parties agree to refer to arbitration any dispute which may arise between them under the contract, such a contract is valid (Exceptions 1 and 2 to Section 28). (c) The Section does not affect an agreement whereby parties agree "not to file an appeal" in a higher court. Thus where it was agreed that neither party shall appeal against the trail court's decision, the agreement was held valid, for, Section 28 applies only to absolute restriction on taking the legal proceedings, whereas here the restriction is only partial as the parties can go to a court of law alright and the only restriction is that the losing party cannot file an appeal (Kedar Nath vs Sita Ram 11). (d) Lastly, this Section does not prevent the parties to a contract from selecting one of the two courts which are equally competent to try the suit. Thus in A. Milton & Co. vs Ojha Automobile Engineering Company's Case 12 , there was an agreement which inter- alia provided — "Any litigation arising out of this agreement shall be settled in the High Court of Judicature at Calcutta, and in no other court whatsoever." The defendants filed a suit in Agra whereas the plaintiff brought a suit in Calcutta. It was held that the agreement was binding between the parties and it was not open to the defendants to proceed with their suit in Agra. Curtailing the period of limitation. Any agreement curtailing the period of limitation prescribed by the Limitation Act is also void under Section 28. Thus, if a clause in an agreement between A and B provides that either party can sue for breach within a year of breach only, the clause is void and despite the clause the parties have a right to sue in case of breach by either party within the time allowed by the Limitation Act i.e., within three years from the date of breach. It is relevant to state that agreements extending the period of limitation prescribed by the Limitation Act are also void, not under this Section but under Section 23, as the object will be to defeat the provisions of the law (Rama Murthy vs Gopayya 13). Forfeiture of contract rights. Under Clause (c) of Section 28 (stated above) an agreement which provides for forfeiture of any rights arising from a contract, if suit is not brought within a specified time (say 3 months) is also void. This Clause was inserted by the Indian Contract (Amendment) Act, 1996. 10 Such cases come under "Agreements Stifling Prosecutions" which have been discussed in the preceding chapter. 11 A.I.R. (1969) Bom. 221. 12 A.I.R. (1931) Cal. 279. Also see Hakam Singh vs Gamman (India) Ltd., (1971) 1 S.C.C. 286. 13 (1917), 40 Mad. 701.

 NOTES The distinction between Clause (b) and Clause (c) of Section 28 (stated above) may be noted. Under Clause (b), the agreement limits the time within which one may enforce his contract rights thereby curtailing the period of limitation prescribed by the Limitation Act, whereas under Clause (c), the agreement limits the time within which one is to have any contract rights to enforce. Thus, Clause (c) refers to an agreement which does not affect the remedy for breach but which extinguishes the right itself after the specified time and such a stipulation has also been declared void. The background behind the passing of the Indian Contract (Amendment) Act, 1996 may be briefly stated as follows. Prior to this Amendment Act, the insurance policy documents issued by general insurance companies invariably provided that if a claim is rejected and a

suit is not filed
within three months after such rejection, all benefits under the policy shall be forfeited.
Such a provision was held valid and binding on the ground that it is outside the scope of Section 28 (Baroda Spinning Co. Ltd. vs Satyanarayan Marine & Fire Insurance Co. Ltd. 14). The learned judge observed: "... what the plaintiff was forbidden to do was to limit the time within which he was to enforce his rights; what he has done is to limit the time within which he is to have any rights to enforce; and that appears to me to be a very different thing". However, the Supreme Court in the Food Corporation of India vs New India Assurance Co. Ltd. (1994) Case held that insurance contracts restraining the time period within which one is to have any contract rights to enforce were violative of the Limitation Act. The Parliament has therefore amended Section 28 by inserting a new clause. Accordingly, henceforth general insurance companies cannot insist that suits for claims be brought within a period of time shorter than the period provided under the Limitation Act, otherwise all benefits under the policy shall be forfeited. 4.
Uncertain Agreements: "
Agreements,
the meaning of which is not certain, or capable of being made certain,
are void" (
Sec. 29). Through Section 29 the law aims to ensure that the parties to a contract should be aware of the precise nature and scope of their mutual rights and obligations under the contract. Thus, if the words used by the parties are vague or indefinite, the law cannot enforce the agreement. Illustrations (to Sec. 29). (
a)
A agrees
to sell to B "a hundred tons
of oil."
There is nothing whatever to show
what kind of oil was intended.
The agreement is void for uncertainty. (
b)
A, who is
a dealer in coconut oil only,
agrees to sell to B "one hundred tons of oil."
The nature of A's trade affords an indication of the
meaning of the words, and A has entered into a contract for the sale of one hundred tons of coconut oil. (c)
A
agrees to sell to B "
one thousand maunds
of rice at a price to be fixed by C." As the price is
capable of being made certain, there is no uncertainty here to make the agreement void. (
d)
A agrees to sell to B "his white horse for
rupees five hundred or rupees one thousand."
There is
nothing to show which of the two prices was to be given. The agreement is void.
Further,
an agreement "to enter into an agreement in future" is void
for uncertainty
unless all the terms of the proposed agreement are agreed expressly or implicitly. Thus, an agreement to engage a servant some time next year, at a salary to be mutually agreed upon is a void agreement. 5. Wagering Agreements: What is a wager? Literally the word 'wager' means a 'a bet': something stated to be lost or won on the result of a doubtful issue, and, therefore, wagering agreements are nothing but ordinary betting agreements. Thus where A and B mutually agree that if it rains today A will pay B Rs 100 and if it does not rain B will pay A
Rs 100 or where C and D enter into an agreement that on tossing up a coin, if it falls head upwards C will pay D Rs 50 and if it falls tail upwards D will pay C Rs 50, there is a wagering agreement. 14 (1914), 38 Bom. 344.
Void Agreements 88 Self-Instructional Material NOTES In Thacker vs Hardy 15 Cotton, L.J., described a 'wager as follows:
"
The essence of gaming and wagering is that one party is to win and the other to lose
upon a future event which at the time of the contract is of an uncertain nature — that is to say, if the event turns out one way A, will lose; but if it turns out the other way he will
win."

Possibly the most expressive and all-encompassing definition of a "wagering agreement" was given by Hawkins, J., in Carlill vs Carbolic Smoke Ball Co.: 16 "
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 upon the determination of that event, one shall win from the other, and the
other shall pay or hand over to him, a sum of money or other stake;
neither of the contracting parties having any other interest in that contract than the sum of stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties.
It is essential to a 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 may
win but cannot lose,
or may lose but cannot win,
it is
not a wagering contract."
Certain aspects of the above definition require to be emphasised. In the first place, wager
is a game of chance in which the contingency of either gain or loss
is wholly dependent on
an 'uncertain event.'
An event may be uncertain, not only because it is
a future event, but because it is not yet known to the parties. Thus a wager may be made upon the result of the cricket match which is to take place next month in Calcutta, or upon the result of an election which is over, if the parties do not know the result. Secondly, the parties to a wager must have no interest in the event's happening or non-happening except the winning or losing of the bet laid between them. It is here that wagering agreements differ from insurance contracts which are valid because parties have an interest to protect the life or property, and have, for that very reason, entered into the contract of insurance. Essential features of a wager. The essentials of a wagering agreement may thus be summarised as follows: (
a)
There
must be
a promise to pay money or money's worth. (
b)
The promise must be
conditional on an event happening or not happening. (
c) The event must be
an uncertain one.
If one of the parties has the event in his own hands, the transaction
is not a wager. (d) Each party must stand to win or lose under the terms of agreement. An agreement is not a wager if one party may only win and cannot lose, or if
he may lose but cannot win, or if he can neither win nor lose. (
e) No party should have a proprietary interest in the event. The stake must be the only interest which the parties have in the agreement. Agreements by way of wager, void. Section 30
lays down that "
agreements by way of wager are void; and
no suit shall be brought
for recovering anything alleged to be won on any wager,
or entrusted to any person
to abide the result of any game or other uncertain event on which any wager is made."
Thus,
where
A
and B enter into an agreement which provides that if England's cricket team wins
the test
match, A will pay B Rs 100, and if it loses B will pay Rs 100 to A,

nothing can be recovered by the winning party under the agreement, it being a wager. Similarly, where C and D enter into a wagering agreement and each deposits Rs 100 with Z instructing him to pay or give the total sum to the winner, no suit can be brought by the winner for recovering the bet amount from Z, the stake-holder. Further, if Z had paid the sum to the winner, the loser cannot bring a suit, for recovering his 15 (1878), 4 QBD. 685. 16 (1892), 2 Q.B. 484. Void Agreements Self-Instructional Material 89 NOTES Rs 100, either against the winner or against Z, the stake-holder, even if Z had paid after the loser's definite instructions not to pay. Of course the loser can recover back his deposit if he makes the demand before the stake-holder had paid it over to the winner (Ratnakalli vs Vochalapu 17). But even such a deposit cannot be recovered by a loser in the States of Maharashtra and Gujarat where such an agreement is void and illegal. The Section makes an exception in favour of certain prizes for horse racing by providing further that "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 toward any plate, prize or sum of money, of the value or amount of five hundred rupees or upwards, to be awarded to the winner or winners of any horse race." Thus, a bet on a horse race carrying a prize of Rs 500 or more to the winners has been made valid under the exception. But with a view to protecting the poor persons from gambling, a bet on a horse race carrying a prize of less than Rs 500 remains a wager. It is important to note that in the States of Maharashtra and Gujarat wagering agreements are, by a local statute, not only void but also illegal. As a result in these states the collateral transactions to wagering agreements become tainted with illegality and hence are void. Special cases. We now turn to certain special cases in order to examine as to whether they are wagers: Commercial transactions. Agreements for sale and purchase of any commodity or share market transactions, in which there is a genuine intention to do legitimate business i.e., to give and take delivery of goods or shares, are not wagering agreements. If there is no such genuine intention and parties only want to gamble on the rise or fall of the market by paying or receiving the differences in prices only, the transaction would be a wagering agreement and therefore void. "In order to constitute a wagering contract, neither party should intend to perform the contract itself, but only to pay the differences" 18 . Lotteries. A lottery is a game of chance. Hence the lottery business is a wagering transaction. Such a transaction is not only void but also illegal because Section 294-A of the Indian Penal Code declares 'conducting of lottery' a punishable offence. If a lottery is authorised by the Government, the only effect of such permission is that the persons conducting the lottery (i.e., the persons running the lottery and the buyer of lottery ticket) will not be guilty of a criminal offence, but the lottery remains a wager alright (Dorabji Tata vs Lance 19). Crossword puzzles. Where prizes depend upon a chance, it is a lottery and therefore a wagering transaction. Thus a crossword puzzle, in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution, is a wager. But if prizes depend upon skill and intelligence, it is a valid transaction. Thus prize competitions which are games of skill and in which an effort is made to select the best competitor e.g., picture puzzles, literary competitions and athletic competitions are not wagers. Even in such competitions the amount of prize should not exceed Rs 1,000, otherwise they shall be wagers as per the provisions of the Prize Competition Act, 1955. Insurance contracts. Insurance contracts are valid contracts even though they provide for payment of money by the insurer on the happening of a future uncertain event. Such contracts differ from wagering agreements mainly in three respects: (a) The holder of an insurance policy must have an 'insurable interest' in the event upon which the insurance money becomes payable. Thus contracts of insurance are entered into to protect an interest. In a wagering agreement there is no interest to protect and the parties bet exclusively because they can thereby make some easy money. 17 A.I.R. (1928) Mad. 434. 18 Pollock and Mulla, Indian Contract Act, 6th Ed., p. 234. 19 (1918), 42 Bom. 676.

Check Your Progress State whether the following are True or False: 1. An agreement to many a particular person is a void agreement. 2. Every agreement in restraint of trade is void. 3. A suit can be filed for recovering anything which is won on a 'wager'. 4. A lottery always remains a 'wager', though it may not be illegal.

 (b) Contracts of insurance are based on scientific and actuarial calculation of risks, whereas wagering agreements are a gamble without any scientific calculation of risks. (

c)
Contracts of insurance are regarded as beneficial to the public,
whereas wagering agreements do not serve any useful purpose. 6.
Agreements Contingent on Impossible Events. "
Contingent agreements
to do or not to
do anything, if an impossible event happens,
are
void, whether
the impossibility of the event is known or not to the parties to the agreement at the time when it is made." (
Sec. 36) Illustrations (to Sec. 36). (a)
A agrees to pay B Rs 1,000 (as a loan)
if two straight lines should enclose a space. The agreement is
void. (
b)
A
agrees to pay B
Rs. 1,000 (
as a loan)
if B will marry A'
s daughter, C. C was dead at the time of the agreement.
The agreement is
void. 7.
Agreements to do Impossible Acts. "
An
agreement to do an act impossible in itself is void." (
Sec. 56 Para 1) Illustrations. (a)
A agrees with B to discover treasure by magic. The agreement
is void [
Illustration (a)
to
Section 56]. (
b) A agrees with B to run with a speed of 100 Kilometres per hour. The agreement is void.
No Restitution.
The term 'restitution' means 'return' or 'restoration' of the benefit received from the plaintiff under the agreement.
As per Section 65 no restitution of the benefit received is allowed in the case of expressly declared void agreemnts. 20
7.3 TEST QUESTIONS 1.
Discuss briefly expressly declared void agreements under the Indian Contract Act. 2.
Discuss the law relating to (a) agreements in restraint of marriage, and (b) uncertain agreements. 3. "
An agreement in restraint of trade is void." Discuss the statement giving
exceptions
to it, if any. 4. What is a wager? Is an agreement by way of wager
void or illegal? Is
a contract of insurance a wager? 7.4 PRACTICAL PROBLEMS Attempt the following problems, giving reasons
for your answers: 1. A agrees to sell all the goods manufactured by him in the ensuing season to B. In breach of the said agreement A sold some goods manufactured during the said season to C. Thereupon B sued A for breach of contract. Will B succeed? [Hint. Yes, B will succeed because the agreement between him and A is valid as it aims to promote business and does not restrain it.] 2. A agrees to sell his cow to B for Rs 500 if the cow gives 6 kg milk every day, but for Rs 10 only if it fails to do so. The cow fails, whereupon B remands the cow for Rs. 10 as agreed. A refuses. B brings a suit against him. Will B succeed? [Hint. No, B will not succeed as the transaction, though ostensibly a sale, is in reality a wager (Brogden vs Marriott, 5 LJ (CP) 302).] 3. A lends money to B to enable him to pay off the loss which he has sustained in a wagering transaction with C. Can A recover the money lent by him? 20 For details refer to unit 1.

Void Agreements Self-Instructional Material 91 NOTES [Hint. A can recover, because an agreement collateral to a wagering agreement remains valid except in Maharashtra and Gujarat States where wagering agreements are illegal.] 4. A and B are partners in a business. They enter into a wagering agreement with a third party. On losing the bet A satisfies his own and also B's liability under the agreement. Can A claim from B the amount paid on his behalf? [Hint. Yes, A can claim the amount from B because a wagering agreement is only void and not illegal and therefore a collateral contract can be enforced.] 5.
A and B enter into a wagering agreement and deposit Rs 500 each with C instructing him to give the total sum to the winner.
A wins. He sues C for the stake amount. B also sues C for a return of the stake deposited by him with C. Decide. [Hint. A cannot recover the bet amount from C because the law will not assist in the enforcement of a wagering agreement. Both A and B, however, can recover the amount deposited by them, because it is clear from the facts of the case that the sum is still in the hands of C. Of course they cannot even recover their deposit money if the transaction took place in Maharashtra and Gujarat States where a wagering agreement is not only void but also illegal.]
Contingent Contracts Self-Instructional Material 93 NOTES UNIT 8 CONTINGENT CONTRACTS Structure 8.0 Introduction 8.1 Unit Objectives 8.2 Definition 8.3 Essentials of Contingent Contract 8.4 Rules Regarding the Performance
of Contingent Contracts 8.5 Difference between a Contingent Contract and a Wagering Agreement 8.6 Test Questions 8.7 Practical Problems 8.0 INTRODUCTION In this unit we shall examine which is called a 'contingent contract', its essentials and the rules regarding enforcement of this type of contracts. Contracts
of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts. 8.1 UNIT OBJECTIVES ? Be clear about the basic characteristics of 'Contingent Contract'. ? Be familiar with the rules regarding enforcement of Contingent Contracts. 8.2 DEFINITION Section 31 of the
Contract Act defines
a contingent contract as follows: "
A
contingent contract is a contract
to do or not to do something, if some event, collateral to such contract does or does not happen."
Thus it is
a contract,
the performance of which is dependent upon, the
happening or non-happening of
an uncertain
event, collateral to such contract.
Illustration. A contracts to indemnify B
upto Rs 20,000, in consideration of B paying Rs 1,000 annual premium, if B's factory is burnt.
This is a contingent contract. Any ordinary contract can be changed into
a contingent contract, if its performance is made dependent upon
the happening or non-happening of
an uncertain event, collateral to such contract.
For example, the following are contingent contracts: (a)
A contracts to sell B 10 bales of cotton for Rs 20,000, if the ship by which they are coming returns safely. (
b) A promises to give a loan of Rs 1,000 to B, if he is elected the president of a particular association. (c) A promises to pay Rs 50,000 to B if a certain ship does not return, of course after charging usual premium. (It is a contract of insurance.) (d) C
advances a loan of Rs 10,000 to D and M promises to C that if D does not repay the loan, M will do so. (
It is a contract of guarantee.) Contracts
of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.
Contingent Contracts 94
Self-Instructional Material NOTES As the performance of a contract is made dependent upon a contingency, contingent contracts are also known as 'conditional' contracts. But in certain cases a contract may look like a 'conditional' contract, whereas in fact it may be simply an ordinary absolute contract where the promisor undertakes to perform the contract in all events. For example, where A promises to pay Rs 500 to B, a property broker, if B manages to get a two rooms accommodation for him at a rental of Rs 2,500 per month, it is not a contingent contract, though on the face of it, appears like a conditional contract. It is an ordinary absolute contract because the uncertain event (namely, managing to get an accommodation) itself forms the consideration of the contract and is not a collateral event. Hence it must be clearly understood that in the case of contingent contracts the uncertain event must be collateral to such contracts.
Collateral event. According to Pollock and Mulla, a 'collateral event' means an event which

is “neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise.” 1 Thus, where C contracts to pay Rs 100 to D for white- washing his house on the terms that no payment shall be made till the completion of the work, it is not a contingent contract, because the event D’s completing the work) is not collateral to the contract, but is itself a reciprocal promise or is the very thing contracted for, and is thus an integral part of the contract. Similarly, a contract for the sale of goods wherein the seller agrees to give delivery of goods after a week provided the purchaser makes the payment within two days, is an absolute contract and not a contingent contract because the event (making payment by the buyer) is an integral part of the contract (a condition precedent) and not collateral to the contract. In simple words, the collateral event is one which
does not form part of consideration of the contract, and is independent of it. For example, A
contracts to pay Rs 50,000 to B, a contractor, for constructing a building, provided the construction is approved by an architect. It is a contingent contract because the consideration of the promise to pay Rs 50,000, is the construction of the building, and the event, namely, approval by an architect, is a collateral event, which is independent of the consideration, and it is on the happening of this collateral event that the contract shall be enforced. 8.3 ESSENTIALS OF CONTINGENT CONTRACT From the forgoing discussion the following two essentials of
a contingent contract become evident: 1.
The performance of such a contract depends upon the happening or non-happening of some future uncertain event. 2. The future uncertain event is collateral i.e., incidental to the contract. 8.4
RULES REGARDING
THE PERFORMANCE
OF CONTINGENT CONTRACTS The rules regarding the performance of contingent contracts, as contained in Sections 32 to 36 of the
Contract Act, are
given below: 1.
Contingent contracts to do or not to do
anything, if an uncertain
future event happens,
cannot be enforced by law unless and
until that
event
has happened.
If the event becomes impossible,
such
contracts become void (
Sec. 32).
Illustrations. (to Sec. 32). (a)
A makes a contract with B to buy B’s horse if A survives C.
The
contract cannot be enforced by law unless and until C
dies in A’s
lifetime. 1
Indian Contract Act by Pollock and Mulla, p. 235. Check Your Progress 1. What are the essentials of contingent contract ? 2. Describe the rules regarding the performance of contingent contracts.
Contingent Contracts Self-Instructional Material 95 NOTES (b)
A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse has been offered, refuses to buy it. The
contract cannot be enforced by law unless and until C
refuses to buy the horse. (
c)
A contracts to pay B a sum of money (as loan) when B marries C. C dies without being married to B. The contract becomes void. 2.
Contingent
contracts
to do or not to do anything, if an uncertain future
event
does not happen,
can be enforced when the happening of that event becomes impossible,
and not before (

Sec. 33). Illustration (to Sec. 33).
A agrees to pay B a sum of money (as insurance claim) if a certain ship does not return (
of course after charging premium).
The ship is sunk. The contract
can be enforced when the ship sinks. 3.
If
a contract is contingent upon how a person will act at
an
unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time,
or otherwise than under further contingencies (
Sec. 34).
Illustration (to Sec. 34).
A agrees to pay B a sum of money (as loan)
if B marries C. C marries D. The marriage of B to C must now
be considered impossible, although it is possible that D may die and
that C may afterwards marry B. (
If later B actually marries C (the D's widow), it will not revive the old obligation of A to pay the sum, because that came to an end when C married D). 4.
Contingent contracts to do or not to do anything, if
a specified
uncertain event happens
within a fixed time, becomes void, if, at the
expiration of the time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible [
Sec. 35 (1)]. Illustration (to Sec. 35).
A promises to pay B a sum of money (as loan)
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
or
if the ship does not return within the year. 5.
Contingent contracts to do or not to do anything, if
a specified uncertain event does not happen
within a fixed time, may be enforced
by law when the time fixed has expired and such event has not happened, or, before the time fixed
has
expired, if it becomes certain that such event will not happen [
Sec. 35 (2)]. Illustration (to Sec. 35).
A promises
to pay B a sum of money (as insurance claim)
if a certain ship does not return within a
year. The contract may be enforced if the ship does not return within the year, or is burnt within the year. 6.
Contingent agreements to do or not
to
do anything, if an impossible event happens,
are
void, whether
the impossibility of the event is known or not to the parties to the agreement at the time when it is made (
Sec. 36). IIllustrations (to Sec. 36). (a)
A agrees to pay B Rs. 1,000 (as a loan),
if two straight lines should enclose a space. The agreement is
void. (
b)
A

agrees to pay B
Rs 1,000 (
as a loan),
if B will marry A'
s daughter C. C was dead at the time of the agreement.
The agreement is void. 8.5
DIFFERENCE BETWEEN A CONTINGENT CONTRACT AND A WAGERING AGREEMENT
The main
points of distinction between the two are as under: 1. A contingent contract is a valid contract but a wagering agreement is absolutely void. 2. In a contingent contract
the parties have real interest in the occurrence or non- occurrence of the event
e.g., insurable interest in the property insured, but in a wager the parties are not interested in the occurrence of the event except for the winning or losing the bet amount.
Contingent Contracts 96 Self-Instructional Material NOTES 3.
In a contingent contract the future uncertain event is merely collateral whereas
in a wagering agreement the
uncertain event is the sole determining factor
of the agreement. 8.6
TEST QUESTIONS 1. Define the term "contingent contracts". Discuss the rules relating to the performance of contingent contracts. 2. (a) What are the essential characteristics of a contingent contract? (b) To what extent the impossibility of the contingency affects the performance of the contract? 3. Distinguish between a contingent contract and a wagering agreement. What are the rules relating to the performance
of contingent contracts? 8.7 PRACTICAL PROBLEMS Attempt the following problems, giving reasons
for your answers: 1.
A agrees to construct a building for B for Rs 2 lakhs, on the terms that no payment shall be made till the completion of the work. Is this a contingent contract? [Hint. No, this is not a
contingent contract because the
uncertain event (i.e., A's completing the work) is not collateral to the contract but is the very thing contracted for, and is thus an integral part of the contract.] 2.
A agrees to sell land to B at a price to be fixed by C. C refuses to fix the price. Is
the
contract enforceable? [Hint. No,
the contract is not enforceable because by C's refusal to fix the price, the agreement becomes void for uncertainty in terms.] 3. A promises to pay B for his services whatever A himself will think right or reasonable. Later, being dissatisfied with the payment made, B sues A. Decide. [Hint. B's suit will not be admitted by the Court because if the performance of a promise is contingent upon the mere will and pleasure of the promisor, there is no contract. The rule of law being " agreements,
the meaning of which is not certain, or capable of being made certain,
are void" (
Sec. 29).]
MODULE - 3
Performance of Contracts Self-Instructional Material 99 NOTES UNIT 9 PERFORMANCE OF CONTRACTS Structure 9.0 Introduction 9.1 Unit Objectives 9.2

Test Questions 9.11 Practical Problems 9.0 INTRODUCTION "
Performance of Contract" means fulfilling of their respective legal obligations created under the contract by both the promisor and the promisee. When a contract is duly performed by both the parties, the contract comes to a happy ending and nothing more remains. Performance by all the parties of the respective obligations is the normal and natural mode of discharging or terminating a contract. 9.1

UNIT OBJECTIVES ? Understand how obligations under a contract must be carried out by the parties. ? Be clear about the rules regarding performance of joint promises. ? Be familiar about the rules regarding assignment of contracts and appropriation of payments. ? Understand the rules regarding the time and place of performance of a contract. 9.2 WHO CAN DEMAND PERFORMANCE? It is only the promisee who can demand performance of the promise under a contract,
for, the general rule is that "a person
cannot acquire rights under a contract to which he is not a party" (
T.G. Venkataraman vs State of Madras 1).
A third party cannot demand performance of the contract even if it was made for his benefit. 2
In case of
the
death of the promisee, his legal representatives are entitled to
enforce the performance of the contract against the promisor. 1 A.I.R. (1970) S.C. 508. 2 There are, however, certain exceptions to the general rule: where "a stranger to a contract can sue".
Performance of Contracts 100 Self-Instructional Material NOTES Illustrations. (a)
A promises B to pay C a sum
of Rs 1,000.
The person who can demand performance is B and not C.
If
A does not pay the amount to C, C cannot take any action against A. It is only B who can take action against A.
On the death of B, B's legal representatives are entitled to enforce the promise against A. (
b) A mortgaged his land to B, part of the consideration for the same being B's promise to discharge a debt of A to C. B did not pay to C. It was held that C was a stranger to the contract and could not sue B for the payment of the debt (Babu Ram vs Dhan Singh 3). 9.3
BY WHOM CONTRACTS MUST BE PERFORMED? 1.
By the promisor himself. In the case of a contract involving personal skill, taste or
credit; e.g., a contract to paint a picture, a contract of agency or service; the promisor must himself perform the contract. Section 40 states thus, "
if it appears
from the nature of the case that it was the intention of the parties
to any contract that any promise contained in
it
should be performed by the promisor himself,
such promise must
be performed by the promisor."
Illustration.
A promises to paint a picture for B. A
must perform this promise personally [
Illustration (b) to Section 40]. 2.
By the promisor or his agent. In the case of
a contract of impersonal nature; e.g., a contract of sale of goods or a contract to lend a sum of money,
the promisor himself or his agent may
perform the contract [Section 40 Clause (2)]. Illustration.
A promises to pay B a sum of money.
A
may perform this promise, either
by
personally paying the money to B or by causing it
to be paid to B by
another [
Illustration (a) to Section 40]. 3.
By the legal representatives.
In case of the
death of the" promisor before performance, the liability of performance falls on his legal representatives, unless a contrary intention appears from the contract [
Section 37 Clause (2)]. Thus, in the case of contracts involving personal skill, the heirs or legal representatives of a deceased promisor are not bound to perform the contract. Such contracts come

to an end
on the death of the promisor. The rule of law is: "
a personal cause of action comes to an end with the death of the person concerned". In the case of contracts not involving personal considerations,
the legal representatives are bound
to perform the contract. But
their liability is limited to the estate of the
deceased which has come to their hands,
in case of breach of contract. They are not personally liable.
Illustrations (
to Sec. 37). (
a)
A promises to paint a picture for B by a certain day at a certain price. A dies before
the
day.
The contract cannot be enforced either by A's representatives or by B. (
b)
A
promises to deliver goods to B on a certain day
on payment
of
Rs 1,000.
A dies before that day. A's representatives are bound to deliver the goods to B,
and B is bound to pay
the
Rs 1,000 to A's representatives. 4. Performance by a third person. Section 41 lays down that
if
a promisee accepts performance of the
promise from a third person, he cannot afterwards enforce it against the promisor.
Thus, where a promisee accepted lesser amount from a third party in full satisfaction of his claim,
it was held that he cannot enforce the promise against the promisor (
Lala Kapurchand vs Mir Nawab
Azamjnh 4).
Notice that under this Section performance of the promise by a stranger, once accepted by the promisee, discharges the promisor, although the latter has neither authorised nor ratified the act of the third party. 3
A.I.R. (1957) Punj. 169. 4 A.I.R. (1963) S.C. 250.
Performance of Contracts Self-Instructional Material 101 NOTES 9.4 PERFORMANCE OF JOINT PROMISES Joint promises may take any of the following shapes: (i) where several joint promisors make a promise with a single promisee, e.g.,
A, B and C jointly promise to pay Rs 3,000 to D,
or (ii) where a single promisor makes a promise with several joint promisees, e.g., P promises to pay Rs 3,000 to Q and R jointly, or (iii) where several joint promisors make a promise with several joint promisees, e.g.,
A, B and C jointly promise to pay Rs 3,000 to
P,Q and R jointly. We have earlier seen as to "
who can demand performance," and "by whom contracts must be performed,"
when there is an agreement between a single promisor and a single promisee. We now attempt to answer the aforesaid questions in the case of joint promises. Who can demand performance of joint promises? The answer to this question is found in Section 45 which provides that
when a promise is made to several persons jointly,
then, unless a contrary intention appears from the contract, the
right to claim performance rests with all
the
promisees jointly and a single promisee cannot demand performance. When any
one of the promisees dies, the right to claim performance rests with
the legal
representatives of such deceased person jointly with the surviving promisees.
When all the promisees

are dead, the right to claim performance rests with the legal representatives of all jointly. In brief, so long as all the joint promisees are alive,
the right to claim performance rests with all of them
jointly and on the death of any
promisee his legal representatives step into his shoes. Illustration (to Sec. 45).
A, in
consideration of Rs 5,000, lent to him by
B and C,
promises B and C jointly to repay them that sum with interest on a day specified, B dies. The right to claim performance rests with B's representative jointly with C during
Cs life and
after
the death of C with the representatives of B and C jointly.
It is worth noting that under the terms of the Section if a promisor makes the payment to one of the several joint promisees, it does not operate as a complete discharge of the debt (Govindlal vs Firm Thakurdas 5). By whom joint promises must be performed? The rules on the subject as
contained in Sections 42 to 44 of the Contract Act, are as follows: 1.
All promisors
must Jointly fulfil the promise.
When two or more persons have made a joint promise (
e.g., signed a promissory note jointly),
then, unless a contrary intention appears
by
the contract, all
such persons
must jointly fulfil the promise.
When any one of
the Joint promisors
dies, his legal representatives must,
jointly with the surviving promisors, fulfil the promise. On the death of all the
original promisors, the legal representatives of all of them jointly must fulfil the promise (
Sec. 42). The above rule is of course subject to the following usual conditions: (a) Contracts involving personal skill, e.g., to paint a picture, come to an end on the death of any of the joint promisors and the liability of performance does not fall on the legal representatives. (b) Wherever the legal representatives are made liable to perform the promise, they are not personally liable. Their liability is limited to the assets inherited by them. 2. Any one or more
of joint promisors may be compelled to perform.
When
two or more persons make a joint promise,
the promisee
is entitled, in the absence of
express agreement to the contrary,
to
compel any one or more of such joint promisors to perform
the
whole of the promise (
Sec. 43, Para 1). In other words, according to the Section the liability of joint 5 A.I.R. (1974) Bom. 164.
Performance of Contracts 102 Self-Instructional Material NOTES promisors is "joint and several" as against the promisee, unless there is a contract to the contrary.
For
example, A, B and C jointly promise to pay
D Rs 3,000. D may compel either A or B or C
or all or any two of them to pay him

Rs 3,000. In case of death of original debtor, if the debt falls upon a number of heirs, promisee must bring the suit against all heirs collectively, because the liability is only joint and not several in case of co-heirs. Co-heirs are not joint promisors. It will be pertinent to discuss as to what is the effect of a "decree" obtained against only one or two of the joint promisors? The Calcutta High Court has held 6 that a decree against some only of the joint promisors constitutes a bar to a second suit against other co-promisors, even if the promisee fails to realise the whole of the decretal amount, for, his claim merges in the decree. Thus in the above example, if D sues only A and could recover only Rs 1,500 from him, on a decree of Rs 3,000, he cannot as per the above verdict, sue for the balance other joint promisors later on. But the Madras High Court has dissented 7 from the above decision. It is
of the view that as the liability of joint promisors is joint and several under Section 43, a
judgment obtained against some only of the joint promisors and remaining unsatisfied is no bar to a second suit on the contract against the other joint promisors. Thus, according to the Madras High Court verdict, in our above example D can sue the remaining joint promisors later on for the unsatisfied portion of the decree. The Madras High Court's view seems logical. In fact a decision of the Supreme Court is required to settle the law on the point in question. 3. Right of contribution inter-se between joint promisors. If one of several joint promisors is made to perform the whole contract, he may require equal contribution from the other
joint promisors, unless a contrary intention appears from the contract (
Sec. 43, Para 2). Thus, in our example, if A is compelled to pay the entire amount of Rs 3,000, he can realise from B and C Rs 1,000 each. 4.
Sharing of loss by default in contribution. If any one of the joint promisors makes a default in making contribution, if any, the remaining joint promisors must bear the loss arising from such default in equal shares (
Sec.43, Para 3). Thus, in our example, if A is compelled to pay the whole and C is unable to pay anything, A is entitled to receive Rs 1,500 from B. If C's estate is able to pay one-half of his share, A is entitled to receive Rs 500 from C's estate and Rs 1,250 from B [Illustrations (b) and (c) to Section 43]. 5. Effect of release of one joint promisor. In case of joint promise, if one of the joint promisors is released from his liability by the promisee, his liability to the promisee ceases but this does not discharge the other joint promisors from their liability;
neither does it
free the joint promisor so released from
his liability to contribute to the other
joint promisors (Sec. 44). 9.5
ASSIGNMENT OF CONTRACTS Assignment of contract means transfer of contractual rights and liabilities
to
a third party
with or without the concurrence of the other party to
the contract.
By virtue of assignment, as assignee can bring an action on his own initiative (without making the assignor a party to the suit) against the other party to the contract. The Indian Contract Act contains no specific provisions dealing with assignment of contracts. But the law on the subject is well settled and the rules which have been applied by Courts in India in this regard are as follows: 6 In Phani Bhushan vs Rajendra, A.I.R. (1947) Cal. 1 1. The effect of the decision is that the liability of joint promisors is "joint and alternative." 7 In T.R. Chettiar vs M.K. Chettiar, A.I.R. (1970) Mad. 337.
The effect of the decision is that the liability of joint promisors is "joint and several."
Performance of Contracts Self-Instructional Material 103 NOTES 1. Contracts
involving personal skill, taste or credit, e.g., a contract to paint a picture, a contract
to perform a service or to marry, cannot be assigned. 2. The obligations (i.e., the liabilities) under a contract cannot be as signed except with the consent of the promisee, and when such consent is given, it is really a "novation" resulting in a substitution of liabilities. For instance, if X owes Y Rs. 200, he cannot transfer the liability to Z and force Y to collect his money from Z. But if Y agrees to accept Z as his debtor in place of X, there is "novation" (i.e., the old contract is substituted by new contract) and the liability to pay the debt stands transferred from X to Z. 3. The rights and benefits under a contract are assignable unless the contract is of personal nature or the rights are incapable of assignment either under the law or under an agreement between the parties, and the assignee can demand performance against the other contracting party. This is so because it makes no difference to the party bound by that obligation, whether he is called upon to perform it in favour of the original party or in favour of the assignee. But the assignee takes the assignment ' subject to all equities', if any. This means that the debtor may plead against the assignee all defences that he could have pleaded against the assignor.
For instance, if one of the two parties is induced to enter into a contract by fraud, and the fraudulent party assigns his interest in the contract to a bonafide third party for value, the defrauded party is entitled to rescind the contract in equity in spite of its assignment to an innocent party (Graham vs Johnson 8).
An "actionable claim," i.e., a claim to any debt,

or to
any beneficial interest in movable property
not in possession of the
claimant,
upon which legal action can be taken, can always be assigned but the assignment in order
to be complete and effectual must be made by an instrument in writing.
Although notice of assignment to the debtor
is not required under law, 9 nevertheless it is in the interest of the assignee to give notice to the debtor because in the absence of notice the assignee is bound by any payments which the debtor may make to the assignor in ignorance of the assignment. There are special provisions for assigning certain classes of contracts, e.g., negotiable instruments, life and marine insurance policies. 4.
Assignment by operation of law takes place in cases of death and insolvency. Upon the death of a party his rights and liabilities under a contract devolve upon his heirs and legal representatives (except in the case of a contract involving personal qualifications). In case of insolvency, all rights and liabilities of the insolvent pass to the Official Assignee or Receiver, as the case may be. 9.6 ORDER OF PERFORMANCE OF
RECIPROCAL PROMISES Promises which form the consideration for each other are called "reciprocal promises" or "mutual promises." It is common knowledge that "bilateral contracts," 10 where both contracting parties have to perform their promises, involve "mutual promises" amongst the parties. In such contracts each party gives a promise, in return for a promise; e.g.,
A, promises to sell certain goods to B and B, in return promises to pay the price
thereof to A, and
there is an obligation on each party to perform his own promise and to accept performance of
other's promise. Reciprocal promises may be classified into three categories: (1) Mutual and Independent, (2) Mutual and Dependent, and (3) Mutual and Concurrent. Sections 51 to 54 of the 8 (1869), L.R. 8 Eq. 36. 9 Section 130, The Transfer of Property Act. 10 For detailed discussion on "Unilateral" and "Bilateral" contracts, please refer to Unit 1—Heading: Kinds of Contracts from the point of view of the Extent of Execution.
Performance of Contracts 104 Self-Instructional Material NOTES Contract Act lay down the rules regarding the order of performance of reciprocal promises, which are stated below: 1.
Mutual and Independent. Where
each party must perform his promise independently
without waiting for the performance or the willingness to perform of the other, the promises are 'mutual and independent.'
According to Section 52, such promises must be performed in the order
expressly fixed by the contract, and where the order is not expressly fixed, they must be performed in that order which the nature of the transaction requires.
Illustrations. (a)
A,
promises to deliver certain goods to B on 10th April and B promises to pay
the price
in advance on 1st April and on default to pay interest @ 15 per cent per annum from 1st April till the date of payment. In this case A's promise to deliver goods is independent of B's promise to pay the price. Even if B does not pay the price on 1st April, A must deliver the goods on 10th April. A can, of course, sue B for the payment of price and damages. (b)
A and B contract that A shall build a house for B at a fixed price. A'
s promise to build the house must be performed before B's promise to pay for it [
Illustration (a)
to Section 52]. Whether the promises are such as are to be 'independently performed is often a question of construction depending on the intention of the parties collected from the agreement as a whole or from what 'the nature of transaction requires.' 2.
Mutual
and Dependent. Where the performance of the
promise by one party depends on the prior performance of the promise by the other party, the
promises are 'mutual and
dependent.'
Section 54 provides for such promises and lays down that if the promisor who is required to perform his promise in the first place,
fails to perform it, such promisor
cannot claim the performance of the reciprocal promise, and

must make compensation to the
other party
to the contract for any loss which such other party may sustain by
the
non- performance of the contract.
Illustrations. (a)
A contracts with B to execute certain builder's work for a fixed price, B supplying the scaffolding and timber necessary for the work. B refuses to furnish any scaffolding or timber,
and
the work cannot be executed. A need not execute the work, and B is bound to make compensation to A for any loss caused to him by the non-performance of the contract [
Illustration (b) to Section 54]. (b) A promises B to sell him one hundred bales of merchandise to be delivered next day, and B promises A to pay for them within a month. A does not deliver according to his promise. B's promise to pay need not be performed and A must make compensation [Illustration (d) to Section 54]. 3.
Mutual and Concurrent. Where the two promises are to be performed simultaneously, they are said to be 'mutual and concurrent.'
According, to Section 51, in the case of such promises
the
promisor need not
perform his promise unless the promisee is ready and willing to perform his
reciprocal promise.
Illustrations (to Sec. 51). (
a)
A and B contract that A shall deliver goods to B to be paid for by
B on delivery.
Here the promises are 'mutual and concurrent' and therefore
A need not deliver the goods, unless B is ready and willing to pay for the goods on delivery:
and
B need not pay for the goods, unless A is
ready and willing to deliver
them on payment. (
b)
A and B contract that A shall deliver goods to B
at a price to be paid by instalments, the first instalment
to be paid on delivery.
A need not deliver, unless B is ready and willing to pay the first instalment on delivery. B need not pay the first instalment, unless A is ready and willing to deliver the goods
on payment of the first
instalment. 4. Consequences where a party prevents performance. "
When a contract contains reciprocal promises and one party to
the contract
prevents the other from performing his promise,
the contract becomes voidable at the option of the party
so prevented;
and
he is entitled to compensation from the other party for any loss
which he may sustain in consequence of the non performance of the contract." (
Sec. 53)
Performance of Contracts Self-Instructional Material 105 NOTES Illustration (to
Sec. 53).
A and B contract that B shall execute certain work for A
for
Rs 1,000. B is ready and willing to do the work accordingly, but
A prevents him from doing so. The contract becomes voidable at the option of B, and if he elects to rescind it, he is entitled to recover
from A
compensation for any loss which he has incurred

by its non-
performance. 9.7
TIME AND PLACE FOR PERFORMANCE Sections 46 to 50 and 55 of the Contract Act lay down the rules regarding the time and place for performance of a contract, which are summarised below: Where prescribed by the promisee. Where the time and place are prescribed by the promisee, the performance of the contract must be at the specified time and place. Where not prescribed by the promisee. If no time and place are prescribed by the promisee, then the contract must be performed: (a) Within a reasonable time, on a working day
and within the usual hours of business.
The question, "
what is a reasonable time" is, in each particular case, a question of fact.
It
depends either on special circumstances of each particular case
or
the usage of trade or the intention of parties at the time of entering into contract.
Illustration (
to Sec. 47).
A promises to deliver goods at B's warehouse on 1st January. On that day A brings the goods to B's warehouse, but after the
usual
hour for closing
it, and they are not received. A
has not performed his promise. (
b) At proper place e.g., at godown or shop, and not at a public meeting or a fair. "
What is a proper
place" is, in each particular case, a question of fact.
Generally speaking the promisor must ask the promisee
where he would like the contract to be performed, and to perform it at such place (Sec. 49). Illustration (to Sec.49).
A undertakes to deliver a thousand maunds
of jute to B on a fixed day.
A must apply to B
to appoint a reasonable place for the
purpose of receiving it and must deliver it to him at such place.
Effects of
failure to perform a contract within the stipulated time. Section 55 deals with the subject and lays down the following rules: 1. Where "time is of
the essence of the contract", and there is failure to perform within
the fixed time,
the contract (or so much of it as remains unperformed) becomes voidable at the option of the promisee.
He may rescind the contract and sue for the breach. 2. Where "
time is not of the essence of the contract," failure to perform within the specified time does not make the contract voidable.
It means that in such a case the promisee cannot rescind the contract and he will have to accept the delayed performance. But he would be entitled to claim compensation from the promisor for any loss caused to him by the delay. This rule is, however, subject to the condition that the promisor should not delay the performance beyond a reasonable time, otherwise
the contract will become voidable at the option of the promisee. 3.
In case of a contract voidable on account of the promisor's failure to perform his promise within the agreed time or within a reasonable time, as the case may be, if the promisee, instead of rescinding the contract, accepts the delayed performance, he cannot afterwards claim
compensation for any loss caused by the delay,
unless,
at the time of accepting the delayed performance, he gives notice to the promisor of his intention to
do so.
When is the
time the essence
of the contract? "Time is of the essence of the contract," (
i) if the parties to the contract have expressly agreed to treat it as

such, or (ii) if the nature of transaction and the intention of parties were such that the performance within a limited time was necessary. Even where a time is specified for the performance of a certain promise, 'time may not be of the essence of the contract' and one has to look at the nature
Performance of Contracts 106 Self-Instructional Material NOTES and construction of the contract and the intention of the parties in order to ascertain whether "
time is of the essence of the contract" or not.
It is well settled
that
unless a different intention appears from
the terms of the
contract,
ordinarily in commercial contracts the time of delivery of goods is of the essence of the contract but not the time of payment of the price (Wasoo Enterprises vs J.J. Oil Mills 11). This is so because
there are great chances of rapid market fluctuations and also because after entering into a contract the businessman, on that basis, may enter into other contracts with other persons which cannot be fulfilled unless he receives the delivery of goods under the contract. In contracts for the purchase of land, usually time is not of the essence of the contract because land values do not frequently fluctuate (G. Pillai vs P. Nadar 12). Mode or manner of performance. "
The performance of any promise may be made in any manner,... which the promisee prescribes
or sanctions" (
Sec. 50).
The promisor must perform the promise in strict accordance with the terms of the contract or instructions from the promisee. He has no right to substitute, for what he has been directed, something else, even if the substitute may be more beneficial to the promisee. Illustrations (to Sec. 50). (a)
B owes A Rs 2.000. A desires B to pay the amount to A's account with C, a banker. B, who also banks with C, orders the amount to be transferred
from his account to A's credit, and this is done by C.
Afterwards, and before A knows of the transfer, C fails. There has been a good payment by B. (b)
A desires B, who owes him Rs 100, to send him a note for Rs 100 by post.
The debt is discharged as soon as B puts into the post a letter containing
the note duly addressed to A. 9.8
APPROPRIATION OF
PAYMENTS When a debtor, who owes several debts to the same creditor, makes a payment which is insufficient to satisfy the whole indebtedness, the question arises, "as to which of the debts the payment is to be applied?" Sections 59 to 61 of the Contract Act answer this question and lay down the following rules: 1. Debtor's express instructions must be followed.
Appropriation is a right given to the debtor for his benefit.
Thus if the debtor expressly states that the payment made by him
is to be applied to the discharge of some particular debt, the
creditor must
act accordingly otherwise he should not accept the payment. 2. Debtor's implied intention must be followed. If there are no express instructions, then debtor's implied intention should be gathered from the circumstances attending the payment and appropriation must be done accordingly. Illustrations (to Sec. 59). (
a)
A owes B, among other debts Rs 1,000 upon a promissory note which falls due on
the 1
st
June. He owes B no other debt of that amount. On
the 1
st
June A pays to B Rs 1,000.
The payment is to be applied to the discharge of
the promissory note. (b) A owes
to
B, among other debts, the sum of
Rs 567.
B writes to A and demands payment of this sum. A sends
to B

Rs 5.67.
This payment is to be applied to the discharge of the debt of which B had demanded payment. 3.
Appropriation by creditor.
If there is no express or implied direction by the debtor regarding appropriation,
then the creditor has got the option to apply the payment to any debt lawfully due from the debtor,
including a debt which is barred by the Limitation Act. 4. Appropriation by law. Where neither the debtor nor the creditor has made any appropriation, then according to law,
the payment is to be
applied in discharge of
the debts in order of time, whether or not they are
time-barred.
If the debts are of equal standing,
the
payment shall be applied in discharge of each proportionately. 11
A.I.R. (1968) Guj. 57. 12 (1967), 1 S.C.R. 227.
Check Your Progress State whether the following are True or False: 1.
An offer to perform a promise in part is a valid tender. 2. In case of several joint promisors,
the promise can demand performance from any one of the joint promiser. 3.
Contractual obligations involving personal skill or ability cannot be assigned. 4.
Where times
is of
the essence of contract and the promisor fails to perform his promise in time, the contract becomes. 5.
In the absence of
any direction by the debter regarding appropriation, a creditor can apply the payment to any debt, including a time-barred debt.
Performance of Contracts Self-Instructional Material 107 NOTES 5. When principal and interest both due. If a payment has been made without expressly stating whether it is towards interest or principal, payment is to be applied towards interest first, and then the balance to principal (Srinivasulu vs Kondappa 13). It may be emphasised that if the creditor accepts the payment, he must follow the above rules of appropriation otherwise he must refuse to accept the payment.
9.9
CONTRACTS WHICH
NEED NOT BE PERFORMED The circumstances under which contracts need not be performed are as follows: 1. If parties to a contract agree to 'Novation,' 'Rescission' or 'Alteration', the original contract need not be performed (
Section 62). In such cases the original contract disappears and
is substituted by a new contract. 14 2. If parties to a contract agree to dispense with or remit performance of promise either wholly or in part, the original contract stands discharged (
Sec. 63). This is technically called as 'Remission.' 3.
When a person at whose option a contract is voidable rescinds it, the other party thereto need not
perform his promise (
Sec. 64). 4.
If any promisee
neglects or refuses to afford the promisor reasonable facilities for the performance of his promise,
the promisor is excused
for
the non-performance of the contract (
Sec. 67). For instance,
A contracts with B to
repair B's house. B neglects or refuses to point out to A the places in which his house requires repair. A is excused for the non-performance of the contract, if it is caused by such neglect or refusal (
Illustration to Sec. 67). 9.10
TEST QUESTIONS 1.
What do you understand by performance of a contract?
State
who can demand performance
and by whom contracts must be performed? 2.
State
with illustrations the provisions of the Indian Contract Act relating to the devolution of

joint rights and liabilities. 3. What are reciprocal promises? State the provisions of the Indian Contract Act which deal with the order of performance of reciprocal promises. 4. (a) Discuss the law relating to assignment of contracts. (b) Write a note on "Time is of the essence of the contract." 5. (a)
State
the rules relating to appropriation of payment made by a debtor to his creditor. (
b) State and discuss the circumstances under which contracts need not be performed. 9.11
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your
answers: 1. P, Q and R jointly promise to pay Z Rs 3,000. P and Q are not traceable. Can Z compel R to pay him in full? 13 (1960), A.P. 174. See also Harishchandra vs Kailashchandra, A.I.R. (1975), Raj. 15. 14 For details refer Discharge of Contracts.
Performance of Contracts 108 Self-Instructional Material NOTES [Hint. Yes, Z can compel R to pay him the full amount because the liability of joint promisors is 'joint and several' under Section 43.] 2. A Firm consisting of two partners A and B, owes a sum of Rs 5, 000 to C. C filed a suit to recover the sum against A only and obtained a decree. The decree remains partially unsatisfied and C could recover from A Rs 3,000 only. C now wants to file a suit against B for the balance of Rs 2,000. Advise C. [Hint. C can file a suit against B for recovering the balance amount because the liability of joint promisors is 'joint and several' as per Sec. 43. But according to Calcutta High Court C cannot file the suit against B for the balance amount because in that Court's opinion once a judgment has been obtained, C's claim merges in the decree.] 3. A owes B a sum of Rs. 5,000. C, who is A's friend pays to B Rs. 2000. B accepts the amount in full satisfaction of his claim against A. Will this payment discharges A from the whole debt ? [Hint. Yes, the payment by C to B discharges A from the whole debt.
Section 41 lays down
that
if
a promisee accepts performance of the promise from a third person,
the promisor is discharged.] 4.
A borrows Rs 3,000 from B, C and D. When the debt becomes due A tenders it to B who accepts it. Is A discharged by the payment? [Hint.
A is not discharged by the payment because under the terms of Section 45 a payment to one of several joint promisees does not operate as a complete discharge of a debt (Govindlal vs Firm Thakurdas, A.I.R. 1974 Bom. 174).] 5. A and B execute a promissory note in favour of X and Y for Rs 4,000. Will X succeed if he alone sues A on the pronote? [Hint. X will not succeed if he sues alone. Y must join him because according to Section 45 the right to claim performance rests with all the promisees jointly and a single promisee cannot demand performance.] 6. A obtains two loans of Rs 25,000 each from a bank, one of which is guaranteed by B. A sends the bank a sum of Rs 30,000 without any direction regarding appropriation towards the loans The bank appropriates Rs 25,000 towards the loan not guaranteed by B and Rs 5,000 only towards the loan guaranteed by B. B objects to such appropriation. Can he succeed? [Hint. B cannot succeed. In the absence of any express or implied instructions from the debtor regarding appropriation, the creditor is entitled to apply the payment to any of the two debts and hence the appropriation done by the bank is perfectly valid and binding, as per Section 60.]
Discharge of Contracts Self-Instructional Material 109 NOTES UNIT 10 DISCHARGE OF CONTRACTS Structure 10.0 Introduction 10.1 Unit Objectives 10.2 Discharge
by Performance 10.3 Discharge by Mutual Consent or Agreement 10.4 Discharge by Subsequent or Supervening Impossibility or Illegality 10.5 Cases not Covered by Supervening Impossibility 10.6
Discharge
by Lapse of Time 10.7 Discharge by
Operation of Law 10.8 Discharge by Breach of
Contract 10.9
Test Questions 10.10 Practical Problems 10.0 INTRODUCTION
When the rights and obligations arising out of a contract are extinguished, the contract is said to be discharged or terminated.
A contract
may be discharged in any of the following ways: 1. By
performance—
actual or attempted. 2. By mutual consent
or agreement. 3.
By subsequent or supervening impossibility or illegality. 4.
By lapse of time. 5. By operation of law. 6. By breach of contract. 10.1
UNIT OBJECTIVES ? Understand the various modes of discharge of

contracts ? To know the essentials of a valid tender of performance ? Be clear about the doctrine of supervening impossibility 10.2
DISCHARGE BY PERFORMANCE Performance of a contract is the principal and most usual mode of discharge of a contract.
Performance may be: (1) Actual performance; or (2) Attempted performance or Tender. 1. Actual performance.
When each party
to a contract
fulfils his obligation
arising under the contract within the time and in the manner prescribed,
it
amounts to actual performance of the contract and the contract comes to an end or stands discharged. But if one party only performs his
promise, he alone is discharged. Such a party gets a right of action against the other party who is guilty of breach.
Discharge of
Contracts 110 Self-Instructional Material NOTES 2.
Attempted performance or tender.
When the promisor
offers to perform his obligation
under the contract,
but is unable to do so because the promisee does not accept the performance, it is called "
attempted performance" or "tender."
Thus "tender"
is not actual performance but is only an "offer
to perform"
the obligation
under the
contract.
A valid tender of performance is equivalent to performance.
Essentials of a valid tender.
A valid tender or offer of performance must fulfil the following conditions. 1 1. It must be unconditional.
A conditional tender is no tender. For example,
A, who is a debtor of company B, offers to pay if shares are allotted to him
at par. It is no tender. 2.
It must be made at proper time and place.
A
tender before or after the
due date or at a place other than agreed upon is not a valid tender. For
example,
A is a tenant of B. He offers him rent at a marriage party. B is not bound to accept as
the
tender is not made at a proper place. 3. It must be of the whole obligation
contracted for and not only of the part. Thus deciding of his own to pay in instalments and offering the first instalment was held
an
invalid tender as it was not of the whole amount due (Behari Lal vs Ram Gulam 2). 4. If the tender relates to delivery of goods, it must give a reasonable opportunity to the promisee
for inspection of goods
so that he may be sure that the goods tendered are of contract description. 5.
It must be made by a person who is in a position and
is willing to perform
the promise.
A tender by a minor or idiot
is
not a valid
tender. 6.
It must be made to the proper person, i.e., the promisee or his
duly authorised

agent.
Tender made to a stranger
is invalid. 7.
If there are several joint promisees, an offer to any one of them is a valid tender. (But the actual payment must be made to all joint promisees, and not to any one of them,
for a valid discharge of the contract, for, Section 45 provides that
when a promise is made to two or more persons jointly,
the right to claim performance rests with all
of them
jointly.) 8.
In case of tender of money, exact amount should be tendered
in the legal tender money.
Tendering a smaller or larger amount is an invalid tender, e.g., tendering Rs 100 currency note to a conductor of a bus for a two rupees ticket is not a valid tender. Similarly, a tender by a cheque is invalid as it is not legal tender but if the creditor accepts the cheque, he cannot afterwards raise an objection. Effect of
refusal to accept a valid tender (Sec 38).
The effect of refusal to accept a properly made "offer of performance"
is that
the contract is deemed to have been performed by the
promisor,
i.e., tenderer, and the promisee can be sued for breach of contract. A valid tender, thus, discharges the contract.
Exception. Tender of money, however, does not discharge the contract. The money will have to be paid even after the refusal of tender, of course without interest from the date of refusal. In case of a suit, cost of defence can also be recovered from the plaintiff, if tender of money is proved (Jagat Tarini vs Naba Gopal 3). 1 As per Section 30 and Judicial decisions. 2 (1902), 24 All. 461. 3 (1907), 34 Cal. 305.
Discharge of Contracts Self-Instructional Material 111 NOTES 10.3 DISCHARGE BY MUTUAL CONSENT OR 10.3 AGREEMENT Since
a contract is created by means of an agreement, it may also be discharged by another agreement between the same parties.
Sections 62
and 63 deal with this subject and provide for the following methods
of discharging a contract by mutual agreement: 1.
Novation. "
Novation occurs when
a
new contract is substituted for an existing
contract,
either between the same parties or between different parties,
the consideration mutually being the discharge of the old contract.
If parties are
not changed then the nature of the obligation (i.e., material terms of the contract) must be altered substantially in the new substituted contract, for a mere variation of some of the terms of a contract, while the parties remain the same, is not "novation" but "alteration." When the parties to a contract agree for "novation," the original contract is discharged and need not be performed. Illustrations (a) A is indebted to B and B to C. By mutual agreement B's debt to C and B's loan to A are cancelled and C accepts A as his debtor. There is novation involving change of parties. (
b)
A owes B Rs 10,000. A
enters into an agreement 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. [
Illustration (b)
to
Section 62]. The following points are also worth noting in connection with novation: (a)
Novation cannot be compulsory, it can only be with the mutual consent of all the parties.
Illustration.
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 agreement.
B still owes C Rs 1,000 and no new contract has been entered into. [Illustration (c) to
Section 62] (b) The new contract must be valid and enforceable. If it suffers from any legal flaw, e.g., want of proper stamp or registration etc., on account of which it becomes unenforceable, then the original contract revives (Mahabir Prasad vs Satyanarain 4) 2.
Alteration. Alteration of a contract
means change in one or more of the
material terms of a contract.
If a material alteration
in a written contract is done by mutual consent, the original contract is discharged by alteration and the new contract in its altered form takes its place.
A material alteration is one which alters the legal effect of the contract, e.g., a change in the amount of money
to be paid or a change in the rate of interest. Immaterial alteration, e.g., correcting a clerical error in figures
or the spelling of a name, has no effect on the validity of the contract
and does not amount to alteration in the technical sense. It is relevant to state that a material alteration made in a written contract by one party without the consent of the other, will, make the whole contract void and no person can maintain an action upon it.
It comes under "discharge of a contract by operation of law" which will be discussed later. The difference between "novation" and "alteration" may be noted. In case of novation there may be a change of parties also while in case of alteration parties remain the same, only the terms of a contract are altered. 3.
Rescission. A contract may be discharged, before the date of performance, by agreement between the parties to the effect that it shall no longer bind them. Such an agreement amounts to "rescission" or cancellation of the contract, the consideration for mutual pro-mises being the abandonment by the respective parties of their rights under the contract. An agreement of rescission releases the parties from their obligations arising out of the contract. Such agreements are to be distinguished from 'agreements in restraint of legal proceedings" which are void as per Section 28. Law cannot force the parties to 4 A.I.R. (1963), Pat. 131.
Discharge of Contracts 112 Self-Instructional Material NOTES take a legal action for breach of contract and, therefore, if they consent to treat non- performance or part performance of a contract equivalent to full performance or discharge of the contract, it is perfectly alright. If is just like this: A contracts to marry B. It is a valid contract. But if A contracts with B not to marry C, it is a void agreement "being in restraint of marriage" as per Section 26. Hence "an agreement to excuse performance" is valid, while "an agreement not to sue for breach" is void, although in practical life both may mean the same. Illustration.
A promises to deliver certain goods to B on a certain date.
Before the date of performance, A and B
mutually agree that the contract will not be performed. The
contract stands discharged by rescission. There
may also be an implied rescission of a contract, e.g., where
there is
non-performance of a contract by both the parties for a long period, without complaint,
it amounts to an implied rescission.
Notice that in the case of
rescission, the existing contract is cancelled by mutual consent without substituting a new contract in its place. 4.
Remission.
Remission may be defined "as
the
acceptance of a
lesser sum than what was contracted for
or a lesser fulfilment of the promise made."
Section 63
deals with remission of performance and lays down that
a
promisee may remit or give up
wholly or in part, the performance of the promise made to him,

and a promise to do so is binding even though there is no consideration for it. The Section further provides that an agreement to extend the time for the performance of a promise also does not require consideration to support it on the ground that it is a partial remission of performance. Illustrations. (a) If the promisee agrees to accept Rs 2,000 in full satisfaction of a claim of Rs 5,000, the promise is enforceable and the promisee cannot in future bring a suit for the recovery of Rs 5,000. (In England it would have been only "accord" which is unenforceable and the actual payment of Rs 2,000 and its acceptance in full satisfaction of the claim by the other party would have been "accord and satisfaction" which alone would have discharged the old contract. "Accord" without "satisfaction" is no discharge of the contract in English law.) (b)
A
owes B Rs 5,000. A pays to B and
B accepts, in satisfaction of
the whole debt.
Rs 2,000 paid at the time and place at which
the Rs 5,000 were payable. The whole debt is discharged [
Illustration (b) to
Section 63]. (c)
A owes B Rs 2,000, and is also indebted to other creditors. A makes an agreement with his creditors, including B, to pay them a composition of eight annas (fifty paise) in the rupee upon their respective demands. Payment to B of Rs 1,000 is a discharge of B's demand [Illustration (e) to
Section 63]. (d)
A owes B Rs 5,000 payable on 1st June. A is not in a position to meet his liability on
the due date and as such makes a request to
B to extend the time for payment by three months. B
accedes to A's request. The promise is binding and no suit can be instituted before the expiry of the extended period of credit although the promise is not supported by any consideration. 5. Waiver. Waiver means the deliberate abandonment
or
giving up
of
a right which a party is entitled to under a contract, whereupon the other party
to the contract is released from his obligation.
Strictly speaking there is no need of an agreement for a waiver but because we are discussing it as a method of discharge under 'mutual consent,' we presume that the other party consents to it. Thus, where A promises to tailor a shirt for B if he will sing a song at his birthday party and accordingly B sang the song but afterwards B forbids A to tailor the shirt, to which A consents, the contract is terminated by waiver. 10.4
DISCHARGE BY SUBSEQUENT OR 10.4 SUPERVENING IMPOSSIBILITY OR 10.4 ILLEGALITY
Impossibility at the time of contract.
There is no question of discharge of a contract which is entered into to perform something that is obviously impossible, e.g., an agreement
Discharge of Contracts Self-Instructional Material 113 NOTES to discover treasure by magic, because, in such a case there is no contract to terminate, it being an agreement void ab-initio by virtue of Section 56, Para I, which
provides: "
an
agreement to do an act impossible in itself is void."
Notice that this paragraph of the Section speaks of something which is impossible inherently or by its very nature and which may or may not be known to both
the parties
at the time when the contract is made.
But
if the impossibility is
not obvious and the promisor alone knows
of the impossibility or illegality then existing or the promisor might have known as such after using
reasonable diligence, such
promisor is bound
to compensate the promisee for any loss he may suffer
through the non-performance of the promise,
in spite of the agreement being void ab-initio [Section 56, Para 3]. Illustration.
A contracts to marry B, being already married to C,

and
being forbidden by the law to which he is subject to practise polygamy.
A must make compensation to
B for the loss caused to her by the non-performance of
his promise [
Illustration (c) to
Section 56]. Subsequent impossibility. In fact it is this case, where the impossibility supervenes after the contract has been made, which is material to our study of discharge of contracts. In this connection. Section 56, Para 2, declares: "
A contract to do an act which, after the contract
is made, becomes impossible, or,
by reason of some event which the promisor could not prevent,
unlawful, becomes void when the act becomes impossible or unlawful".
In
order that the Section would apply the following conditions must be fulfilled: (1) that the act should have become impossible; (2) that
impossibility should be
by reason of some event which the promisor could not prevent;
and (3) that
the impossibility should not be self-induced by the promisor
or due to his negligence.
Further, the word "impossible" should be construed here in its practical sense and not only in a physical or literal sense. It is sufficient for the act
to be impossible that it becomes impracticable or extremely hazardous or useless from the point of view of the object and purpose which the parties had in view,
because if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain, it can very well be said that the promisor found it impossible to do the act which he promised to do. 5 Thus, under Section 56 (Para 2), where an event which could not reasonably
have been in the contemplation of the parties when the contract
was made, renders performance impossible or unlawful, the contract becomes void and stands discharged. This is known as frustration of the contract brought about by supervening impossibility. It is also known as the doctrine of supervening impossibility. The rationale behind the doctrine is that
if
the performance of a contract becomes impossible by reason of supervening impossibility or illegality of the act agreed to be done,
it is logical to absolve the parties from further performance of it as they never did promise to perform an impossibility. It seems necessary to emphasise that the "doctrine of supervening impossibility," as enunciated in Section 56 (Para 2), is wider than the "doctrine of frustration" known to the English law. Referring to this aspect, the Supreme Court observed in Satyabrata Ghose vs Mugneeram Bangur & Co., 6 as follows: "
The doctrine of frustration
is really an aspect or part of the law of discharge
of contract by reason of supervening impossibility or illegality
of the act
agreed to be done and hence comes within the purview of
Section 56 of the Contract Act. It would be incorrect to say that Section 56 applies only to cases of physical impossibility and that where this Section is not applicable, recourse can be had to the principles of English law on the subject of frustration. It must be held also that to the extent that the Contract Act deals with a particu- lar subject, it is exhaustive upon the same and it is not permissible to import the principles of English law de hors these statutory provisions." 5 Adapted from the Supreme Court observation in Satyabrata Ghose vs Mugneeram Bangur & Co., (1954), S.C. 44. 6 Ibid. Discharge of Contracts 114 Self-Instructional Material NOTES It is for the reason stated above that we shall not be discussing the "doctrine of frustration of English law" separately. It may be of interest to note that in the case of subsequent impossibility or illegality,
the dissolution of the contract occurs automatically. It does not depend, as does "
novation" or "remission" of a contract, on the choice of the parties. It depends on the effect of what has actually happened on the possibility of performing the contract. Cases where the doctrine of supervening impossibility applies.
A contract will be discharged on the ground of
supervening impossibility
in

the following cases: 1.
Destruction of subject-matter.
When the subject-matter of a contract,
subsequent to its formation, is destroyed, without
the fault of
the
promisor or promisee, the contract is discharged.
Note that it is so only when specific property or goods are destroyed which cannot be regained. Illustrations. (
a) A music hall was agreed to be
let out
for a series of concerts on certain days. The hall was
destroyed by fire before the date of the
first concert. The plaintiff sued the defendant for damages for the
breach of contract. It was held that the contract has become void
and the defendant was not liable (Taylor vs Caldwei 7). (b) The defendant contracted to sell a part of a specific crop of potatoes to be grown on his farms, but failed to supply them as the crop was destroyed by a
pest. The contract was held to be discharged (Howell vs Couplanc 8). (c) Similarly, if a factory premises on which a machinery is to be installed are destroyed by fire, or a ship under a charter party is seized by a foreign government, the contract is discharged (Tatem Ltd. vs Gambo 9). 2.
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 pro-perty affected by the contract and the performance of the contract remains possible in literal sense.
The leading case of Krell vs Henry 10 is a good illustration on the point: H hired a room in London from K with the object; as both parties well knew; of using the room to view the intended coronation procession of King Edward VII on a particular date. By reason of the King's illness the procession was postponed. H consequently could not use the room although he could go there and sit but with no purpose as there was no procession. K
filed a suit for the recovery of rent. It was held that
H need not pay the rent as the contract was discharged on failure of the ultimate purpose or on postponement of the procession which was the foundation of the contract. 3. Death or
personal incapacity of promisor.
Where
the performance of a contract depends upon the personal skill or
qualification
or the existence of a given person,
the contract is discharged on the illness or incapacity or
the death of that person. Illustrations. (
a)
A and
B contract to marry each other. Before the
time
fixed for the marriage, A goes mad. The contract
becomes void [
Illustration (b)
to
Section 56]. (
b)
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 those occasions becomes void [
Illustration (e) to
Section 56]. (c)
An artist undertook to paint a picture for a certain price, but before he could do so,
he met with an accident and lost his

right arm. Held, the artist was discharged due to disablement. 7 (1863), 122 A.R. 299. For an Indian case see: V.L. Narasu vs P.S.V. Iyer, (1953), I.L.R. Mad. 831. 8 (1876), 1 Q.B.D. 258. 9 (1939), 1 K.B. 132. 10 (1903), 2 K.B. 740. For an Indian case see: Jawala Pd. vs Jawala Bank, A.I.R. (1957), All. 143.
Discharge of Contracts Self-Instructional Material 115 NOTES 4. Change of law. A subsequent change in law may render the contract illegal and in such cases the contract is deemed discharged. The law may actually forbid the doing of some act undertaken in the contract, or it may take from the control of the promisor something in respect of which he has contracted to act or not to act in a certain way. Illustrations. (a) A sold to B 100 bags of wheat at Rs 700 per bag. But before delivery the Government rendered the sale and purchase of wheat by private traders illegal under the Defence of India Rules. The contract was discharged by impossibility created by subsequent change in law. (b) There was a contract for the sale of the trees of a forest. Subsequently by an Act of Legislature, the forest was acquired by the State Government. The contract was discharged because it had become impossible of performance. 5.
Outbreak of war. All contracts entered into with an alien enemy
during war
are
illegal and void ab-initio.
Contracts entered into before the outbreak of war are suspended during
the war
and may be revived after the war is over
provided they have not already become time-barred.
It may be noted that
if war is declared between the countries of the contracting parties then only the contract is suspended during war. If war is declared between the country of one of the parties to the contract and a third country, the contract remains binding, and if the party of the country now at war could not perform the contract because of dislocation of transport etc., it will be treated as “difficulty in performance” only and does not discharge the contract (Tsakiroglou & Co., Ltd. vs Noblee Thorl 11). 10.5 CASES NOT COVERED BY SUPERVENING 10.5 IMPOSSIBILITY “He that agrees to do an act must do it or pay damages for not doing it” is the general rule of the law of contract. Thus, unless the performance becomes absolutely impossible (as discussed above), a person is bound to perform any obligation which he has undertaken, and cannot claim to be excused by the mere fact that performance has subsequently become unexpectedly burdensome, more difficult or expensive. Some of the cases where impossibility of performance is not an excuse are as follows: 1. Difficulty of performance. Increased or unexpected difficulty and expense do not, as a rule, excuse from performance. Illustrations. (a) A, sold to B a certain quantity of Finnish birch timber A, found it impossible to fulfil this contract because the outbreak of war disorganised the transport and A could not get any supply of timber from Finland. Held, B was not concerned with the way in which A was going to get timber and, therefore, there was no frustration. The Court of Appeal observed: “For the contract to be dissolved there must have been a failure of something which was at the basis of the contract in the intention of both parties, and that was not the case here.” (Blackburn Bobbin Co., Ltd. vs Alien & Sons Ltd. 12) (b) X contracted with Y
to send certain goods from Bombay to Delhi in September. In August
transport companies went on strike and transport
was available at very high rates. Held, the increase in freight rates did not excuse performance (
Karl Etilinger vs Chagandas & Co. 13) (c) A contracts with B to supply B 1000 tons of raw silk, by a fixed day for a specified price. A fails to perform his contract with B since he could not procure the required quantity from the market Held, mere non-availability of goods agreed to be sold did not excuse performance (Gwalior Rayon Silk Mfg. Co. vs Andavar & Co. 14). 11 (1962), A.C. 93. 12 (1918), 2 K.B. 467. 13 (1916), 40 Bom. 301. 14 I.R. (1991), Ker. 134. Check Your Progress 1. Explain discharge by performance. 2. Explain discharge by mutual consent. 3. Define doctrine of super-vening impossibility. 4. Define the term remission.
Discharge of Contracts 116 Self-Instructional Material NOTES 2. Commercial impossibility. When in a transaction profits dwindle to a very low level or actual loss becomes certain, it is said that the performance of the contract has become commercially impossible. Such a situation may arise on account of higher price of the raw material or increase in the wage bill etc. Commercial impossibility also does not discharge a contract (Sachindra vs Gopal 15). 3. Impossibility due to the default of a third person. The doctrine of supervening impossibility does not cover cases where the contract could not be performed because of the impossibility created by
the failure of
a third person on whose work the promisor relied.
Illustrations. (a) A, a wholesaler,
enters
into a contract with B for the sale of certain goods ‘to be
produced by Z’, a manufacturer of those goods. Z does not manufacture those goods. A is liable to B

for damages.
The words 'to be produced by Z simply indicate quality of goods here. (b)
A, agreed to sell to B 61 bales of cloth to be manufactured by the
New
Victoria Mills, Kanpur, "as soon as they are supplied to him by the said Mill." In a suit for damages for non-delivery of goods
the defendant (A)
pleaded impossibility on the ground that the goods were not supplied to him by the Mill.
Held, that the words "as soon as they are supplied to him by the Mill" simply indicate the process of delivery and did not convey the meaning that delivery was contingent on their being supplied by the Mill. Hence the case did not fall within the provisions of Sections 32 and 56 as the default was due to the fault of the defendant. B is, therefore, entitled to recover damages from A. (Ganga Saran vs Ram Charan Ram Gopal 16) 4. Strikes and lock-outs. A strike by the workmen or a lock-out by the employer also does not excuse performance because the former is manageable (as labour is available otherwise) and the latter is self-induced. Where the impossibility is not absolute or where it is due to the default of the promisor himself, Section 56 would not apply. As such these events also do not discharge a contract. Illustration. The lessor of certain salt pans, failed to repair them according to the terms of the contract, on the ground of a strike of the workmen. Held, a strike by the workmen was not sufficient reason to excuse performance of the contract (Hari Laxman vs Secretary of State for India 17). 5.
Failure of one of the objects. When a
contract is entered into for several objects, the failure of one of them does not discharge
the contract. Illustration. A company agreed to let out a boat to H, (
a) for
viewing a naval review
on the occasion of
the coronation of King Edward VII, and (b) to sail round the fleet. Due to
illness of the King, the naval review was later cancelled but the fleet
was assembled. Held, the
contract was not discharged because the holding of the review was not the sole basis of the contract.
To sail round the fleet, which formed an equally basic object of the contract was still capable of attainment (H.B. Steamboat Co. vs Hutton 18). 10.6
DISCHARGE BY LAPSE OF TIME The Limitation Act lays down that
in case of breach of
a contract legal action should be taken within a specified period, called the period of limitation, otherwise
the
promisee is debarred from instituting a suit in a court of law and the contract stands discharged. Thus in certain circumstances lapse of time
may also discharge a contract. For example,
the period of limitation for simple contracts is three years under the Limitation Act, and therefore on default by a debtor if the creditor does not file a suit of recovery against him within three years of default, the debt becomes time-barred on
the
expiry of three years and the creditor
will be deprived of his remedy at law. This in effect implies discharge of contract. 15 (1949),
Cal. 240. 16 (1952), S.C.R. 36. 17 (1928), 30 Bom. L.R. 49. 18 (1903), 2 K.B. 683.
Discharge of Contracts Self-Instructional Material 117 NOTES Again, where "time is of essence in a contract," if the contract is not performed at the fixed
time, the contract comes to an end, and the party not at fault need not perform his obliga- tion and may sue the other party for damages. 10.7
DISCHARGE BY OPERATION OF LAW A contract terminates by operation of law in the following
cases: (
a) Death.
Where
the contract is of a personal nature, the death of the promisor
discharges the
contract. In other contracts the rights and liabilities of the
deceased
person pass on to the legal representatives of the
dead man. (b) Insolvency.

A contract is discharged by the
insolvency of one of the parties to it when an Insolvency Court passes an "order of discharge"
exonerating the insolvent from liabilities on debts incurred prior to his adjudication. (c)
Merger. Where an inferior right contract merges into a superior right
contract, the former stands discharged automatically.
Illustrations. (a) Where a man holding property under a contract of tenancy buys the property, his rights as a tenant are merged into the rights of ownership and the contract of tenancy stands discharged by operation of law. (b) Where a part-time lecturer is made full time lecturer, the contract of part-time lectureship is discharged by merger. (
c) A bill of exchange
is discharged if the acceptor becomes the holder of it at or after its maturity in his own
right. (d) Unauthorised material alteration. A material alteration made in a written document or
contract by one party without the consent of the other, will make the whole contract void.
Thus, where the amount of money to be received is altered, or an additional signature is forged, on a promissory note by a creditor, he cannot bring a suit on it and the pro-note cannot by enforced against the debtor even in its original shape. The effect of making such an alteration is exactly the same as that of cancelling the contract (Gour Chunder vs Prasanna 19). However, the document, though altered, can be used as proof of the transaction and the creditor may be allowed to claim refund of money actually advanced by him under Section 65 of the Contract Act which is based on the equitable doctrine of restitution (Ananthrao vs Kandikanda 20). 10.8
DISCHARGE BY BREACH OF CONTRACT Breach of contract by a party thereto is also a method of discharge of a contract, because "breach" also brings to an end the obligations created by a contract on the part of each of the parties. Of course the aggrieved party, i.e., the party not at fault can sue for damages for breach of contract as per law; but the contract as such stands terminated. Breach of contract may be of two kinds: (1) Anticipatory breach; and (2) Actual breach. 1.
Anticipatory breach. An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived.
It may take place in two ways: (a) Expressly by words spoken or written. Here
a party to the contract communicates to the other party, before the due date of performance, his intention not to perform it. For example, A contracts with B to supply 100 bags of
wheat for Rs 60,000 on 1st March. On 15th February
A inform
B
that he will not be able to supply the
wheat. There is express
rejection of the contract. 19 (1906), 33
Cal. 812. 20 (1920), 43 Mad. 703. Check Your Progress 5. Explain the cases which are not covered under super- vening impossibility 6. Explain two cases where a contract terminates by operation of law. 7. Explain discharge by breach of contract with suitable example.
Discharge of Contracts 118 Self-Instructional Material NOTES (b) Impliedly by the conduct of one of the parties. Here a party by his own voluntary act disables himself from performing the contract.
For example, (i) a person contracts to sell a particular horse to another on 1st of June and before that date he sells the horse to somebody else; (ii)
A agrees to marry B but before the agreed date of marriage she marries C. In
both the above cases there occurs an anticipatory breach of contract brought about
by the conduct of one of the parties.
Section 39 of the
Contract Act deals with anticipatory breach
of contract
and provides as
follows: "
When a party to a contract
has refused to perform, or disabled himself from performing, his promise
in its
entirety, the promisee may put an end to the contract,
unless he has signified, by words or conduct, his acquiescence in its continuance."
Effect of an anticipatory breach. When there is an anticipatory breach of contract, the promisee is excused from performance or from further performance. Further, it gives an option 21 to the promisee (i.e., the aggrieved party) whereby: (i) he may either treat

the contract as rescinded and sue the other party for damages for breach of contract immediately without waiting until the due date of performance, or (ii) he may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in that case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on reconsideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract. Illustrations. (a) A, agrees to employ B as a clerk, the service to commence from 1st June. On the 20th of May he informs B that his services will not be required. B is exonerated from his obligation under the contract and may at once sue A for damages for breach of contract without waiting until the time fixed for performance (Mersey Steel and Iron Co. vs Naylor 22). (b) A, agrees to sell his house to B for Rs 8,50,000 on 1st of March. But on 10th February he changes his mind and writes to B that he will not be able to sell his house. There is an anticipatory breach of contract. Two courses are open to B: (i) he may treat the contract as rescinded and at once sue A for damages, or (ii) he may wait till 1st of March. B adopts the second course. On 28th February the house is destroyed by fire. The contract stands discharged by supervening impossibility. A is entitled to take advantage of this supervening impossibility and B cannot recover any damages from him. If the house did not catch fire, A could have taken back his letter of repudiation and asked B to take possession of the house on payment as per agreement. 2. Actual breach. Actual breach may also discharge a contract. It occurs when a party fails to perform his obligation upon the date fixed for performance by the contract, as for example, where on the appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery. It is important to note that there can be no actual breach of contract by reason of non-peformance so long as the time for performance has not yet arrived. Actual breach entitles the party not in default to elect to treat the contract as discharged and to sue the party at fault for damages for breach of contract. 10.9 TEST QUESTIONS 1. State briefly the various modes in which a contract may be discharged. 2. What do you mean by “attempted performance or tender?” State the essentials of a valid tender. Discuss the effect of refusal to accept a valid tender. 3. Discuss the law relating to discharge of a contract by mutual consent. 21 Frost vs Knight, (1897), 21 Bom. 23. 22 (1884), 9 App. Cas 434. Discharge of Contracts Self-Instructional Material 119 NOTES 4. What is meant by “supervening impossibility?” Does this excuse the promisor from performing the contract in all cases? 5. “Impossibility of performance is, as a rule, not an excuse for non-performance of a contract.” Discuss. 6. Discuss fully the “doctrine of supervening impossibility.” 7. What do you understand by “anticipatory breach of contract?” Discuss the consequences of such breach on the rights and liabilities of the parties. 10.10 PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. The unloading of a ship was delayed beyond the date agreed with the shipowners owing to a strike of dock labourers. On a suit by the shipowners for damages, the plea of impossibility of performance was raised. Advise the shipowners. [Hint. The shipowners are bound to succeed in the suit. Strike by workmen renders performance only difficult or expensive and not impossible and as such it is not covered under the doctrine of supervening impossibility.] 2. A contracts to marry B in two years time. Shortly afterwards he breaks of the engagement without B’s consent. B writes repeatedly begging him to adhere to the contract. Just before the expiry of two years, a change in law makes it illegal for A to marry B. On the expiry of two years, B sues A for the breach of the contract. Will she succeed? [Hint. No, B will not succeed because when she files the suit for breach, the contract has already been discharged by supervening

impossibility and A is entitled to take advantage of that. (Refer to "Anticipatory Breach")] 3. A wine merchant contract to sell to a customer five dozen bottles of a particular brand of Champagne. At the time of the contract the wine merchant's whole stock of wine had been destroyed by fire, but he was not aware of this fact. What is the effect on the legal rights of the parties? [Hint. The legal rights of the parties remain unaffected. It is only the destruction of specific subject-matter which cannot be replaced, that the contract is discharged under impossibility. As it is not so here and the bottles can be procured from somewhere else, the wine merchant is bound to supply.] 4. A agrees to sell his scooter to B a month after the date of the contract.
But just after 10 days
of the contract he sells the scooter to C. Thereupon B sues A for the breach of contract. A contends that he could still perform the contract by repurchasing the scooter from C.
Decide the suit. [Hint. Here there is anticipatory breach of contract by conduct from A's side and therefore his contention will not be upheld. B is entitled to elect to
treat the contract as rescinded and sue A for the breach of contract
immediately.]
Quasi-Contracts Self-Instructional Material 121 NOTES UNIT 11 QUASI-CONTRACTS Structure 11.0 Introduction 11.1 Unit Objectives 11.2 Quasi-Contractual Obligations 11.3 Test Questions 11.4 Practical Problems 11.0 INTRODUCTION We have seen that
a contract is the result of an agreement enforceable by law.
But in some cases
there is no offer, no acceptance, no consensus ad-idem
and in fact
no intention on the part of parties to enter into a contract
and still the law, from the conduct and relationship of the parties, implies a promise imposing obligation on the one party and conferring a right in favour of the other. In other words under certain special circumstances
obligations resembling those created by a contract are imposed by law
although the parties have never entered into a contract. Such obligations imposed by law are referred to
as '
Quasi-Contracts' or 'Constructive
Contracts' under the English law, and "certain relations resembling those created by contracts" under the Indian law.
The term 'quasi-contract has been used because such a contract resembles with a contract so far as result or effect is concerned
but it has little or no affinity with a contract in respect of mode of creation. A quasi-contract rests upon the equitable "doctrine of unjust enrichment" which declares
that a person
shall not be allowed to enrich himself unjustly at the expense of another.
Duty, and
not a
promise or agreement, is the basis of such contracts. It may be noted that a suit for damages for the breach of the contract can be filed in the case of a quasi-contract in the same way as in the case of a completed contract (Sec. 73).
11.1 UNIT OBJECTIVES ? To be clear about various Quasi-contractual obligations ? Understand the responsibilities and duties of finder of goods 11.2 QUASI–CONTRACTUAL OBLIGATIONS 'Quasi-contractual obligations' under Sections 68 to 72,
are discussed below: 1.
Claim
for necessaries supplied to a
person incapable of contracting or on his account (
Sec. 68). "
If
a person, incapable of entering into a contract, or
any one
whom he is legally
bound
to support,
is supplied by another
person with necessaries suited
to his condition in life, the
person who

has
furnished such supplies is entitled to
be reimbursed from the property of
such
incapable person."
This provision has already been considered in connection with minor's agreements
in
the chapter of "Capacity of Parties." With a view to recapitulate it may be stated here that although agreements by minors, idiots, lunatics, etc., are void ab-initio, but Section 68 makes an exception to this rule by providing that their estates are liable to reimburse the supplier who supplies them or to some one whom they are legally bound to support with 'necessaries' of life. The following points need to be emphasised:
Quasi-Contracts 122 Self-Instructional Material NOTES (i) The Section does not create any personal liability but only the estates are liable. (ii) The things supplied must come within the category of 'necessaries'. The word 'necessaries' here covers not only bare necessities of existence, e.g., food
and clothes, but all things which are reasonably necessary to the incompetent person, having regard to his status in society, e.g., a watch, a radio, a bicycle may be
included therein. (iii) Necessaries should be supplied only to such incompetent person or to some one whom he is legally bound to support, such as his wife and children. (iv) Incompetent person's property is liable to pay only a reasonable price for the goods or services supplied and not the price which the incompetent person might have 'agreed to' (legally speaking an incompetent person cannot agree to anything). Illustrations (to Sec. 68). (
a)
A supplies
B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's
property. (
b)
A supplies the wife and children of
B, a lunatic, with necessaries suitable to their condition in life.
A
is entitled to be reimbursed from B's
property. 2.
Reimbursement
of person paying money due by
another, in payment of which he is
interested (
Sec. 69). "
A person who is interested in the payment of money
which
another is bound
by law to pay, and who therefore pays it, is entitled to be reimbursed by the other."
Illustration (to
Sec. 69).
B holds land in Bengal, on a lease granted by A, the reimbursed. The revenue payable
by A
to the
Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence
of
such sale will be
the
annulment of B's lease. B, to prevent the sale and
the consequent annulment of his own lease, pays
to the
govern- ment
the sum due from A. A is bound to make good to
B the amount so
paid.
In order to make Section 69 applicable, the following conditions must be satisfied: (i)
The

plaintiff
should be interested in making the payment in order to protect his own interest
and the
payment should not be voluntary one. Moreover, the payment must have been done in good faith and not to manufacture evidence of title to land or any other thing. Illustrations. (a) A sub-tenant pays the arrears of rent due by the tenant to the landlord, in order to save the tenancy from forfeiture. The sub-tenant is entitled to recover from the tenant, the amount paid by him to the landlord, although there is no contract between the two. (b) A, pays the arrears of rent of his neighbour B, just to avoid a struggle between B and his landlord. A cannot recover from B as he acted voluntarily and had no interest of his own in the payment. [But if B should agree to reimburse A, this would be a good contract under Section 25(2).] (ii)
The payment must be such as the other party was bound by law to
pay.
Illustration.
A'
s goods were wrongfully attached to realise the
arrears
of Government revenue due by B. A pays the dues to save
the goods from
being sold. He is entitled to recover the amount from B (
Abid Hussain vs Ganga Sahai 1). (iii) The payment must not be such as the plaintiff himself was
bound to pay. He should only be interested in making the payment. In
other words, a suit under this Section is maintainable only for reimbursement and not for contribution. Thus, where there is a joint liability on joint wrong doers and only one of them discharges the liability, no suit for contribution from the other would be 'maintainable under this Section (Ramkrishna vs Radhakrishana 2). [A suit for contribution from the other joint promisor would be maintainable under Section 43.] 1 (1928), 26 All. L.J. 435. 2 A.I.R. (1970), Ori. 237.
Quasi-Contracts Self-Instructional Material 123 NOTES Illustration. A and B have been fined jointly Rs 500 for selling adulterated ghee. A alone pays the amount of fine in good faith. A cannot later claim contribution from B under Section 69. Notice that although B was bound by law to pay and A has paid B's share in good faith, yet A cannot recover as he himself was bound to make the payment, being jointly liable with B and was not simply interested in making the payment. [A can, however, claim contribution form B under
Section 43.] 3. Obligation of person enjoying benefit of non-gratuitous act (
Sec.70). This is the third type of quasi-contract provided in the Contract
Act. Section 70 lays down thus, "
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."
For
giving rise to
a
right of action under
this Section, the following
three
conditions must be fulfilled: (i) The thing must have been done
lawfully
in goods faith.
This means that the act done must be in pursuance of the implied wishes (because there should not be any request in the case of a quasi-contract) and in the presence of the other party, giving him the full choice to reject the thing or service. (
ii) The thing
must have been done by a person not intending to act gratuitously,
i.e., it must have been done with the intention of being paid for. (
iii)

The person for whom the act is done must have enjoyed the benefit of the act. Illustrations. (a) A, a tradesman, leaves goods at B' s house by mistake. B treats the goods as his own. He is bound to pay A for them. [Illustration to Section 70] (b) 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. [Illustration to Section 70] (c) Where a coolie takes the luggage at the railway station without being asked by the passenger or a shoe-shiner starts shining shoes of the passenger without being asked to do so, and if the passenger does not object to that, then he is bound to pay reasonably for the same as the work was not intended to be gratuitous. 4. Responsibility of finder of goods (Sec. 71). Section 71 lays down another circumstance in which also a quasi-contractual obligation is to be presumed. It says: " A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee." Thus an agreement is also implied by law between the owner and finder of the goods and the latter is deemed to be a bailee. 3 Duties of finder of goods. He must try to find out the real owner of the goods and must not appropriate the property to his own use. If the real owner is traced, he must restore the goods to him on demand. If he does not take these measures, he will be guilty of criminal mis-appropriation of the property under Section 403 of Indian Penal Code. Further, till the goods are in possession of the finder, he must take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value (Sec. 151). The rights of a finder of goods have been discussed in Sections 168—169 which provide as follows: Rights of finder of goods 4 . Till the true owner is found out, he can retain possession of the goods against everybody in the world. He is entitled to receive from the true owner, all expenses incurred by him for preserving the goods or finding the true owner. He has a lien on the goods for the money so spent, i.e., he can refuse to return the

goods to the true 3 For the duties and rights of a bailee, refer to Bailment and Pledge. 4 These have been discussed in detail later.
Quasi-Contracts 124 Self-Instructional Material NOTES owner until these moneys are paid. He is not entitled to file a suit for the recovery of such sums. But he can file a suit against the owner to recover any reward, which was offered by the owner for the return of the goods, provided he came to know of the offer of reward before actually finding out the goods.
The
finder of goods is entitled to
sell the goods
if
the owner cannot be
found out
or if
he refuses to pay the lawful
charges of
the finder,
in the
following two situations only: (a)
when
the thing is
in danger of perishing or of
losing the greater part' of its value, or (
b) when the lawful charges to the finder
amount to at least two-thirds of the value
of
goods found.
The true owner is entitled to get the balance of sale proceeds, if
there is surplus after meeting the lawful charges. It is to be noted that no one except the real owner can claim possession of goods from the finder. If anybody deprives him of the possession of the goods, he can file a suit for damages for trespass. Illustration.
H
picked
up a diamond on the floor of F's shop and handed it over to F to keep it till the owner
appeared. In spite of best efforts
the
true owner could not be searched. After
the lapse of
some weeks,
H
tendered to F the lawful expenses incurred by him for finding the true owner and
an indemnity bond
and requested him to return the diamond to him (i.e., H). F refused to do so.
Held, F must return the diamond to H
as he was entitled to retain
the goods as against everybody except the true owner (Hollins vs Fowled). 5.
Liability of person to whom money is paid, or thing delivered by mistake or
under coercion (
Sec. 72).
This is the fifth and the last kind of quasi-contract mentioned in the Act. Section 72 declares thus, "
A person to whom money has been paid, or anything delivered, by mistake or under coercion, must
repay or return it."
Accordingly, if one party under a mistake pays to another party money which is not due by contract or otherwise, that money must be repaid. The term 'mistake' has been used in the Section without any qualification or limitation whatever and comprises within its scope a mistake of law as well as a mistake of fact (Sales Tax Officer vs Kanhaiyalal Mukundlal 6). The term 'coercion' has been used in its ordinary sense and not as defined in Section 15 7 (Peplad Bulakhidas Mills vs Union of India 8). Here 'coercion' means 'under pressure'. Illustrations. (
a)

A and B jointly owe Rs 100 to C. A alone
pays the amount to C, and B, not knowing this fact, pays Rs 100
over again to C. C is bound to repay the amount to B [
Illustration
to Section 72]. (b)
A railway company refuses to deliver
up
certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods.
He
is entitled to recover so much of the charge as was illegally excessive (
Illustration to
Section 72). (
c)
A pays some money to B by mistake. It is really due to C.
B must refund the money to A. C, however, cannot recover the amount from
B
in the absence of privity of contract between B and C. (d) A fruit parcel is
delivered under a mistake to R who consumes the fruits thinking them as birthday present.
R must return the parcel or pay for the fruits. Although there is no agreement between R and the true owner, yet he is bound to pay as the law regards it a quasi-contract. 5 L.R 7 H.L. 757. 6 (1959), S.C.R. 1350. 7 For the definition of 'coercion' as given in Sec. 15. 8 A.I.R. (1970), Guj. 59. Check Your Progress 1. Define Quasi-contracts. 2. Explain the doctrine of unjust enrichment.
Quasi-Contracts Self-Instructional Material 125 NOTES It is to be noted that this Section does not cover a case where money has been paid in payment of a natural obligation. Thus, where one has paid up a time-barred debt, he cannot recover it. Similarly, the Section does not apply when there is a deliberate disregard of law, e.g., where moneys are paid voluntarily knowing fully well that the contract has become void, it cannot be recovered under the Section (Ananth Bandhu vs Dom. of India 9). 11.3
TEST QUESTIONS 1. What are quasi-contracts? Discuss the quasi-contracts dealt with
under the Indian Contract Act. 2. "
A
quasi-contract is not a contract at all. It is an obligation which the law creates."
Amplify and state the quasi-contracts
recognised under the Indian Contract Act. 3. Under the Indian Contract Act, there are "certain relations resembling those created by a contract."
Explain giving illustrations. 4.
Discuss the rights and duties of a finder of goods. 11.4
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A,
a Hindu minor, fraudulently representing himself as major, takes a loan of Rs 5,000 for the marriage of his sister from B at 8 per cent interest. Can B recover the loan and the interest? [Hint. Although the minor cannot be estopped from setting up his minority, yet B can recover the loan out of A's property, if any, because marriage expenses of one's sister are included within the scope of 'necessaries' (Nanadan Pd. vs Ajudhia Pd. 1910, 32 All. 325). Interest, of course, will not be allowed.] 2. A contracts to sell a part of a specific crop of potatoes to be grown on his farms to B for Rs 1,000. The delivery is to be made after two months and the payment is to be made one month before delivery. Soon after the crop is destroyed by a pest to the knowledge of both the parties but still B makes the payment as agreed. On the expiry of two months, when no potatoes are delivered to B, B sues A for breach of the contract and for refund of the purchase price. Will B succeed? [Hint. No, B will not succeed. The contract in question stands discharged by subsequent destruction of subject-matter and hence there arises no question of its breach. As regards the refund of purchase price, it also cannot be recovered because Sec. 72 does not apply when there is a deliberate disregard of law (Ananth Bandhu vs Dom. of India, A.I.R. 1955, Cal, 626).] 9 A.I.R. (1955) Cal. 626.
Remedies for Breach of Contract Self-Instructional Material 127 NOTES UNIT 12 REMEDIES FOR BREACH UNIT 12 OF CONTRACT Structure 12.0 Introduction 12.1 Unit Objectives 12.2 Rescission of The
Contract 12.3 Suit for Damages 12.4
Duty to Mitigate Damage Suffered 12.5 Liquidated Damages and Penalty 12.6
Summary of the Rules Regarding the Measure of Damages 12.7 Suit for Specific Performance 12.8 Suit for an Injunction 12.9 Test Questions 12.10 Practical Problems 12.0 INTRODUCTION

Whenever there is breach of a contract, the injured party becomes entitled to any one or more of the following remedies against the guilty party: 1.
Rescission of the contract. 2.
Suit for
damages. 3. Suit upon quantum meruit. 4.
Suit for specific performance
of the contract. 5. Suit for
an injunction. As regards the last two remedies stated above, the law is regulated by the Specific Relief Act, 1963. 12.1
UNIT OBJECTIVES ? Understand the fundamental principles underlying damages ? Know different kinds of damages ? Note the circumstances when vindictive damages are awarded 12.2
RESCISSION
OF THE CONTRACT
When there is a
breach of contract by one party, the other party may rescind the contract
and
need not perform his part of
obligations under the contract and may sit quietly at home if he decides not
to
take any legal action against the guilty party. But in case
the aggrieved party intends to sue the guilty party for damages for breach of contract,
he
has to file a suit for rescission of the contract. When the court grants rescission,
the aggrieved party
is freed from all his obligations under
the contract; and becomes
entitled to compensation
for any
damage which he has sustained through
the non-fulfilment of the contract (
Sec. 75).
Remedies for Breach of Contract 128 Self-Instructional Material NOTES Illustration.
A contracts to supply 100 kg of tea leaves for Rs 8,000 to B on 15 April. If A does not supply the tea leaves on the appointed day, B need not pay the price. B may treat the contract as rescinded and may sit quietly at home. B may also file a 'suit for rescission' and claim damages.
Thus, applying to the court for 'rescission of the contract' is necessary for claiming dam- ages for breach or for availing any other remedy. In practice a 'suit for rescission' is accompanied by a 'suit for damages,' etc., in the same plaint. 12.3
SUIT FOR
DAMAGES Damages are a
monetary compensation allowed
to the injured party for the loss or injury suffered by him
as
a result of the breach of contract.
The fundamental
principle underlying damages is not punishment but compensation.
By awarding damages
the court aims to put the injured party into
the position in which he would have been, had there been
performance and not breach,
and not to punish the defaulter party.
As a general rule, "compensation must be commensurate with the injury or loss sustained, arising naturally from the breach." "If actual loss is not proved, no damages will be awarded." Assessment of damages. We will now consider the extent to which a plaintiff is entitled to demand damages for breach of contract. The rules in this regard have been laid down by Section 73. Accordingly, an
injured
party
is
entitled to receive from the defaulter party: (

a)
Such damages
which naturally arose
in the usual course of
things
from
such breach.
No
compensation is to be given generally
for any remote or indirect loss sustained by reason
of the breach (
Ordinary Damages). (
b) Such
damages
which the parties knew, when they entered into the contract, as likely to result from the breach (
Special Damages). (c)
In estimating the loss or damage caused to a party by breach,
the means which existed of remedying the inconvenience caused by the breach must also be taken into account (
Explanation
to Sec. 73). (Duty to mitigate damage suffered.) With a view to making the study of the quantum of damages easily comprehensible, the above rules, as enunciated in Section 73 may now be considered in some more details under appropriate heads.
Different kinds of damages. Damages may be of four kinds: 1. Ordinary or General or Compensatory damages (i.e., damages arising naturally from the breach). 2. Special damages (i.e., damages in contemplation of the parties at the time of contract). 3. Exemplary, Punitive or Vindictive damages. 4. Nominal damages.
We shall now see these kinds one by one. 1.
Ordinary
Damages. When a contract has been broken, the injured party can,
as a rule, always recover
from
the guilty party ordinary or general damages. These are such
dam- ages
as may fairly and reasonably be considered as arising
naturally
and directly in the usual course of things from the breach
of contract itself.
In other words, ordinary damages are restricted to the “direct or proximate consequences” of the breach of contract and remote or indirect losses, which
are not the natural and probable consequence of the breach of contract,
are generally not regarded.
Illustrations. (a)
The leading case of Hadley vs Baxendale, 1 which is said to be the foundation of modern law of damages in England and India (as Sec. 73 is almost based on the rules laid down
in this case); is an authority on the point. In that case: 1 (1854), 9 Exch. 341
Remedies for Breach of Contract Self-Instructional Material 129 NOTES H’
s mill was stopped by a breakage of the crankshaft, H
delivered the shaft to B, a common carrier, to take it to the
manufacturers at Greenwich as a pattern for a new one. The only information given to B was that the article to be carried was the broken shaft of the mill. It was
not made known
to B that delay would result in loss of profits.
By some neglect on the part
of
B the delivery of the shaft was delayed beyond a reasonable time.
In consequence the mill remained idle for a longer period than should have been necessary. H brought an action against B claiming damages for loss of profits which would have been made during the period of delay. Held that B was not liable for loss of profits caused by the delay because it was a remote consequence, and only

nominal damages
were awarded. The Court pointed out that B, the defendant, was never told
that the
delay in the delivery of the shaft would entail loss of profits of the mill;
the
plaintiffs might have had another shaft, or there might have been some other defect
in
the machinery to cause the stoppage, or for any other reason there might have been loss actually. Accordingly it was not a direct consequence of the breach and hence not recoverable. (
b)
A contracts to pay a sum of money to B on a specified day. A does not pay the money on that day. B, in consequence of not receiving the money on that day, is unable to pay his debts, and is totally ruined. A is not liable to make good to B anything except the principal sum he contracted to pay, together with interest upto the date of payment [
Illustration (n)
to Section 73]. (If a suit has been filed then A will have also to pay 'cost of the suit' to B.) (c)
A contracts to sell and deliver 500 bales of cotton to B on a fixed day. A knows nothing of B's mode of conducting his business. A breaks his promise, and B, having no cotton, is obliged to close his mill. A is not responsible to B for the loss caused to B by the closing of the mill [
Illustration (p) to Section 73]. (B, however, can claim damages for the breach of contract. He cannot claim the loss of profits caused by the closing of the mill because it cannot
be considered
to have been in contemplation of both the parties when they made the contract
and thus is
a remote consequence of the breach.) In the case of a contract for 'sale and purchase' the general rule as regards measure of damages is
that
the damages would be assessed on
the difference between the contract price and the
market price at the date of
breach
and any subsequent increase or decrease in the market price would not be taken note of.
If there is no market price for the subject-matter of the contract, the
rule is to take the market price of the nearest substitute. If there is no nearest substitute, the market price is to be ascertained by adding to the price at the place of purchase, the conveyance charges to the place of, delivery plus the usual profit of the importer (
Hajee Ismail & Sons vs Wilson & Co. 2).
If the delivery is to be made in instalments, then the due date of each instalment is taken as the date of breach and the measure of damages is the sum of the difference of the market value at the several dates of delivery. Illustrations. (a)
A agrees to sell to B 5 bags of rice at Rs 500 per bag,
delivery
to
be given after two months. On the date of delivery the price of rice goes up and the rate is Rs 550 per bag.
A
refuses to deliver the bags to B. B can claim from A Rs 250, as ordinary damages arising directly from the breach, being the difference between the contract price (i.e., Rs 500 per bag) and the market price (i.e., Rs 550 per bag) on the date of delivery of 5 bags. Notice that if
Rs 250
are paid to B by way of damages, then he will be in the same position as if the contract has been performed. (
b)
A contracts to buy from B, at a stated price, 50 maunds
of rice, no time being fixed for delivery. A 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 [Illustration (c) to
Section 73]. (c)
A contracts to buy B's ship for Rs 60,000, but breaks his promise.
As a consequence of breach B sold the ship in the open market and he could only get Rs 52,000 for the ship. B can recover by way of compensation Rs 8,000, the excess of the contract price over the actual sale price [Adapted from Illustration (d) to Section 73]. Under a contract of 'sale of goods,' if there is a
breach of 'warranty,' the seller is liable to pay all damages which the purchaser has to pay to the person to whom the goods are sold by him, whether the seller is aware of such a sale or not. In order that the purchaser should 2 (1918), 41 Mad. 709.
Remedies for Breach of Contract 130 Self-Instructional Material NOTES be able to claim such damages and costs it is an overriding requirement that the sub- contracts should have been made on the same terms and conditions as the first contract.
Illustration. [(m) to Sec. 73].
A sells certain merchandise to B, warranting it to be of a particular quality, and B, in reliance upon this warranty, sells it to C with a similar warranty. The goods prove to be not according to the warranty, and B becomes liable to pay C a sum of money by way of compensation. B is entitled to be reimbursed this sum by A. 2. Special Damages. Special damages are those which arise on account of the special or unusual circumstances affecting the plaintiff. In other words, they are such remote losses which
are not the natural and probable consequence
of
the breach of contract.
Unlike ordinary damages, special
damages cannot be claimed as a matter of right.
These can be claimed only
if
the special circumstances which would result in a special loss in case of breach of contract are brought to the notice of the other party.
It is important that such damages must be
in
contemplation of the parties at the time when the contract is entered into.
Subsequent knowledge of the special circumstances will not
create any special liability on the guilty party. Illustrations. (a)
A, having contracted with B
to supply B 1,000
tons of iron at Rs 100 a ton, to be delivered at a stated time, contracts with
C for the purchase of 1,000 tons of iron at Rs 80 a ton, telling C that he does so for
the
purpose of performing his contract with B. C fails to perform his contract with A, and A could not procure other iron, and B, in consequence rescinds the contract. C must pay to A Rs 20,000 being the profit which A would have made by the performance of his contract with B. [Illustration (j) to
Section 73]. (If C was not told of B's contract then only the difference in contract price and market price, if any, could be claimed.) (
b) A contracts with B to make and deliver to B, by a fixed day, for a specified price a certain piece of machinery. A does not deliver the piece of machinery at the time specified, and, in consequence of this, B is obliged to procure another at a higher price than that which he was to have paid to A, and is prevented from performing a contract which B had made with a third person at the time of his contract with A, (but which had not been then communicated to A), and is compelled to make compensation for breach of that contract.
A
must pay to B, by way of compensation, the differ- ence between the contract price
of the
piece of machinery and the sum paid by B for another, but not the sum paid by B to the third person by way of compensation [Illustration (k) to Section 73]. (
c)
A, a builder, contracts to erect and finish a house by the first of
January, in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that,
before the

first of
January, it falls down, and has to be rebuilt by B, who, in
consequence loses the rent which he was to have received from C, and is obliged to make compensation for breach of that contract, A must pay to B,
by way of compensation, (i)
for the cost of rebuilding the house, (ii)
for the rent lost, and (iii) for the compensation made to C. [
Illustration (I) to Section 73] 3.
Exemplary or Vindictive Damages. These are such
damages which are awarded
with a view
to punishing the guilty party for
the
breach and not
by way of compensation for the loss suffered by the aggrieved party.
As observed earlier, the cardinal principle
of
the
law
of damages for a breach of contract
is to compensate the injured party for the
loss suffered and not to punish
the
guilty party. Hence, obviously,
exemplary damages have no place in the law of contract
and are not recoverable for a breach of contract. There are, however, two exceptions to this rule: (a) Breach of a contract to marry. In this case the
amount of
the damages will depend upon the extent of injury to the party's feelings. One may be ruined, other may not mind so much. (
b) Dishonour of a cheque by a banker when there are sufficient funds to the credit of the customer.
In this case
the rule of ascertaining damages is, "the smaller the cheque, the greater the damage."
Of course, the actual amount of damages will differ according
to the status of the party. 4.
Nominal Damages. Nominal damages are those which are awarded only for the name sake.
These are
neither awarded by way of compensation to the aggrieved party nor by
Remedies for Breach of Contract Self-Instructional Material 131 NOTES
way of punishment to the guilty party. These are awarded to establish the right to decree for breach of contract when the injured party has not actually suffered any real damage and consist
of a very small sum of money, say, a rupee
or two. For example,
where
in a contract of sale of goods,
if
the contract price and the market price is almost
the
same at the date of breach of
the contract,
then the
aggrieved party is entitled only to nominal damages. 12.4
DUTY TO MITIGATE DAMAGE SUFFERED It is the duty of the
injured party to
mitigate damage suffered as a result of the breach of contract by the other party. He must use all reasonable means of mitigating the damage, just
as a prudent man would, under similar circumstances in his own case. He

cannot recover any part of the damage, traceable to his own neglect to mitigate.
The onus of proof, however, is on the defendant to show that the
plaintiff has
failed in his duty of mitigation and the plaintiff is free from the burden of proving that he tried his best to mitigate the loss (
Pauzu, Ltd. vs Sounders 3). "
The rule in regard to initiation must be applied with discretion and a man who has already put himself in
the
wrong by breaking his contract has no right to impose new and extraordinary duties on the aggrieved party." 4 "Courts should take care to see that they have put the plaintiff
in the same position as if the contract had been performed,
and have not been overgenerous to the contract-breaker by too severe an application of the rule that the plaintiff must take reasonable steps to mitigate damages." 5
Illustrations. (a)
Where a servant
is dismissed, even though wrongfully, it is
his
duty to mitigate the damages by seeking other employment. He can recover only nominal damages if he refuses a reasonable offer of fresh employment.
But if it cannot be proved that he has failed in his duty of mitigation, he will be entitled to the full
salary for the whole of the unexpired period of service, if the contract of employment was for a fixed period. If the contract of
employment was not for a
fixed term, then the principle of awarding damages for a reasonable period
of notice comes into play (S.S. Shetty vs Bharat Nidhi Ltd. 6). (b) A took a shop on rent from B and paid one month's rent in advance. B could not give possession of the shop to A. A chose to do no business for 8 months though there were other shops available in the vicinity. A sued B for breach of contract and claimed damages for the loss suffered. Held, he was entitled only to a refund of his advance, and nothing more, as he had failed in his duty to minimise the loss by not taking another shop in the neighbourhood (Neki vs Pribhu 7). 12.5 LIQUIDATED DAMAGES AND PENALTY Let us first know what we mean by the two terms. "
Liquidated damages' means a sum fixed up in advance,
which is a fair and genuine pre-estimate of
the
probable loss that
is likely to result from the breach. 'Penalty' means a sum fixed
up
in
advance,
which is extravagant and unconscionable
in amount in comparison with the greatest loss that
could conceivably be proved to have followed
from the breach. Thus
the
essence of a penalty is a payment of money stipulated as in terrorem of the offending party.
Sometimes the
parties fix up at the time of the contract the sum payable as damages in case of breach. In such a case, a distinction is made in English Law as to whether the provision amounts to liquidated damages' or a 'penalty'. Courts
in
England usually allow liquidated damages' as stipulated in the contract, without any regard to the actual loss sustained. 3 (1919), 2
K.B. 581. 4 Pollock & Mulla on the Indian Contract and Specific Relief Acts, (8th ed.) at p. 468. 5 Ibid., p. 472. 6 A.I.R. (1958). S.C. 12. 7 100 I.C. 662. Check Your Progress 1. What do you understand by rescission of the contract? 2. Explain different kinds of damages briefly. 3. Differentiate nominal and exemplary damages.
Remedies for Breach of Contract 132 Self-Instructional Material NOTES 'Penalty' clauses, however, are treated as invalid and the
courts in that case calculate damages according to the ordinary principles and allow only reasonable compensation.
Under

the Indian Law Section 74 does away with the distinction between liquidated damages' and 'penalty'.
This Section lays down that the courts are not bound to treat the sum mentioned in the contract, either by way of liquidated damages or penalty, as the sum payable as damages for breach. Instead the courts are required to allow reasonable compensation so as to cover
the actual loss sustained, not exceeding the amount so named in the contract. Thus,
according to the Section,
the named sum, regardless whether it is a penalty or not, determines only the maximum limit liability in case of
the
breach of contract. The Section does not confer a special benefit upon any party; it merely declares the law that notwithstanding any term in the contract pre-determining damages or providing for forfeiture of any property by way of penalty, the Court will award to the party aggrieved only reasonable compensation not exceeding the amount named or penalty stipulated. Exception. There is, however, one exception provided for by Section 74 to the above rule. When any person enters into any bailbond, recognizance or other instrument of the same nature, or under
the provisions of any law or under the orders of the Government, gives any
bond for the performance of any public duty or act in which the public are interested, he shall be liable to pay the whole sum mentioned therein upon breach of the condition of any such instrument. Illustrations. (
a)
A contracts with B to pay Rs 1,000 if he fails to pay
B Rs 500 on a given day.
A
fails 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. [Illustration (a)
to
Section 74] (b) A agreed to
build a house for B by 31st March, 2003. A further agreed to pay Rs. 5,000 per month as damages in case of delay beyond the agreed date. A
was late by two months. B sued A for Rs 23,500, the actual loss caused to him as a result of
escalation in prices of building material during the period of delay. A is liable to pay Rs. 10,000 only because when
a sum is named in the
contract as the amount to be paid
in case of breach,
the court will allow only reasonable compensation so as to cover the actual loss sustained within the limits stated in the contract. (
c) A borrows Rs 100 from B, and gives him a bond for Rs 200 payable by five yearly instalments of Rs 40, with a stipulation that, in default of payment of any instalment, the whole shall become due. This is a stipulation by way of penalty. [Illustration (g) to Section 74]. Stipulation regarding payment of
interest. The Explanation added to Section 74 states, "
a stipulation for increased interest from the date of default may be
a stipulation by way of penalty." It
implies that such a stipulation may be considered a penalty clause and disallowed by the courts, if the enhanced rate is exorbitant.
Illustration [(d) to Sec. 74].
A gives B a bond for
the
repayment of Rs 1,000 with interest at 12 per cent per annum at the end of six months, with a stipulation that in case of default interest shall be payable at the rate of 75
per
cent p.a.
from the date of default. This is a stipulation by way of penalty and
B is only entitled to recover from A such compensation as the court considers reasonable.
The following rules must also be noted in connection with payment of interest: (a) Unless
the parties
have made a stipulation for the payment of interest, or there is a usage to that effect, interest cannot be recovered legally as damages, generally speaking (Mababir Prasad vs Durga Datta 8). (b) Where a contract provides that the amount should be paid without interest by a particular date and on default it will
be

payable with interest, such a stipulation may be allowed if the interest is reasonable. If the interest is exorbitant, the courts will give relief. (c) Payment of compound interest on default, is allowed, only if it is not at an enhanced rate (Bhushan Rao vs Subayya 9). 8 A.I.R. (1961), S.C. 990. 9 (1936), 38 Born. L.R. 1229 (P.C.).
Remedies for Breach of Contract Self-Instructional Material 133 NOTES
Earnest money. Money deposited as security for the due performance of a contract is known as earnest money. Forfeiture
of earnest
money is allowed if the amount is reasonable. But where it is in the nature of penalty, the-court has jurisdiction to award such sum only as it considers reasonable but not exceeding the amount so agreed (
Fateh Chand vs Balkishen Dass 10).
The proportion the amount bears to the total sale price, the nature of the contract and other circumstances have to be taken into account in ascertaining the reasonableness of the amount. Cost of suit. The aggrieved party is entitled, in addition to the damages, to get the costs of getting the decree for damages from the defaulter party.
The cost of suit for damages is in the discretion of
the court. 12.6
SUMMARY OF THE RULES REGARDING THE 12.7 MEASURE OF DAMAGES The principles governing the measure of damages discussed above may be summarised as under: 1.
The damages are awarded
by way of compensation for the loss suffered by the aggrieved party
and not for the purpose of punishing the guilty party
for the breach. 2.
The injured party is to
be placed in the same position, so far as money can do, as
if
the
contract had been performed. 3.
The aggrieved party can recover by way of compensation only the actual loss suffered by him,
arising
naturally in the usual course of things from the breach
itself. 4. Special or remote damages, i.e.,
damages which are not the natural and probable consequence of the breach are
usually not allowed until they are
in the knowledge of both
the parties at the time of entering into the contract. 5.
The fact that damages are difficult to assess does not prevent the injured party from recovering them. 6.
When no real loss arises from the breach of contract, only nominal damages are awarded. 7. If the parties fix up in advance the sum payable as damages in case of breach of contract, the court will allow only reasonable compensation so as to cover
the actual loss sustained, not exceeding the amount so named in the contract. 8.
Exemplary damages
cannot be awarded for breach of contract except in case of breach of contract of marriage
or wrongful refusal by the bank to honour the customer's cheque. 9. It is the duty of the injured party to minimise the damage suffered. 10.
The injured party is entitled to get the costs of getting the decree for damages
from the defaulter party. Suit Upon Quantum Meruit (Sections 65 and 70).
The third
remedy for a breach of contract available to an injured party against the guilty party is to file a
suit upon
quantum meruit. The phrase quantum meruit literally
means "
as much as
is earned"
or "
in proportion to the work done."
A
right to sue upon quantum meruit usually arises where
after part performance of the contract by one party, there is a

breach of contract, or the contract is discovered void or becomes void. This remedy may be availed of either without claiming damages (i.e., claiming reasonable compensation only for the work done) or in addition to claiming damages for breach (i.e., claiming reasonable compensation for part performance and damages for the remaining unperformed part). 10 A.I.R. (1963), S.C. 1405. Remedies for Breach of Contract 134 Self-Instructional Material NOTES The aggrieved party may file a suit upon quantum meruit and may claim payment in proportion to work done or goods supplied in the following cases: 1. Where work has been done in pursuance of a contract, which has been discharged by the default of the defendant. Illustrations. (a) P agreed to write a volume on ancient armour to be published in a magazine owned by C. For this he was to receive $ 100 on completion. When he had completed part, but not the whole, of his volume, C abandoned the magazine. P was held entitled to get damages for breach of contract and payment quantum meruit for the part already completed. (Planche vs Colburn 11) (b) A, engages B, a contractor, to build a three storied house. After a part is constructed A prevents B from working any more. B, the contractor, is entitled to get reasonable compensation for work done under the doctrine of quantum meruit in addition to the damages for breach of contract. Notice that in both the above cases the contract was wrongfully terminated by the defendant, and both damages as well as payment quantum meruit have been allowed. It is important that in the case of a wrongful breach of contract the injured party can always claim payment quantum meruit, whether the contract is divisible or indivisible. 2. Where work has been done in pursuance of a contract which is 'discovered void' or 'becomes void,' provided the contract is divisible. Illustrations. (a) C was appointed as managing director of a company by the board of directors under a written contract which provided for his remuneration. The contract was found void because the directors who constituted the 'Board' were not qualified to make the appointment. C nevertheless, purporting to act under the agreement, rendered services to the company and sued for the sums specified in the agreement, or, alternatively, for a reasonable remuneration on a quantum meruit. Held, C could recover on a quantum meruit. (Craven-Ellis vs Canons Ltd. 12). (b) A contracts with B to repair his house at a piece rate. After a part of the repairs were carried out, the house is destroyed by lightning. Although the contract becomes void and stands discharged because of destruction of the house, A can claim payment for the work done on 'quantum meruit. Note that if under the contract a lump sum is to be paid for the repair job as a whole, then A cannot claim quantum meruit because no money is due till the whole job is done. 3. When a person enjoys benefit of non-gratuitous act although there exists no express agreement between the parties. One of such cases is provided in Section 70.3 Section 70 lays down that when services are rendered or goods are supplied by a person, (i) without any intention of doing so gratuitously, and (ii) the benefit of the same is enjoyed by the other party, the latter must compensate the former or restore the thing so delivered. Illustrations. (a) A, a trader, leaves certain goods at B' s house by mistake. B treats the goods as his own. He is bound to pay A for them. [Illustration (a)

to Section 70] (b) Where A ploughed the field of B with a tractor to the satisfaction of 3 in B's presence, it was held that A was entitled to payment as the work was not intended to be gratuitous and the other party has enjoyed the benefit of the Same. (Ram Krishan vs Rangoobert 14) 4. A party who is guilty of breach of contract may also sue on a quantum meruit provided both the following conditions are fulfilled: (a) the contract must be divisible, and (b) the other party must have enjoyed the benefit of the part which has been performed, although he had an option of declining it. 11 (1831), 8
Bing. l4. 12 (1936), 2 K.B. 403. 13 Section 70 has also been discussed under "Quasi-Contracts". 14 A.I.R. (1959), Bom. 519.
Remedies for Breach of Contract Self-Instructional Material 135 NOTES Illustrations. (a) Where a common carrier fails to take a complete consignment to the agreed destination, he may recover pro-rata freight. (He will, of course, be liable for breach of the contract.) (b) S had agreed to erect upon H's land two houses and stables for $ 565. S did part of the work and then abandoned the contract, H himself completed the buildings using some materials left on his land by S. In an action by S for the value of work done and of the materials used by H, it was held that S could recover the value of the materials (for H had the option to accept or to reject these) but he could not recover the value of the work done (for H had no option with regard to the partly erected building, but to accept that). The court observed, "The mere fact that a defendant is in possession of what he cannot help keeping, or even has done work upon it, affords no ground for such an inference. He is not bound to keep unfinished a building which in an incom- plete state would be a nuisance on his land." (Sumpter vs Hedges 15). 12.7 SUIT FOR SPECIFIC PERFORMANCE
Specific performance means the actual carrying out of the contract as agreed.
Under certain circumstances an aggrieved party may file a suit for specific performance, i.e., for a decree by the court directing the defendant to actually perform the promise that he has made. Such a suit may be filed either instead of or in addition to a suit for damages.
A decree for specific performance is not granted for contracts of every description. It is only where it is just and equitable so to do, i.e., where the legal remedy is inadequate or defective, that the courts issue a decree for specific performance. It is usually granted in contracts connected with land, buildings, rare articles and unique goods having some special value to the party suing because of family association. Notice that in all these contracts monetary compensation is not an adequate relief because the injured party will not be able to get an exact substitute in the market.
Specific performance is not granted, as a rule, in the following cases: . (i) Where monetary compensation is an adequate relief. Thus the courts refuse specific performance of a contract to lend or to borrow money or where the contract is for the sale of goods easily procurable elsewhere. (ii) Where the court cannot supervise the actual execution of the contract, e.g., a building construction contract. Moreover, in most cases damages afford an adequate remedy. (iii) Where the contract is for personal services, e.g., a contract to marry or to paint a picture. In such contracts 'injunction' (i.e., an order which forbids the defendant to perform a like personal service for other persons) is granted in place of specific performance. 12.8 SUIT FOR AN INJUNCTION 'Injunction' is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of the negative terms of the contract.
To put it differently, where a party is in breach of negative term of the contract. (i.e., where he is doing something which he promised not to do), the court may, by issuing an injunction restrain him from doing,

what he promised not to do.
Thus 'injunction'
is a preventive relief. It is particularly appropriate in cases of 'anticipatory breach of contract'
where damages would not be an adequate relief. Illustrations. (a) A, agreed to sing at B's theatre for three months from 1st April and to sing for no one else during that period. Subsequently she contracted to sing at C's theatre and refused to sing at B's theatre. On a suit by B, the court refused to order specific performance of her positive 15 (1898), 1 Q.B. 673. Check Your Progress 4. Explain the circumstances in which an aggrieved party may file a suit for specific performance 5. What do you understand by suit for an injunction? 6. Explain the principles governing the measure of damages.
Remedies for Breach of Contract 136 Self-Instructional Material NOTES engagement to sing at the plaintiff's theatre, but granted an injunction restraining from singing, elsewhere and awarded damages to B to compensate him for the loss caused by A's refusal. (Lumley vs Wagner 16). (b) G agreed to take the whole of his supply of electricity from a certain company. The agreement was held to import a negative promise that he would take none from elsewhere.
He was, therefore, restrained by an injunction from buying electricity from any other company. (Metropolitan Electric Supply Company vs Ginder 17). 12.9
TEST QUESTIONS 1. Discuss briefly the remedies for breach of contract. 2. What principles are applied in order to assess the amount of damages recoverable for a
breach of contract? 3. "
If a contract is broken, the law will endeavour, so far as money can do it, place the injured party
in the same position as if the contract has been performed.'
Discuss the statement indicating the rules which guide the court in the assessment of damages. 4. Explain the terms "penalty" and "
liquidated damages". If the parties to a contract have agreed on the amount of damages payable in the event of its breach
can the court enhance or reduce that amount? 5. What is meant by suing on quantum meruit? Under what circumstances ; claim on a quantum meruit arise? 6. When can an aggrieved party file a suit for 'specific performance' and for an 'injunction'? Explain and illustrate. 12.10
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1.
A
contracts to pay a sum of money to B on a specified day. A does not pay the amount on that day. B in consequence of not receiving the money on that day, is unable to pay his debts and is totally ruined.
B claims heavy damages. Advise A. [Hint.
A is liable to pay interest only from the specified day upto the date of payment. In other words B can claim only ordinary damages. B cannot claim heavy damages unless A had notice of the special circumstances resulting in the special loss at the time of entering into the contract.] 2.
A agreed to erect a plant for B by 31st
March, 1996. A further agreed to pay Rs 500 per month as damages in case of delay beyond the agreed date. A was late by four months. B sued A for Rs 4,500, the actual loss caused to him as a result of the delay. What damages will you award, and why? [Hint. B is entitled to recover Rs 2,000 only, because when
a sum is named in the
contract as the amount to be paid
in case of breach,
the court will allow only reason- able compensation so as to cover the actual loss sustained, within the limits stated in the contract.] 3.
A employs B as manager of his factory
for a term of three years at a monthly salary of Rs 3,000.
Without any lapse on the part of B, A dismisses him after two years of service. B could not get an alternate job elsewhere and files a suit for damages for breach of contract against. Will he succeed? If yes, assess the amount of damages recoverable by him. 16 (1852), De G.M. & G. 604. 17 (1901), 2 Ch. 799.
Remedies for Breach of Contract Self-Instructional Material 137 NOTES [Hint. Yes, B will succeed.
If it cannot be proved that B has failed in his duty
to mitigate the loss subsequent upon the breach, B
will be entitled to full
salary for the whole of the unexpired period of service

i.e., one year. Hence the amount of damages recoverable by B amounts to Rs 36,000.] 4. A mate was engaged for a lump sum to be paid after the completion of voyage. The mate dies when only 2/3 of the voyage was completed. His legal representatives claim damages on quantum meruit. Decide. [Hint. The legal representatives of the mate cannot recover anything as the doctrine of quantum meruit is inapplicable under the circumstances (Cutter vs Powell, 6 T.R. 320). The rule of law on the point is that 'party in default' cannot sue upon quantum meruit, if the contract is 'indivisible' and a lump sum is to be paid for the job as a whole,
because no money is due till the job is done.]
MODULE - 4
Indemnity and Guarantee Self-Instructional Material 141 NOTES UNIT 13 INDEMNITY AND GUARANTEE Structure 13.0 Introduction 13.1 Unit Objectives 13.2 Contracts of Indemnity 13.3 Contracts of Guarantee 13.4 Test Questions 13.5 Practical Problems 13.0 INTRODUCTION A contract of indemnity involves two parties: the indemnifier
and
the indemnified. The liability of the indemnifier to the indemnifed
is primary.
A contract of guarantee involves
three parties:
the creditor, the principal debtor and the
surety.
The liability of the
surety to the creditor is collateral or secondary.
The primary liability is that of the principal debtor.
A contract of
indemnity
is
an original and independent contract whereas a contract of guarantee
is a collateral undertaking and presupposes an original contract. A contract of indemnity is undertaken to keep a person, with whom the contract is made, harmless. A contract of guarantee is an obligation to answer for the debt, default or miscarriage of a person to the other with whom the contract is made. 13.1 UNIT OBJECTIVES ? Understand the two types of contracts, namely indemnity contracts and guarantee contracts and distinction between the two ? Be clear about the nature and extent of Surety's liability ? Know the conditions in which continuing guarantee may be revoked ? Understand the circumstances of discharge of surety from liability. 13.2
CONTRACTS
OF
INDEMNITY 13.2.1 Definition "
A
contract by which
one party promises to save the other from loss caused to him by the conduct of the promisor himself or by
the conduct of any other person,
is called a
contract of
indemnity" (
Section 124). A
contract of indemnity is really a part of the general class of 'contingent contracts.'
It is entered into with the object of protecting the promisee against anticipated loss.
The contingency upon which the whole contract of indemnity depends is the happening
of loss.
The person who promises to make
good the loss is called the '
indemnifier' (promisor), and the person
whose loss is to be
made good is
called the "
indemnified or
indemnity-holder' (
promisee).
Illustrations. (a)
The R/R (Railway Receipt) pertaining to certain goods is lost by B. A

as also B
claim the goods from Railway Company. In view of the rival claimants of goods, the Railway Co. asked A to give an 'indemnity bond". A, accordingly, gets the goods on executing the 'indemnity bond.' A is the indemnifier and the Railway Co. is the indemnity-holder. Later, B, the real owner, sues the Railway Co. for damages and gets a decree against the Railway Co. The Railway Co.
Indemnity
and Guarantee 142 Self-Instructional Material NOTES (
indemnity-holder) can claim indemnity from A, the indemnifier, for the loss caused to it by his conduct. (b) A
lost his share certificate. He applied to the company for the
issue of a duplicate certificate. The Company asked A to furnish an 'indemnity bond' in its favour to protect it against any claim that may be made by any person on the original certificate. A, accordingly executed the 'indemnity bond'. It is a contract of indemnity between A and the Company. A
is the 'indemnifier' and the Company is the '
indemnified' or 'indemnity-holder'. (
c)
A contracts
to indemnify B against the consequences of any proceedings which C may take against B in respect
of a certain sum of
Rs 200.
This is a contract of indemnity (
Illustration to
Section 124). A is the 'indemnifier' and B is the 'indemnified'. (For the sake of clarity we further elucidate the illustration. The background of the instant contract of indemnity might have been a situation like this: B owed Rs 200 to C on a promissory note. On the date of payment C could not return the promissory note (which was lost) to B and hence A assured B that no suit will be filed later by C in respect of the sum and requested B to make the payment without insisting on getting back the promissory note and promised
to indemnify B against the consequences of any suit which C may file against B in
that regard. As a result B makes the payment. B's paying to C as per the desire of A is the consideration moving from B's side and A's promise to indemnify B is the consideration moving from A's side. It is a contract of indemnity between A and B, if A did all this of his own, without any request from C. Should C file a suit against B in respect of the sum and B is ordered to pay to C Rs 200 plus the costs of the suit, A shall be required to pay B the total amount under the present contract of indemnity.) It is to be noted that
a person may undertake
to save the other from loss caused to him, by the conduct of
a third person
either at the request of the third person or without any request from such third person. In the first case there would be a 'contract of guarantee' and the third person would be responsible to the surety. In the latter case there would be a 'contract of indemnity' and the third person (debtor) cannot be held responsible to the indemnifier, as there is 'no privity of contract' between them. 1
A contract of indemnity, being a species of contract, must have all the essential elements of a valid contract; and an indemnity given under coercion or for an illegal object cannot be enforced. Further, a contract of indemnity may be express or implied. For example, there is an implied promise to indemnify agent by the principal in a contract of agency. Similarly, when shares are transferred the transferee is impliedly bound to indemnify the transferor against future calls made before the registration of transfer. Rights of Indemnity-holder When Sued (Sec. 125).
For the sake of clarity we shall be discussing
the rights of indemnity-holder when sued with the help of an example. Suppose a vendor contracts to indemnify the vendee against the costs of litigation if title to the property is disturbed, and the vendee is sued by a rival owner, then the vendee, i.e., the indemnity-holder has the following rights against the vendor, i.e., the indemnifier: 1.
He
is entitled
to recover all damages which he may be compelled to pay in
respect of
suit to which the promise to indemnify applies. 2.
He is entitled to recover all costs reasonably incurred, in bringing or defending such suit,
provided he acted prudently or with the authority of the promisor (indemnifier). 3.
He is also
entitled

to recover
all sums which he may have
paid
under the terms of
any
compromise
of any such suit,
provided the
compromise was not
contrary to the orders of the indemnifier and
was
prudent or was authorised by the
promisor (
indemnifier). In short the indemnity-holder can recover from the indemnifier, all damages, all costs of the suit and compromise money, if any, provided he acted prudently or with due authority of the indemnifier. 1
Adapted from T.R. Desai's Contract Act, etc. 18th edn. 1976, p. 302.
Indemnity and Guarantee Self-Instructional Material 143 NOTES 13.2.2
Time of Commencement of the Idemnifier's Liability The Indian Contract Act
is silent
on this point. It has been
held that the indemnified can compel the idemnifier to make good his loss even before he
has actually discharge his liability,
provided
his liability has become absolute. "
Indemnity is not necessarily
given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called
upon to pay ..." (
Osman Jamal & Sons Ltd. vs Gopal Purshottam 2). In Liverpool Insurance Company's case 3 Kennedy L.J. observed: "... to indemnify
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."
Illustration.
A
contracts
to indemnify B against the consequences of any proceedings which C may take against B in respect
of a certain sum of
Rs 50,000.
If B is ordered to pay to C, then the moment the liability becomes absolute, he is entitled to call upon the indemnifier (i.e., A)
to save him from that liability and pay it off.
A will have to pay Rs 50,000 plus the costs of the suit to C. Because if B is asked to pay first and then to claim payment from A, the contract of indemnity shall be of little value. It is just possible that B may never pay being not in a position to pay, then if payment is made a condition precedent to recovery, the contract of indemnity may never be enforced.
Hence the liability of indemnifier (i.e., A)
commences, as soon as the liability of the indemnity-holder
to pay becomes clear and certain. 13.3
CONTRACTS
OF GUARANTEE
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" (
Sec. 126). A
contract of
guarantee

is
entered into with
the object of enabling
a person to get a loan or goods on credit or an employment.
The
person who gives the guarantee is called the ‘surety’; the
person in respect of whose default the guarantee is given
is
called the “
principal debtor,’
and
the
person to whom the guarantee is given is
called the ‘
creditor’.
A
guarantee
may be either oral or written (
Sec. 126). Illustrations. (a)
A,
advances
a loan of Rs 5,000 to B and C promises to A
that if B does not repay the loan, C will
do so.
This
is a contract of guarantee.
Here B is the principal debtor,
A is the
creditor and C is the surety
or guarantor. It is important that C must stand surety at the request of B, because then only there will be privity of contract between C and B and it will be a contract of guarantee between A and C. If without B’s request C promises to pay on default, it will be a contract of indemnity. (
b) On the request of B, A promises the employer of B that if B makes a default he shall make good the same to him.
There is a contract
of guarantee. It will be noticed
that
in a contract of
guarantee there are three
separate
contracts —one between the principal debtor and
the creditor, the
second
between the creditor and the surety, and the third between the surety and the
principal debtor
wherein the
principal debtor requests the surety
to act as surety and impliedly promises to indemnify the surety in case
the surety incurs liability. It is of the essence of a contract of guarantee that there should be a liability, existing or future, enforceable at law. Thus a guarantee given for a non-enforceable obligation, e.g., a time barred debt is riot good (Manju Mahadeo vs Shivappa Manju 4). 2 (1928), I.L.R. 56 Cal. 262. 3 (1914), 2 Ch. 617. For an Indian case see Gajanan Moreshwar vs Moreshwvar Madan, A.I.R. (1942), Bom. 302. 4 (1918), 42, Bom. 444.
Indemnity and Guarantee 144 Self-Instructional Material NOTES 13.3.1 Consideration for Guarantee A contract of guarantee,
like every other contract,
must also satisfy all the essential elements of a valid contract,
e.g., genuine consent, legality of object,

competency of parties, etc. It should also be supported by some consideration. But there need be no direct consideration between the surety and
the creditor, and the
consideration received by the principal debtor is sufficient for the surety.
Section 127 expressly provides to this effect
and states
that "
anything
done, or any
promise made, for the benefit of
the principal debtor, may be
a sufficient consideration to the surety for giving
the guarantee."
Illustrations (
appended to Sec. 127). (
a)
B
requests
A to sell and deliver to him goods on credit. A agrees to do so,
provided C
will guarantee the
payment of the price of the goods. C promises to
guarantee the payment in consideration of A's promise to deliver
the goods.
This is sufficient consideration for C's promise. (
b)
A sells and deliver 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. (
c)
A
sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of
B. The agreement
is
void.
The third illustration to the Section (as reproduced above) implies that a guarantee for a past debt would be invalid. There must be some fresh consideration moving from the creditor at the time of guarantee, e.g., a further advance is made or the creditor refrains from suing the principal debtor on the payment having become due; in order to constitute a valid contract of guarantee. But in the case of a further advance the surety must clearly undertake the liability for the total debt including the past debt (
Bank of Scotland vs Morrison 5). 13.3.2
Distinction
between
a
Contract of Indemnity and a Contract of 13.3.2 Guarantee
The
following are the points of
distinction between
the two: 1.

Number
of
parties. In
a contract of indemnity,
there are two parties — the
indemnifier and the indemnity-holder.
In
a contract of guarantee,
there are three parties —
the creditor, the principal debtor and the
surety. 2.
Object or
purpose. A contract of
indemnity is for the reimbursement of loss, whereas a contract of guarantee is for the security of a debt or good conduct of an employee. 3. Number of contracts. In indemnity
there is only one contract between the indemnifier and the indemnified, while in
guarantee,
there are
three contracts — one between the principal debtor and
the creditor, the second between the creditor and the surety, and the third between the surety and the
principal debtor. 4.
Nature of
liability.
In a contract of indemnity, the
liability of the indemnifier is primary in nature.
In a contract of guarantee,
the liability of the surety is
secondary,
i.e., the surety is liable only on default of the principal debtor. (
If the principal debtor
fulfils his obligation, the question of surety's liability does not arise.) 5. Request by the debtor. In a
contract of indemnity, the
indemnifier acts independently without any request of the debtor or the third party,
whereas in a contract of guarantee
it is necessary that the surety should give the guarantee at the request
of the debtor. 6.
Existing debt or duty.
In a contract of indemnity,
in most cases there is no existing debt or duty, whereas
in a
contract of guarantee
there is an existing debt or duty, the performance of which is guaranteed by the surety. 5 (1911),
S.C. 593.
Indemnity and Guarantee Self-Instructional Material 145 NOTES 7.
Right to sue.
In a contract of guarantee, the surety, after he discharges the debt owing to
the creditor, can proceed against the principal debtor in his own right.
But in
the case of
a contract of indemnity,
the indemnifier cannot sue the
third party for loss in his own name,
because there is
no privity of contract. He can do so only, if there is as assignment in his favour,
otherwise he must bring the suit (against the third party) in the name of the indemnified. 13.3.3
Nature
and Extent of Surety's Liability Regarding

the extent
of the
surety's liability
Section 128 provides, thus "
the liability of the surety is co-extensive with that of the
principal debtor,
unless
it
is otherwise provided by the contract."
The
phrase "co-extensive with that of
the principal debtor"
shows the quantum of the
surety's liability. Accordingly,
the quantum of obligation of a surety is the same as that of a principal debtor, unless there is a contract to the contrary.
In general, it will be neither more nor less, although
by a special contract it may be made less than
that of
the principal debtor, but never greater.
Illustration.
A
guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is
dishonoured by
C.
A
is liable not only for the amount of the bill
and interest thereon, but also for
the notarial charges which may have been incurred for noting and protesting the bill. (Adapted from the illustration appended to Section 128.) Section 128 provides only for the maximum extent of the surety's liability and it does not deal with the nature of surety's liability. For this, we have to depend upon some other provisions of the Contract Act and judicial decisions; on the basis of which the following generalisations can be made regarding
the nature of surety's liability: 1.
The liability of a surety is secondary or contingent, i.e., the
surety is liable only on default of the principal debtor.
Thus, if the
surety becomes insolvent before default by the principal debtor (
i.e., before the date on which the debt is due for repayment),
the creditor cannot prove against the surety's 'official receiver' in insolvency. 2.
The liability of the surety arises immediately on the default of the principal debtor,
unless there is an express provision in the contract that the
creditor must in the first instance proceed against the principal debtor or must give a notice of default to the surety. If the contract is silent, the creditor may file a suit against the surety directly without suing the principal debtor or without making the principal debtor as co-defendant. In other words,
the
creditor is not bound to exhaust his remedies against the principal debtor before suing the surety (
Bank of Bihar vs Damodar Prasad 6) . The logic behind this rule is that, in law, it is the surety's duty to see that the principal debtor fulfils his obligation. Therefore, as soon as the time for payment has come and the principal debtor does not or is unable to pay or perform his obligation, the surety becomes liable directly, unless otherwise agreed. 3. Where a creditor holds securities from the principal debtor for his debt,
the creditor need not first resort to these securities before suing the surety, unless
otherwise agreed. 4. The surety
will not be liable where the creditor has obtained guarantee by misrepresenting (
either innocently or knowingly)
a material part of the transaction or by keeping silence as to material
circumstance, e.g., obtaining guarantee for the conduct of an employee without disclosing to the surety his previous dishonesty (Sections 142-143). 5. The law treats two separate contracts in a contract of guarantee from creditor's point of view, i.e.,

one between the creditor and
principal debtor and the other between the creditor and surety. In other words, the law does not treat the principal debtor and 6
A.I.R. (1969), S.C. 297.
Indemnity and Guarantee 146 Self-Instructional Material NOTES surety as one person,
and there is no such thing that the surety will be liable only if the principal debtor is liable.
One may be liable while the other may not be.
For example: (i) If some variation in the contract is done later on by the creditor and principal debtor, without surety's consent, the surety is not liable while the principal debtor is liable. (ii)
An admission by the principal debtor is no evidence against the surety or a judgement obtained against the principal debtor will not be enforceable against the surety,
unless otherwise agreed. A surety's liability must be proved by a suit on him independent of any admission by the principal debtor or taking him as a co-defendant (Rambhajan vs Sheo Prasad 7). (iii) A debt may become time-barred as against the principal debtor, but the surety may still be liable, if he has kept his own liability alive by bonafide payment of interest or part of the principal sum within the period of limitation (Raghavendra vs Mahipal 8). Of course, in such a case, after paying the creditor, the surety is entitled to recover the amount from the principal debtor, as the sum so paid was paid rightfully within the meaning of Section 145. It may be noted that if
a debt has become time-barred as against both the principal debtor and surety,
then none of the two
is liable to the creditor. If the surety pays such a debt
he cannot recover it from the principal debtor, because the sum so paid was paid wrongfully within the meaning of Section 145 (Tarachand Lakhmichand vs Gopal 9). (iv) A discharge of the principal debtor by operation of law e.g., insolvency, does not discharge the surety. The surety remains liable for the full amount of debt (Bank of India Ltd. vs R.F. Cowasjee 10). However, when
liability of the principal debtor is scaled down under Debt Relief Act, surety's liability is also reduced (
Narayan Singh vs Chhatar Singh 11) 13.3.4 Continuing
Guarantee A guarantee may be an 'ordinary guarantee' or a 'continuing
guarantee.' When a guarantee is given for a single specific debt or transaction, it is called
an 'ordinary or specific guarantee.' It comes to an end
as soon as the liability under that transaction ends. When
a guarantee extends to a series of distinct and separable transactions, it is called a 'continuing guarantee' (Sec. 129). The guarantee given here
is intended to cover a number of transactions over a period of time.
It is just like a standing offer which is accepted by the creditor every time a subsequent transaction takes place. Being a standing offer it may be revoked at any time by the surety as to future transactions (i.e., acceptances). Illustrations. (a) A guarantees to C for B's credit purchases with a running balance of account not exceeding Rs. 5,000. This is a continuing guarantee. (b) A guarantees to C for B's purchases from C for six months to the extent of Rs. 5.000. This
is a continuing
guarantee. (c)
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 Rs. 5,000,
for the
due collection and payment by C of those rents. This is a
continuing guarantee. [
Illustration (a)
to Section 129] The following points deserve special attention in connection with a continuing guarantee: 1.
A continuing guarantee is not exhausted by the first advance or credit upto the guarantee limit.
Illustration [(b) appended to Sec. 129].
A guarantees payment to B,
a tea dealer, to the amount of £ 100, for any tea he may from time
to
time supply to C. B supplies C with tea to
the
above value of £100, and C pays

B
for it. Afterwards B supplies C with tea to the value of £200. C fails to pay. 7
A.L.J. 142. 8 (1925), 49 Bom. 202. 9 A.I.R. (1959), M.P. 297. 10 A.I.R. (1955). Bom. 419. 11 A.I.R. (1973), Raj. 347.
Indemnity and Guarantee Self-Instructional Material 147 NOTES
The guarantee given by A
was
a continuing guarantee, and he is accordingly liable to B to the extent of £100. 2.
Whether or not
a guarantee is a continuing one depends upon the intention of the
parties, as expressed by the terms of the contract and the surrounding circumstances.
Illustration [(c) appended to Section 129].
A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers
four sacks
to C, which C does
not
pay for.
The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks. 3. The essence
of a continuing guarantee
is that it applies to a series of distinct and separable transactions. As such a guarantee given for an entire consideration is not a continuing guarantee. Illustrations. (a) A leased certain property to B for five years on a specified rent and C executed a contract of guarantee in favour of A ensuring thereby the due fulfillment of B's engagements. B having failed to pay rent for two years, A sued him and got a decree. Thereafter C gave a notice to A revoking his guarantee for the remaining period of the lease. Held, that this was not a Continuing guarantee and C was not competent to revoke it. The guarantee was treated as a specific guarantee because "lease for five years" was an entire or indivisible consideration and not a fragmented one. In a way it was a guarantee for the payment by instalments of a certain sum within a definite time and therefore was not a continuing guarantee (Hasan Ali vs Wali Ullah 12). (b) A guarantee of the fidelity of a person appointed to a place of trust, e.g., the post of Khajanchi in a bank, is not a continuing guarantee and so long as the person is there in the bank the guarantee cannot be revoked (Sen vs Bank of Bengal l3). 13.3.5
Revocation of Continuing Guarantee A continuing guarantee may be revoked
as regards future transactions under the following circumstances: 1. By notice
of revocation
by the surety. Section 130 provides that "
a
continuing guarantee may, at any time,
be
revoked by
the surety, as to future transactions, by notice to the
creditor."
Thus the
surety,
may terminate his continuing guarantee as regards transactions entered into after the notice. He continues to be liable for transactions entered into prior to the notice. Illustration [(a)
appended to Section 130].
A, in consideration of B's discounting, at A's
request, bill of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to
the extent of
Rs. 5,000.
B discounts bills for C to the extent of Rs 2,000. Afterwards, at the end of three months A revokes the guarantee. This revocation discharges A from all liabilities to B
for any subsequent
discounting of bills.
But A is liable to B for Rs 2,000, on default of C. 2.
By death of surety. Section 131 lays down that "
the death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions."

Accordingly, a continuing guarantee is also terminated by the death of the surety so far as regards future transactions unless there is a contract to the contrary. It is not necessary that the creditor must have notice of the death. The estate of the surety is free after death, although the creditor might have entered into a transaction without knowledge of the death of the surety. 3. In the same manner as the surety is discharged. A continuing guarantee is also revoked under the same circumstances under which a surety's liability is discharged, that is: (a) By variance in terms of contract (Section 133). (b) By release or discharge of principal debtor (Section 134). 12 (1930), 28 All. L.J. 1271. 13 32 C.L.J. 223 (P.C.). Indemnity and Guarantee 148 Self-Instructional Material NOTES (c) By arrangement with principal debtor (Section 135). (d) By creditor's act or omission impairing surety's eventual remedy (Section 139). (e) By loss of security (Section 141). These have been discussed later under the heading "Discharge of Surety from Liability." 13.3.6 Rights of Surety A surety has certain rights against the creditor, principal debtor and co-sureties. Surety's rights against the creditor. The surety enjoys the following rights against the creditor: 1. Right to benefit of creditor's securities (Section 141). The surety is entitled to demand from the creditor, at the time of payment, all the securities which the creditor has against the principal debtor at the time when the contract of suretyship is entered into or subsequently acquired. Whether the surety knows of the existence of such security or not is immaterial. If by negligence the creditor loses or, without the consent of the surety, parts with such security as acquired at the time of contract, the surety is discharged to the extent of the value of security. But if the security is lost due to an act of God or enemies of the State or unavoidable accident, the surety would not be discharged (Krishan Talwar vs Hindustan Commercial Bank 14). Similarly, if the subsequently acquired securities are parted with, the liability of the surety would not be reduced (Bhushayya vs Suryanarayan 15). It is to be remembered that the surety is entitled to the benefit of the securities only after paying the debt in full. He cannot claim the benefit of a part of the securities merely because he has paid a part of the debt (Goverdhandas vs Bank of Bengal l6). Illustrations (appended to Section 141). (

a)
C advances to B, his tenant, Rs. 2,000 on the
guarantee of A. C has also a further security for
the 2,000 rupees
by a mortgage of B's furniture, C cancels the mortgage, B becomes insolvent,
and C
sues A
on his guarantee. A
is disharged from liability to the amount of the value of the furniture. (
b) C, a creditor, whose advance to
B
is secured, by a decree, receives also a guarantee for that advance from
A. C afterwards takes B'
s goods in execution under the decree, and then, without the knowledge of
A withdraws the execution. A is discharged. (
c)
A, as surety for B, makes a bond jointly with
B
to C, to secure a loan from C to B. Afterwards C obtains from B
a
further security for the
same debt. Subsequently, C gives up
the further security. A
is not
discharged. 2.
Right to claim set-off, if any. The surety is also entitled to the benefit of
any
set-off or counter claim, which the principal debtor might possess against the creditor
in respect of the same transaction. Surety's
rights against the
principal debtor. The surety enjoys the following two rights against
the principal debtor: 1. Right of subrogation (
Section 140). When the surety pays off the debt
on default of the principal debtor,
he
is
invested with
all the
rights which the creditor had against
the
principal debtor.
The
surety
steps into the shoes of the creditor
and
is
entitled to all the
remedies which the creditor could have enforced against the principal debtor.
The surety
may therefore, claim the securities, if any, held by the creditor and sue the principal debtor, or may claim dividend in
insolvency of
the debtor. 2.
Right to claim
indemnity (Section 145). "
In every contract of guarantee
there is an implied
promise

by
the principal debtor to indemnify the surety; and the surety
is entitled 14
A.I.R. (1957), Punjab, 30. 15 (1944), Mad. 340. 16 (1891), 15 Bom. 48.
Indemnity and Guarantee Self-Instructional Material 149 NOTES
to recover from the principal debtor whatever sum he has 'rightfully paid' under the guarantee,
but no sums which he had paid wrongfully."
Thus
a
surety is entitled to
be indemnified by the principal debtor for whatever sum he has 'rightfully paid' under the guarantee.
The expression 'rightfully paid' means just and equitable payment. It covers the principal sum, interest thereon, noting charges in case of a bill of exchange,
and costs of the suit if there are reasonable grounds to defend the suit.
It does not cover unjust payment like the pay- ment made of
a debt which is time barred as against both the principal debtor and surety.
The following two points
must also be noted in connection with this right to indemnity: (a) The surety
cannot
claim more than what he has actually paid to the creditor.
Thus if he discharges the debt by compromise at less than its full amount, he can get from the principal debtor only the amount actually paid. (b) Actual payment either in cash or by transfer of property is essential for asking the principal debtor to pay. A promissory note given by the surety will not be sufficient to claim indemnity. Illustrations (
appended to Section 145). (
a)
B is indebted to C, and A is surety for the debt. C demands payment from
A,
and on his refusal sues
him for the
amount. A defends the suit, having reasonable grounds for doing so (
some variation in terms later might be A's plea),
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. (
b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange l7 drawn by
B upon
A to secure the
amount. B then endorses the bill to C.
C, the holder of the bill, demands payment of it
from
A, and on A'
s refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit and has to pay the amount of the bill and costs. A can recover from B the amount
of the bill, but not the sum paid for costs, as there was no real ground for defending the action. (
c)
A guarantees to C as regards payment for rice to be supplied by him to B
upto the extent of Rs 2,000.
C supplies to B rice to a less amount than Rs 2,000 but obtains from A payment of the sum
of Rs 2,000
in respect of the rice supplied. A cannot recover from B (
principal debtor) more than the price of the rice actually supplied. (Of course A might recover from C the excess paid under Section 72—"Payment made under a mistake or coercion can be taken back".
Surety's
rights against co-sureties. Where
a debt
is guaranteed by more than one sureties, they are called co-sureties.
In such a case all
the co-sureties are liable to contribute towards the payment of

the guaranteed debt
as per agreement among them.
But in the absence of any agreement, if
one of the co-sureties is compelled to pay the entire debt, he has a right
of
contribution from the other co-surety or co-sureties. The rules of contribution
are laid down in Sections 146-147 which are as follows: 1. Where they are sureties for the same debt for similar amount (i.e., for one and the same amount), the co-sureties are liable to contribute equally, and are entitled to share the benefit of securities, if any, held by any one of the co-sureties, equally. To sum up the principle
it may be said, "
As
between co-sureties, there is equality of burden and benefit."
Further, for the application of the principle it is immaterial whether the sureties are liable jointly under one contract or severally under several
contracts, and whether with or without the knowledge of each other.
There is, however, no right of contribution between persons who become sureties not for the same debt but for different debts. Illustrations (appended to Section 146) (
a)
A,
B, and C
are sureties to D for the sum of Rs 3,000 lent
to
E.
E makes default in payment.
A, B and C are liable,
as between themselves, to pay Rs 1,000 each. (
If C is insolvent and could pay only Rs 500, then A and B will contribute equally to make good his loss.) 17
The bill of exchange in question is technically called an 'Accommodation Bill.'
Indemnity and Guarantee 150 Self-Instructional Material NOTES (
b)
A, B
and C are sureties to D for the sum of Rs 1,000 lent to E,
and
there is a contract between
A, B, and C
that A
is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one-half. E makes default in payment. As between the sureties,
A is liable to pay
Rs. 250, B Rs. 250 and C
Rs 500. 2.
Where they are sureties for the same debt for different sums, the rule is that "subject to the limit fixed by his guarantee, each surety is to contribute equally, (and not proportionately to
the
liability undertaken)." Illustration (appended to
Section 147).
A, B, and C, as
sureties for D, enter into three several bonds each
in a different, penalty, namely, A
in the penalty of
Rs 10,000, B in that of
Rs 20,000 and
C in
that of Rs 40,000, conditioned for D's duly accounting to E.
Then, (i) if
D makes default to the extent of Rs 30,000, A, B, and C are
each liable to pay

Rs 10,000; (
ii) if
D makes default to the extent of Rs 40,000, A
is liable to pay
Rs 10,000 (his maximum limit of liability), and
B and C Rs 15,000 each; (iii) if
D makes
default to the extent of Rs 60,000, then A is liable to pay Rs 10,000, B Rs 20,000 and C Rs 30,000;
and (iv) if
D makes default to the extent of
Rs 70,000, then
A,
B and C have to pay each
the full penalty of
his bond. 13.3.7
Discharge of
Surety from Liability A surety is freed from his obligation under a contract of guarantee under any one of the following circumstances: 1. Notice of revocation. An 'ordinary guarantee' for a single specific debt or transaction cannot be revoked once it is acted upon. But
a '
continuing guarantee' may at any time,
be revoked by
the surety as to future transactions, by
giving notice to the creditor (
Sec. 130). Thus, in such a case, the liability of the surety comes to an end in respect of future transactions which may be entered into by the principal debtor after the surety has served the notice of revocation. The surety shall, however, continue to remain
liable for transactions entered into
prior to the notice. 2.
Death of surety (Sec. 131). In case of a 'continuing guarantee' the death of a surety
also discharges him from liability as regards transactions after his death,
unless there is a contract to the contrary.
The deceased surety's estate will not be liable for any transaction entered into after
the
death, even if the creditor has no notice of
the
death. 3.
Variance in terms of contract (
Sec. 133). "
Any variance, made without the
surety's consent
in
the terms of the contract between the principal debtor and
the creditor,
discharges the surety as to transactions subsequent to
the
variance."
Although the words "as to transactions subsequent to the variance" are more pertinent in the case of 'continuing guarantee', but the principle as laid down in
the
Section is equally applicable in 'specific guarantee' as well. Thus a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor (no matter whether the variation is beneficial to the surety or is made innocently or does not materially affect the position of the surety 18)
because
a surety is liable only for what he has undertaken in the
contract. "
Surety

has a right to say: The contract is no longer that for which I engaged to be surety; you have put an end to the contract that I guaranteed, and my obligation, therefore, is at an end" 19 It is
important to note that mere knowledge and silence of the surety does not amount to an implied consent (Polak vs Everett 20) Again, accepting further security for the same debt is not treated as variance in terms of contract. 18 See Illustration (b) given below. 19 Lord Westbury L.C. in Blest vs Brown, (1862) 4 De. G.F. & J. 367. 20 1 Q.B.D. 669.
Indemnity and Guarantee Self-Instructional Material 151 NOTES
Illustrations (appended to Sec. 133). (
a)
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 his consent, and
is not liable to make good this
loss. (
b)
A guarantees C against the misconduct of B in an office to which
B
is appointed by C, and
of
which
the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered.
Afterwards,
B misconducts himself. A is discharged, by
the
change, from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act. (
c)
C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for
B'
s duly accounting for moneys received by him as such clerk. Afterwards, without
A's
knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary.
A
is not liable for subsequent misconduct of B. (
d)
C contracts to lend
B Rs 5,000 on the first March. A guarantees, repayment. C pays
the 5,000
rupees to B on the first
January.
A is discharged from his liability, as the contract has been varied
in as
much
as C might sue B for the money before
the
first of March. 4.

Release or
discharge of principal debtor (
Sec. 134). This Section provides for the following two ways of discharge of surety from liability: (a)
The
surety is discharged by any contract between the creditor and
the principal debtor,
by which the principal debtor is released.
Any release
of
the
principal debtor is a release of the surety also. (b) The surety is also discharged
by any act or omission of the creditor, the legal consequence of which is
the discharge of the principal debtor.
Illustrations (
appended to Sec. 134). (
a)
A gives
a guarantee to C
for goods to
be supplied by C to B. C supplies
good
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. (
b)
A
contracts with B
for a fixed price
to build a house for B within a stipulated time, B supplying the necessary timber.
C guarantees
A'
s performance of the contract. B omits to supply the timber. C is discharged from his
suretyship (
because the contract
stands discharged against A, the contractor). 5.
Arrangement by creditor with principal debtor without surety's consent (Sec. 135).
Where
the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or
promises to give him time
or
not to sue him,
the surety will be discharged.
But in the following cases, a surety is not discharged: (a)
Where a
contract
to give time to the principal
debtor is made by the creditor with a third person, and not with principal debtor, the surety is not discharged (
Sec. 136).
Illustration (
to
Sec. 136).
C, the holder of an overdue bill of exchange drawn by

A
as surety for B and accepted by B, contracts with M to give time to B. A is not discharged. (
b)
Mere forbearance on the part of
the creditor to sue the principal debtor, or to enforce any other remedy against him,
does not discharge the
surety, unless otherwise agreed (Sec. 137). Illustration (
to
Sec. 137).
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. (c)
Where
there are co-sureties, a
release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility
to the other sureties (
Sec. 138).
Check Your Progress 1. What do you understand by contracts of indemnity? 2. Define contracts of guarantee. 3. What are the special features of contracts of guarantee? 4. Describe the rights which surety enjoys against the principal debtor.
Indemnity and Guarantee 152 Self-Instructional Material NOTES 6.
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 surety is discharged."
In short, it is the duty of the creditor to do every act necessary for the protection of the rights of the surety and if he fails in this duty, the surety is discharged. Thus, where the integrity of a cashier is guaranteed, it is the duty of the employer to give information to the surety if any dishonest act is done by the employee. If the employer continues to employ him after an act of dishonesty (which is proved), the surety is discharged, if he is not informed within a reasonable time, because then the surety's right (eventual remedy) to inform police for necessary recovery action is lost or damaged, i.e., may not be so fruitful as it would have been, had a report been lodged earlier. Illustrations (
appended to
Sec. 139). (
a)
B contracts
to build a ship for C for a given sum, to be paid
by instalments as the work reaches certain stages, (
the last instalment not to be paid before the completion of the ship).
A
becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments.
A is discharged by this prepayment. (b)
A
puts M as

an
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 make up the cash. B omits to see
this done
as promised, and M embezzles.
A is not liable
to B on his guarantee. 7.
Loss of
security (
Sec. 141).
If
the creditor
loses or, 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.
The
word 'loss' here means loss because of carelessness or negligence. Thus if the security
is
lost due to an act of God or enemies of the state or unavoidable accident, the surety would not be discharged. Again, if the securities lost or parted with, were obtained afterwards as a further security, the surety would not be discharged (Bhushayya vs Suryanarayan 21) 8. Invalidation of the contract of guarantee (in between the creditor and the surety). A surety is also discharged from liability when the contract of guarantee (in
between the creditor and the surety) is invalid. A contract of guarantee is invalid in the following
cases: (i) Where the guarantee has been
obtained by means of misrepresentation
or fraud or keeping silence as to material
part of the transaction, by the creditor or with creditor's knowledge and assent (Secs. 142 and 143). Notice that under these Sections the guarantee remains valid if the misrepresentation or concealment is done by the debtor without the concurrence of the creditor. Illustrations (
appended to Sec. 143). (
a)
A engages B as clerk to collect money for him. B fails
to
account for some of his receipts, and
A,
in consequence, calls upon him
to furnish
security for his duly accounting.
C gives
his

guarantee
for
B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid. (
b)
A
guarantees 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. (
ii)
Where a person gives a guarantee upon a contract
that
the
creditor shall not act upon it until another person
has joined in it
as
co-surety,
the guarantee is not valid if
that other person does not join (
Sec. 144). (
iii) Where it lacks
one or more essential elements of a valid contract, e.g., surety is incompetent to contract or the object is illegal. 21 (1944),
Mad. 340.
Indemnity and Guarantee Self-Instructional Material 153 NOTES 13.4 TEST QUESTIONS 1. Define
a contract of indemnity. What are the rights of an indemnity-holder when sued? When does the indemnifier's liability commence? 2.
What is
a contract of guarantee? What are its special features?
Distinguish between a contract of guarantee and a contract of indemnity. 3.
Discuss the nature and extent of surety's liability. 4.
What is a continuing guarantee? When and how is
it revoked? 5.
State
the
rights of a surety against (i) the creditor, (ii) the principal debtor, and (iii) co-sureties.
Illustrate your answer. 6. (a) Why a surety is sometimes called a favoured debtor? (b) "
Between co-sureties there is equality of burden and benefit."
Elucidate. 7.
State and
explain the circumstances under which a surety is discharged from his liability. 8. (
a)
Does
the death of a surety put an end to the contract of guarantee? (
b) Does
the release by the creditor of one of the sureties discharge the others? 13.5
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1.
A
contracts
to indemnify B against the consequences of proceedings which C may take against B in respect
of a certain sum of
money.

C obtains judgement against B for the amount. Without paying any portion of the decree amount, B sues A for its recovery. Will
B succeed? [
Hint. Yes, B will succeed because
the liability of the indemnifier (i.e., A) commences as soon as the liability of the
indemnified (i.e., B) becomes absolute.] 2.
A is employed as a cashier on a salary of Rs 2,000 a month by a bank for a period of three years, C standing surety for A's
good conduct. Nine months afterwards, when the financial position of the bank deteriorates, A agrees to accept a lower salary of Rs 1,500 a month. Two months later, it is discovered that A
has been misappropriating cash all through. What is the liability of C? [Hint. C is liable as a surety for the loss suffered by the bank due to misappropriation by A during the first nine months
but not for misappropriations committed after the reduction in salary. (See illustration (c) to
Sec. 133)] 3.
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.
B then becomes insolvent. Thereafter C sues A for the debt. A pleads C's forbearance to sue B for a year as a defence. Is this a good defence? [Hint. No, this is not a good defence and C must succeed.
Mere forbearance on the part of the creditor to sue the principal debtor
does not discharge the surety, unless otherwise agreed (Sec. 137).] 4.
A guaranteed Z
against trade debts to be contracted by M as a running balance of account to any amount not exceeding Rs 8,000 M became indebted to Z for 10,000
rupees and made a compromise with Z for 60 paise in the rupee, leaving a balance of Rs 4,000 due to Z. Z brings action against A, claiming this amount under the guarantee. Decide?
Indemnity and Guarantee 154 Self-Instructional Material NOTES [Hint. Z is not entitled to recover the balance of Rs 4,000 from A because, as per Section 135, the liability of the surety is discharged when a creditor in composition with his principal debtor accepts a lesser amount in full satisfaction of his claim.] 5. C advances to D Rs 5,000 on the guarantee of A. The loan carries interest at ten per cent per annum. D becomes financially embarrassed subsequently. On D's request, C reduces the interest to six per cent per annum and does not sue D for one year after the loan becomes due, D becomes insolvent. Can C sue A? [Hint. C cannot sue A, because
a surety is discharged from liability when, without his consent, the creditor makes any change m the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (
Sec. 133).]
Bailment and Pledge Self-Instructional Material 155 NOTES UNIT 14 BAILMENT AND PLEDGE Structure 14.0 Introduction 14.1 Unit Objectives 14.2 Bailment 14.3 Finder of Lost Goods 14.4 Pledge or Pawn 14.5 Test Questions 14.6 Practical Problems 14.0 INTRODUCTION
A '
bailment' is
the
delivery of goods by
one person to another for some purpose upon
a contract
that they shall,
when the
purpose is
accomplished,
be returned
or disposed of
according
to
the directions of the person delivering them.
The person delivering the goods is called the 'bailor' and the person to whom the goods are delivered is called the '
bailee'.
The

examples of a
contract of
bailment are: delivering a watch or radio for repair; leaving a car or scooter at a parking stand; leaving luggage in a cloak room; delivering gold to a goldsmith for making ornaments; leaving garments with a dry cleaner and so on. The essence of bailment is the transfer of possession. The ownership remains with the owner. There cannot be a bailment of immovable property.
A 'pledge' is a bailment of goods wherein the goods are delivered as a
security for payment of a debt or
performance of a promise.
The bailor is called
the '
pledgor' or '
pawnor' and the
bailee is called
the '
pledgee' or '
pawnee'.
Thus, pledge is a special kind of bailment.
Pledge can be made only of movable properties. In order to make the pledge legally valid it is essential that the pledgor has the legal right or title to retain the goods. 14.1
UNIT OBJECTIVES ? Understand the meaning of bailment and kinds thereof ? Understand various duties of bailee and bailor ? Know the rights of bailors and bailee against wrong-doers ? Understand the circumstances under which a contract of bailment terminates ? To know the duties and rights of finder of lost goods ? Understand the meaning of pledge and distinction between bailment and pledge ? Know responsibilities and duties of pawnee and pawnor. 14.2
BAILMENT 14.2.1 Definition
According to
Section 148 of the Contract Act — "
A
bailment is the
delivery of goods by
one person to another for
some purpose, upon
a contract
that they shall,
when the
purpose is
accomplished,
by
returned
or otherwise disposed
of
according
to
the directions of the
person delivering them."
The
person delivering the goods is called the 'bailor,' the person to whom they are delivered is
called
the '
bailee,'
and the transaction is called the 'bailment.'
Bailment and Pledge 156 Self-Instructional Material NOTES A 'bailment' is thus a delivery of goods on
condition that the recipient shall ultimately restore them to the bailor or dispose of them according to the directions of the bailor.
Common examples of bailment are hiring of goods, furniture or a cycle, delivering of cloth to a tailor for making a suit, delivering a watch or scooter for repair, depositing goods for safe custody, etc. Essential features.

From the definition given by Section 148 it follows that a bailment has the following characteristic features: 1. It is a delivery of movable goods by one person to another
person (not being his servant). Section 149 explains the mode of delivery to the bailee and states that the delivery of goods may be either 'actual' or 'constructive'. When the bailor hands over to the bailee physical possession of the goods, that is called 'actual delivery.' 'Constructive delivery,' on the other hand, does not involve handing over the physical possession, but something
is done
which has
the effect of putting the goods in the possession
of
the
bailee.
For example, goods stored in a godown can be delivered by handing over the key of the godown, or goods in transit, e.g., when they are at sea or
on a railway, can be delivered by handing over the
bill of lading or the railway receipt representing the goods. 2. The goods are delivered/or some purpose. When goods are delivered by mistake without any purpose, there is no bailment within the meaning of its definition in Section 148. 3. The goods are delivered subject to
the
condition that
when the purpose is accomplished
the
goods are to be returned in specie or disposed of according to the directions of the
bailor,
either in their original form or in an altered form. It is to be emphasised that bailment is concerned with only movable goods.
Money is not included in the category of movable goods.
Thus a deposit of money with a banker is not a bailment because
there is no obligation to return the identical money. But
if notes and coins are deposited in a box for safe custody, it is a bailment as they are to be returned in specie. 14.2.2 Kinds of Bailment Bailment may be classified from the point of view of (i) benefit, and (ii) reward
to the parties. Kinds from 'benefit' point of view. From 'benefit' point of view, bailments can be grouped into three classes; 1.
Bailment for the exclusive benefit of the bailor, e.g., bailor leaves goods in the safe custody of the bailee without any compensation to be paid. 2. Bailment for the exclusive benefit of the bailee, e.g., a loan of some article. Thus where A borrows B's fountain pen to use in the examination hall, the
bailment
is
for the sole benefit of A,
the bailee. 3. Bailment
for the mutual benefit of the bailor and the bailee.
It is
the most common type of bailment. Contracts for repair, hire, etc., fall within this class, wherein the bailor receives the benefit of service and the bailee benefits by the receipt of the agreed charges.
Kinds from 'reward' point of view. Bailments may also be classified on the basis of 'reward' into: 1.
Gratuitous bailment. It
is one
in which
neither the bailor nor the bailee is entitled
to any remuneration,
e.g., loan of a book to a friend, depositing of goods for safe custody without any charge. 2. Non-gratuitous bailment. It is also called as a 'bailment for reward.' Here, either the bailor or the bailee is entitled to
a
remuneration, e.g., motor car let out for hire, cloth given for tailoring for charges.
Bailment
and Pledge Self-Instructional Material 157 NOTES 14.2.3 Consideration in Relation to Gratuitous Bailments There arises a necessity of discovering a consideration to support a contract of bailment where

it is 'for
the exclusive benefit of the bailor' or 'for the exclusive benefit of the
bailee,'
that is, where it is a gratuitous bailment. Perhaps viewing such a transaction as a whole very carefully shall enable us to see how the doctrine of consideration is satisfied. "
The detriment suffered by the bailor in parting with the possession of the goods is suffi- cient consideration to support the
promise on the part of the bailee to return the goods." 14.2.4
Difference between 'Sale' and 'Bailment' In the case of a 'sale'
the ownership is transferred to the buyer
and the buyer is under no obligation to return the goods, but
in the case of a 'bailment' the ownership in goods is not transferred to the
bailee and he is bound to return the goods in specie.
The explanation to Section 148 points out that '
if a person already in possession of
the
goods of another, contracts to hold them as a bailee, he thereby becomes the bailee, and the owner (i.e., the buyer) becomes the bailor although such goods may not have been delivered by way of bailment.'
Thus, where A sells a cycle to B but B leaves it in A's possession
till The completes his other shopping, A becomes a bailee although originally he was the owner. 14.2.5 Difference between 'Bailment' and '
License' A contract of 'license' is that under which one party is permitted to place his goods in the premises belonging to the other party. It is to be noted that in a contract of license, there is no delivery of goods to the licenser. The licenser merely permits the licensee to use the licenser's place for keeping the licensee's goods. Thus, in a contract of license the goods are not delivered to the licenser, while in bailment the goods are delivered to the bailee and the bailee is responsible for their safety. Illustration. A
went to see a horse race. He parked his car in a field belonging to
a farmer, who gave a ticket to him. After the race was over, A returned to the field and found that the car had been stolen. A filed a suit against the farmer. In defence the farmer argued that he was not the bailee of the car and therefore he was under no obligation to look after the safety of the car. He had merely permitted A to use his field for parking the car. It was held, that this was a contract of license and not of bailment and the farmer was under no obligation to look after A's car. The car had not been delivered to the farmer, as such he was not liable for any damage or penalty. (Of course the licenser should not be a party to the theft, i.e., he should not cooperate with the thieves). 14.2.6 Duties of Bailee A bailee is the person to whom the goods are delivered. His duties
are as follows: 1. Duty to take reasonable care of goods delivered to him. Section 151
lays down this duty, thus, "
In all cases of bailment
the bailee
is bound to take
as much care of the goods
bailed
to him
as a
man of ordinary prudence
would,
under similar circumstances, take of his own goods
of the same bulk, quality and value
as the goods bailed."
In other words the bailee must take reasonable care of goods — namely the care which an average prudent man can be expected to take care of his own goods in similar circumstances.
The bailee is not an insurer of goods bailed to him.
If in spite of reasonable care, the goods are lost or destroyed or deteriorated, without any negligence on his part, he is not liable in respect of any damage to the goods. It is open to parties to increase or decrease the obligations of the bailee in the matter of care by special contract. In the absence of any special contract, the standard of reasonable care will apply (Sec. 152). Even where the
 liability of the bailee is increased so as to keep the goods safe from thefts or accidents, he will not be

liable for loss caused by State enemies or, by an act of God, e.g., fire, lightning, flood, etc., or by communal riots (Sunder vs Ram Swarup l). It is important to note that under this duty of reasonable care, the bailee is also bound to take reasonable steps to recover the goods if they have been stolen. Thus, where some goods were stolen from the bailee's custody without his fault, but he made no efforts whether by informing the owner or the police to recover them, he was held liable (Coldman vs Hill 2). Also note that the degree of care required from the bailee is the same whether the bailment is gratuitous or for reward. 2. Duty not to make unauthorised use of goods entrusted to him (Sec. 154).

It is the duty of the bailee to use the goods strictly in accordance with the terms of the bailment. If he makes an unauthorised use of the goods, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

This liability is absolute. It arises even if the bailee is not guilty of any negligence, or the damage is the result of an act of God or inevitable accident. In addition, as per Section 153, the bailor can also terminate the bailment if the bailee makes an unauthorised use of goods. Illustrations. (a) A hired a horse for the purpose of riding to the Exhibition ground. On the Exhibition ground the horse was frightened by the crowd and ran into a ditch and injured itself. The bailee (i.e., A) of the horse was not to be blamed for accident. He is not liable for the injury to the horse. (b) A hired a horse for the purpose of riding to the Exhibition ground. But later on he went riding in a different direction in violation of the contract. During the ride the horse became frightened and ran into a ditch and injured itself. A, the hirer, was not to be blamed for the accident, but he is liable to the bailor for the injury to the horse, because he made an unauthorised use of the horse. (c) A lends a 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. B is liable to make compensation to A for the injury done to the horse. [Illustration (a) to Section 154] (d) A goldsmith accompanied by his wife went from his village to another village to attend a marriage. The goldsmith took with him some ornaments entrusted to his care by customers. The object was to enable his wife to wear the ornaments at the marriage. On the way a gang of robbers attacked them and took away all their goods including the ornaments. The goldsmith was held liable to the customers for the price of ornaments because he had made an unauthorised use of the goods entrusted to his care. 3. Duty not to mix goods bailed with his own goods. It is also the duty of a bailee that he should not mix his own goods with those of the bailor, without bailor's consent.

If the goods are mixed with the consent of the bailor, there is no breach of duty and the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced (Sec. 155). But if the bailee, without the consent of the bailor, mixes up his own goods with those of the bailor, whether intentionally or accidentally, the following rules apply: (a) Where the goods can be separated or divided, the property in the goods remains in the parties respectively,

but
the bailee is bound to bear
the expenses of separation as well as any damage
arising
from the mixture (
Sec. 156).
Illustration (to
Sec. 156).
A bails 100 bales of cotton marked with a particular mark to B. B, without
A's
consent, mixes
the 100
bales with other bales of his own,
bearing a different mark. A is entitled to have his 100 bales returned, and
B is
bound to bear all
the
expenses incurred in the separation of the bales, and any other incidental
damage. (
b) Where the goods mixed cannot be separated, the bailee must compensate the bailor for his loss (Sec. 157). 1 (1992), All. 205. 2 (1919), 1 K.B. 443.
Bailment and Pledge Self-Instructional Material 159 NOTES Illustration (to
Sec. 157).
A bails a barrel of Cape flour worth Rs 45 to B. B, without A's consent mixes the flour with country flour of his own, worth only
Rs 25 a barrel. B must compensate A for the loss of his
flour. 4.
Duty to return the goods.
Section 160 lays down this duty in the following terms: "
It is the duty of the
bailee
to return, or deliver, according to the bailor's directions
the goods bailed,
without demand,
as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished."
Where there are several joint bailors, the bailee may return the goods to any one of the joint owners (
Sec. 165). When
the bailee fails to return
the goods
at the proper time,
he becomes
responsible to the bailor for any loss, destruction or deterioration of the goods
from that time (
Sec. 161).
It is important to note that if the goods are not returned at proper time, the bailee is liable for the loss occurring thereafter even without his negligence, i.e., by an act of God. Of course, this is in addition to the bailee's liability for ordinary damages for breach of contract of bailment. Illustration. A hires a horse from B for one week. But A defaults in returning the horse on the due date. The horse dies one day after the expiry of the period of bailment without any fault on A's part. A is liable for the price of the horse to B, along with damages for the delay. (If the horse dies within one week, i.e., before the expiry of the period of bailment without A's negligence, A is not liable for the price.) 5.
Duty
to deliver any accretion
to
the goods (Sec. 163).
It is the duty of
the bailee to deliver to the

bailor
any natural increase or profit
accruing from the goods bailed,
unless there is a contract to the contrary. Illustration (appended to
Sec. 163).
A leaves a cow in the custody of B to be taken care
of.
The cow has a calf. B is bound to deliver the calf as well as the cow to A. 14.2.7
Duties of
Bailor A bailor is the
person who delivers the goods. His duties are as follows: 1. Duty to disclose faults in goods bailed. Section 150 lays down this duty. The Section makes a distinction between a gratuitous bailor and a bailor for reward and provides as follows: (a)
A gratuitous
bailor
is
bound to disclose to the bailee
all those
faults in the goods bailed, of which
he is aware and which materially interfere with the use of them,
or expose the bailee to extraordinary risks,
and if he
fails to do so, he will be liable to pay such damages to the bailee as may have resulted
directly from the faults. A gratuitous bailor will not be liable for damages arising to the bailee from defects of which he was ignorant. Illustration (to
Sec. 150).
A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured.
A is responsible to B for damage sustained. (
b)
A
bailor for reward
is
responsible for all defects in the goods bailed whether he is aware of the defects or not,
if he does not disclose them to the bailee. Unlike a gratuitous bailor, ignorance of the defects is no defence for him. Illustration (to Sec. 150).
A hires 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. (
If the carriage were lent gratuitously, B would not be liable under the circumstances. Similarly, had B told the fault to A, then also he would not be liable.) It may be mentioned that where
the goods bailed are of dangerous nature,
it is the duty of the bailor to disclose the
fact to the bailee
otherwise he will be liable for all the resulting damage (Great Northern Rly. vs L.E.P. Transport Ltd. 3). For example, A delivers to B, a 3 (1922), 2 K.B. 742.
Bailment and Pledge 160 Self-Instructional Material NOTES carrier, some explosives in a case but does not warn B. The case is handled without extra care necessary for such articles and there is an explosion. The carrier is injured and some other goods are damaged. A, the bailor, is liable for all the resulting damage. 2. Duty to repay necessary expenses in case of gratuitous bailment (Sec. 158).
Where, 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,
it

is the duty of
the bailor to repay all the necessary expenses incurred by
the bailee
for
the
purpose of the bailment.
Thus where a horse is bailed without reward for safe custody,
it is the duty of the bailor to reimburse the
bailee for
usual feeding expenses of the horse
as well as for the medical expenses, if any. 3. Duty to
repay any 'extraordinary' expenses in case of non-gratuitous bailment. Where under the terms of the bailment, the bailee is to receive remuneration for his services,
it is the duty of the bailor to bear extraordinary expenses, if any, incurred by the bailee
in relation to
the thing bailed.
In such a bailment the bailor is not to bear the ordinary or usual expenses. Thus where a horse is bailed for safe custody and the bailee is to receive Rs 80 per day as custody charges, the bailor is not liable to repay the bailee the ordinary expenses of feeding the horse. But if during the bailee's custody the horse falls ill without any negligence on his part, the bailor must repay the bailee the medical expenses incurred
in connection with the treatment of the horse, these being extraordinary expenses. 4. Duty to indemnify bailee (Sec. 164).
A bailor is also bound to indemnify the bailee for any loss suffered by
the bailee,
by reason of the fact that the bailor was not entitled to bail the
goods because of
the defective title. Illustration. A gives his neighbour's scooter to B for use without the neighbour's permission. The neighbour sues B and receives compensation. A is bound to indemnify B for his losses. 5.
Duty
to
receive back the
goods.
It is the
duty
of the bailor to receive back the goods when the
bailee
returns them
after the time of bailment
has expired or the purpose of
bailment
has been
accomplished. If the bailor refuses to
take
delivery of
goods when it is offered at the proper time, the bailee can claim compensation for all necessary expenses of, and incidental to, the safe custody. 14.2.8
Rights of Bailee 1. Enforcement of bailor's duties.
The duties of the bailor are the rights of the
bailee.
As such, the bailee can,
by suit, enforce the duties of the bailor
enumerated above. To recapitulate, the bailee has the following rights
against the bailor (based on the bailor's duties discussed above): (i)
Right to claim damages for loss arising from the undisclosed faults in the goods bailed (Sec. 150). (ii) Right to claim reimbursement for extraordinary expenses incurred in relation to the thing bailed (
Sec. 158). (iii)
Right to indemnity for
any loss suffered by him by reason of defective title of the bailor

to the goods bailed (Sec. 164). (iv)
Right to claim compensation for expenses incurred for the safe custody of the goods if the
bailor has wrongfully refused to take delivery of them after the term of bailment is over. 2. Right to deliver goods to one of several joint bailors (Sec. 165). Where goods have been bailed by
several joint owners,
the bailee has a right to
deliver them to,
or
according to the directions of, one joint owner
without the consent of all,
in the absence of any
agree- ment to the contrary.
Bailment and Pledge Self-Instructional Material 161 NOTES 3.
Right to deliver goods, in good faith, to bailor without title (Sec. 166). The bailee has a right to deliver the goods, in good faith, to the bailor without title, without incurring any liability towards the true owner. 4.
Right of lien. The right to retain possession of the property or goods
belonging to another until
some debt or claim is paid,
is called the right of lien. The right depends on possession and is lost as soon as possession
of the goods is lost. As such it is also called as 'possessory lien.' Liens may be of two types—'particular' and 'general.' '
Particular lien' means the right to retain only that particular property in respect of which the charge is due. '
General lien' means the
right to retain all the goods of the other party until all the claims of the holder against the party are satisfied. In other words, this is a right to retain the goods of another as a
security for a general balance of
account. Bailee's
particular lien.
Section 170 confers the right of particular lien upon a bailee and provides that "
where the bailee has, in accordance with the purpose of
the
bailment,
rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has,
in the
absence of a contract to the contrary,
a
right to retain such goods until he receives due remuneration for the services
he has rendered in respect
of them".
Thus a
bailee has a
particular lien when the following conditions are fulfilled: (i) The bailee must have rendered some service in relation to
the
thing bailed and must be entitled to some remuneration for it, which must not have been paid. (ii) The service rendered by the bailee must be one
involving the exercise of labour or skill in respect of the goods
bailed,
so as to confer an additional value on the article. Illustration [(a)
appended to Sec. 170].
A, delivers a rough diamond to B, a jeweller, to be cut and polished which is accordingly done. B is entitled to retain the stone till he is paid for
the services he has rendered. (
Jeweller's labour and skill must have enhanced the value of the stone.) It is to be emphasised that there is no lien if the labour and skill exercised by the bailee does not improve the value of the goods bailed. Thus a person who takes a horse for feeding and keeping at his stable has no lien for his charges because no additional value has been added to the horse by his labour (Hutton vs Car Maintenance Co. 4). Similarly, there is no lien for safe custody charges because there is no exercise of labour or skill (Vithoba vs Maruthi 5). In such cases the bailee can only sue the bailor for the charges due. (iii)

The services must have been performed in full in accordance with the directions of the bailor, within the agreed time or a reasonable time.
Illustration. A gives his watch to B for repair. B promises A to deliver the watch on the third day. But B takes one week to repair it, B is not entitiled to retain the watch until he is paid. (iv)
There must not be an agreement to perform the service on credit.
Illustration [(b) appended to Sec. 170].
A gives
cloth to
B, a tailor, to make into a coat. B promises A
to deliver
the coat as soon as it is finished,
and to give a three months' credit for the price.
B is
not entitled to retain the coat
until he is paid. (
v)
The goods must be
in possession of the bailee. If possession is lost, the lien is also lost. (
iv) There must not be a contract to the contrary. If all the above mentioned conditions are satisfied, the bailee can exercise his right of particular lien until he is paid for his services. The following points must also be noted in connection with the bailee's particular lien: (a) The bailee retaining the article to enforce his lien cannot charge for keeping it. 4 (1915), 1 Ch. 621. 5 A.I.R. (1940) Nag. 273.
Bailment and Pledge 162 Self-Instructional Material NOTES (b) The bailee cannot exercise his lien for the non-payment of extraordinary expenses incurred in relation to the thing bailed. He should sue for them. Besides the bailee, other persons who are entitled to exercise the right of particular lien are: finder of goods (Sec. 168), pawnee (Secs. 173-174), agent (Sec. 221), and unpaid seller (Sec. 47 of the Sale of Goods Act). Bailee's general lien. As observed earlier,
a general lien
is a right to retain the goods of another as a security for a general balance of
account. In simple words, this
right entitles a person to retain possession of
any goods belonging to another
for any amount due to him whether in respect of those goods or any other goods.
For example, if two loans have been taken against two securities from a banker and the borrower repays one of these loans, the banker may detain both securities until his other loan is paid.
According to Section 171,
bailees coming within the following categories have a '
general lien,'
in the absence of a contract to the contrary: (i) Bankers. A banker has a general
lien on all goods,
cash, cheques and securities deposited with him as banker by a customer, for any money due to him as a banker. Thus, where a customer has a credit balance in one account of the bank and at the same time he owes money to the bank on another account, the banker's general lien entitles him to refuse the customer to operate the account in which he has a credit balance till he clears the debt due to the bank (Davendra Kumar vs Chaudhary Gulab Singh 6). But where valuables and securities are deposited for a specific purpose, e.g., for safe custody, the banker has no general lien on them as the acceptance of the goods for a special purpose impliedly excludes general lien (Cuthbert vs Robarts 7). (ii) Factors. A factor is an agent entrusted with the possession of goods in the ordinary course of his business for
the purpose of sale.
He
has a general lien on the goods of his principal,
if any money is due to him by his principal whether for advances made or for remuneration. (iii) Wharfingers. A wharfinger has a general lien on the goods as regards charges due for the use of wharf against the owner of the goods. (iv)
Attorneys of High Court. An attorney or solicitor of a High Court has a general lien
on all papers and documents belonging to his client
which are in his possession in his professional capacity until

the fee for his professional service and other cost incurred by him are paid. But if the solicitor refuses to act any more for the client, he is not entitled to any lien. (v) Policy brokers. They can retain the policy of fire or marine insurance for their brokerage. (vi) Any other person, if there is an express contract to that effect. 14.2.9
Rights of Bailor 1.
Enforcement of bailee's duties.
The duties of the bailee are
the
rights of the
bailor.
The bailor can enforce by suit all the duties of the
bailee (
already discussed) as his rights.
To recapitulate, the bailor has the following rights against the bailee (based on the bailee's duties discussed earlier): (i)
Right to claim damages for loss
caused to the goods bailed by bailee's negligence (Sec. 151). 6 I.L.R. (1946), Nag. 210. 7 (1909), 2 Ch. 226.
Bailment and Pledge Self-Instructional Material 163 NOTES (ii)
Right to claim compensation for any damage arising from or during unauthorised use of the goods
bailed (Sec. 154). (iii) Right to claim compensation for any loss caused by the unauthorised mixing of goods bailed with his own goods (Secs. 155-156). (iv) Right to demand return of goods
as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished (
Sec. 160). (
v) Right to claim any natural accretion to the goods bailed (Sec. 163). 2. Right to terminate bailment if the bailee uses the goods wrongfully (Sec. 153).
The bailor has a
right to
terminate the bailment, if the bailee does,
with regard to the goods bailed,
any act which is inconsistent with the terms of the
bailment,
although
the term of bailment
has not expired or the purpose of bailment has not been accomplished.
Illustration (to Sec. 153). A gives on hire
to B
a horse
for his own riding. B drives the horse in his carriage.
The contract
of bailment is voidable at the option of A. 3. Right to demand return of goods at any time in case of gratuitous bailment (Sec. 159). When the goods are lent without reward (i.e.,
gratuitously), the bailor can demand their return whenever he pleases even though he lent them for a specified purpose
or
time and the bailee is not guilty of wrongful use. But if the premature return of goods causes the bailee loss in excess of benefit actually derived by him from the use of such goods,
the bailor must indemnify the bailee
for the amount in which the loss occasioned exceeds the benefit derived. 14.2.10
Rights
of
Bailors and Bailees
against
Wrong-doers
If
a
third person
wrongfully deprives the
bailee of the use or possession of the goods
bailed,

or does them any injury, the
bailee is entitled to
use
such remedies as the owner might have
used
in the like case if no bailment had been made;
and either
the bailor or the bailee may bring a suit
against
the wrong-doer
for such deprivation or injury (Sec. 180).
Whatever is obtained by way of relief or compensation in any
such suit,
is to be apportioned,
as between the bailor and the bailee, according to their respective interests (
Sec. 181).
For example,
if somebody forcefully takes possession of a coat from a tailor's shop, then either the tailor or the owner of the coat may sue the wrong-doer. If the tailor
files the suit, he shall hand over the recovered amount, after deducting
his tailoring charges,
to
the owner of the
coat. 14.2.11
Termination of Bailment A contract of bailment terminates under the following circumstances: 1. If the bailment is for a 'specified period,'
the bailment terminates as soon as the
stipulated
period expires. 2. If the bailment is for a 'specific purpose,'
the bailment
terminates as soon as the purpose is fulfilled. 3.
If the
bailee does any act
with
regard to the goods
bailed,
which is inconsistent with the terms of bailment, the
bailment
may be terminated by the bailor even though
the term of bailment has not expired or the purpose of bailment has not been accomplished (
Sec. 153). 4.
A
gratuitous bailment can be terminated by the bailor at any time,
even before the
specified time or
before the purpose is achieved, subject to the limitation that where such termination causes loss in excess of benefit actually derived by the bailee, the bailor must indemnify the bailee for the amount in which the loss occasioned exceeds the benefit derived (
Sec. 159). Check Your Progress 1. Describe the characteristic features of bailment. 2. Differentiate sale and bailment. 3. What are the different kinds of bailment? 4. Describe the duties and responsibilities of bailee.
Bailment and Pledge 164 Self-Instructional Material NOTES 5.
A gratuitous
bailment is terminated by the death either of the bailor
or
of the bailee (
Sec. 162). 14.3
FINDER OF LOST GOODS A finder of lost goods is

under no obligation to take charge of the goods when he comes across. But if he does take the charge of the goods, he becomes responsible for the goods like a bailee in a gratuitous bailment. Section 71 clearly provides to this effect, thus, " a person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee." 14.3.1 Duties of Finder The more important duties of a finder of goods are as follows: 8 1. Duty to find the true owner. It is the duty of the finder to make reasonable efforts to find the true owner of the goods. For example, if one finds goods of little value at a public place, he should shout three times in search of the true owner, and if the goods found are valuable proper advertisement in newspapers etc., should be given. If the finder fails in this duty, he will be liable as a trespasser or a thief. 2. Duty to take reasonable care of the goods as a bailee. A finder must take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same description. If in spite of reasonable care, the goods are lost or destroyed, he is not liable for any loss. 14.3.2 Rights of Finder The rights of a finder of goods are as follows: 1. Right to retain possession of the goods until the true owner is found. A finder has the right to retain possession of the goods against the whole world, except the true owner. It is important that the finder never becomes the owner of the goods. The ownership will always remain with the true owner, and the finder only enjoys the right to retain possession against everybody except the true owner. If anybody deprives him of the possession of the goods, he can maintain an action for trespass. 2. Right of lien over the goods for expenses (Sec. 168). A finder has a right to retain the goods against the true owner until he receives reasonable compensation for trouble and expense incurred by him to preserve the goods and to find out the true owner. But he has no right to file a suit against the owner to recover expenses incurred by him because there is no contract between him and the true owner. He incurred the expenses voluntarily and not at the request of the true owner. Right to sue for reward (Sec. 168). The finder can file a suit against the true owner to recover any reward, which was offered by the true owner for the return of the goods lost, provided he came to know of the offer before actually finding out the goods. He may also retain the goods until he receives the reward. 4. Right of sale (Sec. 169). If the true owner cannot be found with reasonable diligence, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell the goods in the following cases: (a) when the thing is in danger of perishing or of losing the greater part of its value, or 8

For a detailed account of duties, please refer to—"Duties of Bailee".
Bailment and Pledge Self-Instructional Material 165 NOTES (b)
when
the lawful charges of the finder, in respect of the thing found, amount to two- third of its value.
The
true owner, however, is entitled to get the balance of sale proceeds, if
there is a surplus left after meeting the lawful charges of the finder. Illustration. A finds a lost horse. After a diligent search A discovers the true owner and offers to return the horse to him, on condition that the true owner pays The lawful expenses amounting to Rs 150. The true owner refuses to pay. A cannot file a suit for the recovery of the expenses in the absence of privity of contract. He cannot also sell the horse until his lawful charges amount to two-third
of the value of the horse. 14.4
PLEDGE OR PAWN 14.4.1 Definition '
The
bailment of goods
as security for payment of a debt
or performance of a promise is
called 'pledge'.
The bailor
in this case is called the '
pawnor.' The bailee is called
the '
pawnee' (
Sec. 172). Illustration. A
borrows Rs 100
from B and keeps his watch as security for payment of the debt.
The bailment
of watch is
called a pledge.
Thus
a pledge is only
a special kind of bailment. Here goods are deposited with a lender or promisee
as security for the repayment of
a loan or performance of a promise.
Otherwise, like bailment, a pledge also in-volves only a transfer of possession of goods pledged.
The ownership remains with the pledger.
The pledgee or pawnee has
only
a special interest in the goods pledged.
The general interest remains in the pawnor and wholly reverts to him on discharge of the debt.
Further, like bailment, a pledge is concerned with only movable goods. The movable goods include any kind of goods, valuables and documents of title, e.g., railway receipt, bill of lading, etc. (Morvi Mercantile Bank vs Union of India 9). Even a savings bank pass book issued by post office (which must accompany any withdrawal) may be pledged (J. & K. Bank vs Tek Chand 10). 14.4.2 Distinction between Bailment and Pledge 1. As to purpose. Pledge is the
bailment of goods for a specific purpose, i.e., to provide a security for a loan or
for the fulfilment of an obligation, whereas there is no such purpose in case of bailment. A bailment is for a purpose other than the above two, e.g., for repairs, safe custody, etc. 2. As to right of sale. In case of pledge, the pledgee has a right of sale (of the goods pledged) on default after giving notice to the pledger but there is no such right of sale
to the bailee in case of bailment. The bailee may either retain the
goods or sue the bailor for
non-payment of his dues. 3.
As to right of using the goods. In case of pledge, the pledgee has no right of using the goods pledged, while no such restriction, exists for a bailee in case of bailment if the nature of transaction so requires. 14.4.3
Rights of Pawnee 1. Right of retainer (Sec. 173).
The pawnee has the right to
retain the goods pledged
until his dues are paid. He
has the right to

retain the goods pledged, not only for payment of the 9
A.I.R. (1965), S.C. 1954. 10 A.I.R. (1959), J & K. 67.
Bailment and Pledge 166 Self-Instructional Material NOTES
debt or
performance of the promise, but for the
interest due on
the debt and all necessary expenses incurred by
him
in
respect of
the possession or for the preservation of the goods
pledged.
Thus this right
may be termed as the pawnee's right of '
particular lien.' 2. Right of
retainer for subsequent advances (Sec. 174). When
the pawnee lends money to the same debtor after the date of
the pledge
without any further security, it shall be
presumed that the right of retainer over the pledged goods extends even to subsequent advances. This presumption can be rebutted only by a contract to the contrary.
It will be noticed that although a pawnee has a 'particular lien' only, but this Section allows him to track his subsequent advances to the original debt
in the absence of any agreement
to the contrary. 3.
Right to
extraordinary expenses (Sec. 175). The pawnee also has the right
to recover from the pawnor
extraordinary expenses incurred
by him for the preservation of the goods pledged.
But he cannot retain the goods,
if such expenses are not paid. He has only a right to sue the pawnor for recovery of such
extraordinary expenses. 4. Right to sue the pawnor or sell the goods on default of the pawnor. (
Sec. 176). Where a pawnor
makes default
in
the
payment of the debt or performance of the promise,
the
pawnee may
exercise either of
the
following rights: (a) He
may bring a suit against the pawnor for the
recovery of the amount
due
to him and retain the goods
pledged as a collateral security;
or (
b) He may himself sell the thing pledged, after giving to the pawnor a reasonable notice
of his
intention to sell. In connection with the alternative right of sale, the following points must be noted: (i) The requirement of a "reasonable notice' is a statutory obligation and cannot be waived by agreement. A sale without notice is void, notwithstanding any contract
to the contrary. (ii) The pawnee cannot sell the goods to himself and if he does so

then such a sale is void as against the pawnor and the pawnor can recover the goods on paying the amount due. (iii) If the proceeds of such sale are insufficient to meet the full claim of the pawnee, he may recover the balance from the pawnor, but if there is surplus, he must pay it over to the pawnor. 14.4.4
Duties of Pawnee
Pledge being a special kind of bailment, the duties of a pawnee are just like a bailee. 11
Thus a pawnee's duties may be enumerated
as follows: 1.
To take reasonable
care
of the goods pledged. 2. Not to make
any
unauthorised use of
the goods pledged. 3. Not to mix
the goods
pledged with his own goods. 4. Not to
do any act
in violation of the terms of the contract of pledge and of the provisions of the Contract Act. For example, he should not sell the goods pledged without a reasonable notice to the pawnor. 5. To return the goods pledged on receipt of his full dues. 6. To deliver any accretion to the goods pledged, e.g., bonus shares must also be delivered where shares from the subject-matter of pledge. The accretion remains the property of the pawnor (M.R. Dhawan vs Madan Mohan l2). 11 The 'duties of a bailee' have been discussed in detail earlier in this unit. 12 A.I.R. (1969), Del. 313.
Bailment and Pledge Self-Instructional Material 167 NOTES 14.4.5
Rights of Pawnor 1. Enforcement of pawnee's duties.
The duties of the pawnee are
the rights of the pawnor.
The pawnor can, therefore, enforce by suit all the duties
of the
pawnee (enumerated above) as his rights.
For example, if the pawnee makes an unauthorised sale (without giving the notice as required under Section 176), the pawnor can file a suit for redemption of goods, treating the sale as void (of course after depositing with the Court the full amount due), or for damages for conversion. Similarly, the pawnor has a right to receive the pledged goods back along with accretion, if any, on making the payment on stipulated date, and so forth. 2. Defaulting pawnor's right to redeem (Sec. 177). A pawnor, who defaults in payment of the debt amount at the stipulated date, has
a
right
to
redeem the debt at any subsequent time before the actual sale of
goods pledged.
Thus an agreement that the pledge should become irredeemable, if it is not redeemed within a certain time, would be invalid. Ofcourse, the pawnor redeeming after the expiry of the specified time must pay to the pawnee,
in addition, any expenses which have arisen from his default. 14.4.6
Duties of
Pawnor The
more important
duties of a pawnor are as follows: 1.
To compensate the pawnee for any extraordinary expenses incurred
by him (
Sec. 175) 2.
To meet his obligation on stipulated date and comply with
the terms of contract. 14.4.7
Pledge
by Non-owners The owner of goods can always make a valid pledge,
but in the following cases
pledge made by non-
owners will also be valid: 1. Mercantile agents (
Sec. 178).
A

mercantile agent means an
agent having
in the customary
course of business as such agent
authority either to sell goods, or to consign goods
for the purpose of sale,
or to buy goods, or to raise money on the security of goods [
Sec. 2(9) of the Sale of
Goods Act].
A mercantile agent who
is,
with the consent of the owner,
in possession of the goods or the documents of title to
goods (
e.g., railway receipt or bill of lading), can make a valid pledge of
the goods while
acting in the ordinary course of business
of a mercantile agent.
Such a pledge will be valid even if the agent had no actual authority to
pledge,
provided that
the pawnee acts in good faith and
has
not at the time
of the pledge
any notice that the pawnor has no authority to
pledge (
Sec. 178).
It must be noted that a person in bare possession of goods cannot make a valid pledge. For example, a servant to whom goods are entrusted by his master during his (master's) absence cannot make a valid pledge. Similarly, a person entrusted with goods for a specific purpose cannot pledge the goods, e.g., goods held for safe custody or under a contract of hire cannot be pledged. 2.
Person in possession under voidable contract (Sec. 178-A).
A person having possession of goods under a voidable contract
can make a valid pledge
of the goods,
provided
the contract has not been rescinded at the time of the pledge and the
pledgee has
acted
in good faith and without notice of
the
pledger's defect
of title.
For
example, where A purchases a ring from B by exercising coercion and pawns it with C before the contract is rescinded by B, the pledge is valid.
C will get a good title to the ring and B can only claim damages from A. 3. Pledger
having limited interest (Sec. 179).
Where a person pledges goods in which he
has only a limited interest,
the pledge
is valid to the extent of
that interest.
Thus, a
person
Check Your Progress 5. Describe the duties of finder of goods. 6. Define pledge

or pawn briefly. 7. What do you understand by bailee's lien? 8. Describe the cases when pledge made by non-owners of the goods will be valid.

having a lien over the goods may pledge them to the extent of his interest. For example, A delivers a suit length to B, the tailor master, for making a suit and agrees to pay Rs 1,500 as sewing charges. B pledges the suit with C for Rs 3,000. The pledge is valid to the extent of B's interest in the suit, namely, Rs 1,500 (sewing charges). A can, therefore, recover the suit only on paying Rs 1,500 to C, the pledgee (Thakurdas vs Mathura Prasad 13). 4. Seller in possession of goods after sale [Sec. 30 (1) of the Sale of Goods Act].

A seller, left in possession of goods sold, is no more owner of the goods, but a pledge created by him will be valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer. The original buyer can obtain damages from the seller but cannot recover the goods from the pledgee. 5. Buyer in possession of goods under an "agreement to sell" [Sec. 30(2) of the Sale of Goods Act]. Where a buyer under an 'agreement to sell', wherein the goods to become the property of the buyer on fulfilment of certain condition or on expiry of some time, obtains possession of goods with the seller's consent before the payment of price and pledges them, the pledge is valid, provided the pledgee acted in good faith and had no notice of the pledger's defect in title of the goods pledged. It may be mentioned that under an 'agreement to sell' the ownership remains with the seller until the 'agreement to sell' be- comes a 'sale' by the fulfilment of agreed condition. Illustration. A agrees to buy a car if his solicitor approves and obtains possession of the car and pledges it. The pledge is valid, although at the time of pledge A was not the owner and later on also he does not become owner as the solicitor disapproves the purchase. 6. Co-owner in possession. Where there are several joint owners of goods, one of the co- owners in sole possession thereof with the consent of other co-owners may make a valid pledge of the goods. 14.5

TEST QUESTIONS 1. Define a bailment and briefly state the rights and duties of bailor and bailee. 2. Define bailment and give its characteristics. How does bailment differ from 'sale'? What is a bailee's lien? 3. Explain the nature of the bailee's particular lien. How does it differ from the general lien of bankers and factors? 4. What are the rights and obligations of a finder of goods? What is the nature of the lien which finder of goods has over the goods? 5. Define pledge and distinguish between pledge and bailment. When will a pledge made by a non-owners of the goods be valid? 6. Define pledge, and state the respective rights and duties of pawnor and pawnee. 14.6

PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A gives some cloth to a tailor for making a suit of it. The tailor's charges are settled at Rs 1,000. After the suit is ready A tenders Rs 1,000 for the charges but the tailor refuses to deliver the suit till A pays an old debt of Rs 200. Is

the tailor entitled to do so? [Hint. The tailor
is not entitled to refuse to deliver the suit for the old debt
of Rs 200, because a bailee, who renders a service involving the exercise of labour or skill in 13 A.I.R. (1985), All. 66.
Bailment and Pledge Self-Instructional Material 169 NOTES respect of the goods bailed,
so as to confer an additional value on the article,
is entitled only to a right of 'particular lien', i.e., a
right to retain only that particular thing in respect of which the charge is due. (
Sec. 170)] 2.
A lady employed a goldsmith for the purpose of melting old jewellery and making new ones. Every evening
as soon as the goldsmith's work for the day was over, the lady
used to receive the half made jewellery from the goldsmith and put it into a box
which was left in a room in the goldsmith's house of which she retained the key.
One night the box was stolen. Is the goldsmith liable to make good the loss? [Hint.
The goldsmith is not liable to make good the loss of jewellery because he
cannot be said a bailee of the goods. The bailment
must be taken to have come to an end as soon as the lady was put in possession of the
half made jewellery. Again, the lady herself took away the key and therefore there was no effective delivery of the contents of the box to the goldsmith either actually or constructively. As such the goldsmith cannot be regarded as bailee thereof and cannot be made liable for the loss (Kaliaperumal Pillai vs Visalakshmi, A.I.R., 1938, Mad. 32).] 3. A, finds a horse which carries a reward of Rs 200 to the finder offered by B, the owner. A telegraphically informs B about the horse and spends Rs 15 thereon. B comes to take the horse after two days and during the intervening period A spent Rs 80 on feeding the horse. A returns the horse to B without insisting prepayment of his lawful charges of Rs 95 and the amount of reward. Subsequently B
refuses to pay.
A files a suit against B for the recovery of
Rs 295. Will he succeed? [Hint. A will succeed only for the recovery of the amount of reward, i.e., Rs 200 because here there is a contract between A and B. B, while offering the reward, made a general offer which A accepted by returning the horse. But A cannot recover the amount of expenses, i.e., Rs 95 as there is no contract between the two in that regard. A also cannot exercise the right of lien as possession has been lost (Sec. 168). 4. A pledges with B jewels worth Rs 60,000 and borrows Rs 30,000 at 12 percent interest per annum, promising to repay the amount and redeem the jewels within a year. B, having apprehension about the safety of the jewels, because of increasing burglaries in the town, not only insures the jewels but also buys a strong safe at a cost of Rs 800, there being no safety vault in that town and keeps the jewels in that safe. Now, when A comes to repay the loan, B claims the amount due for principal and interest, cost of insurance and cost of the safe. But A admits liability only for the principal and interest. Decide? [
Hint. B is entitled to recover from A the amount of the
principal and the interest plus the cost of insurance and of the safe. There is no dispute so far as the amount of principal and interest is concerned. As regards cost of insurance and of the safe, it should be noted that under Section 175, B, the pawnee, is entitled to these expenses also as they have been incurred for the preservation of the goods pawned and are such which any person of ordinary prudence would reasonably incur in the given circum- stances.] 5. B handed her jewellery to M to value it and tell her what advance he could make on them, it being agreed that M was to keep the jewellery as security if he made the advance. On the same day M pledged the jewellery with A, a pawnbroker, who advanced £1,000 in good faith. Four days later M advanced £500 to B on the security of her jewellery. Subsequently on coming to know of the transaction between M and A, B paid the amount she had borrowed and sued A for the recovery of her jewellery contending that when M advanced the money, no valid pledge could arise as there was no delivery of goods in pursuance of the contract of pledge and M had already parted with the possession of the goods by pledging them with A. Will B succeed? Give reasons.
Bailment and Pledge 170 Self-Instructional Material NOTES [Hint. No, B will not succeed as the pledge is valid. The facts in the instant case are similar to Blundell vs Atten (1921,3 K.B. 233). In that case it was held that the pledge was valid. Delivery made four days before was a good delivery for the purpose of creating a pledge, whenever that pledge was created. "Delivery of possession
and advance need not be simultaneous and a pledge may be perfected by delivery
before or after the advance is made" (Lallan Prasad vs Rahmat Ali, A.I.R. 1967, SC, 1322). B would have succeeded had she made the payment of £500 along with interest to A instead of M because the pledge in between M and A was valid only to the extent of M's interest in the jewellery, namely, £500 (amount of advance to B). Ofcourse, on making the payment to M, B has a right to sue M for the redemption of her jewellery.]
Agency Self-Instructional Material 171 NOTES UNIT 15 AGENCY Structure 15.0 Introduction 15.1 Unit Objectives 15.2 Definitions

of Agent and Principal 15.3 General Rules of Agency 15.4 Kinds of Agents 15.5 Creation of an Agency 15.6 Extent of Agent's Authority 15.7 Delegation of Authority 15.8

Principal's Liability for the Acts of the Agent 15.9 Termination of Agency 15.10 Irrevocable Agency 15.11 Test Questions 15.12 Practical Problems 15.0

INTRODUCTION

An 'Agent' is
a person employed to do any act or to represent another,
known as principal, in dealings with third persons. An agent acts
as a representative of the other in the creation, modification or termination of contractual obligations between
that order and third per- sons.

The essence of a contract of agency is the agent's representative capacity coupled with a power to
affect the legal relations of the principal with third persons. The Contract Act regulates the relationships between agents and principals, agents and the third parties and principals and the third parties. 15.1 UNIT OBJECTIVES ? Understand the various general rules of agency ? Understand various kinds of agents ? Know how to create an agency ? Understand the essentials of valid ratification ? Be clear about the principles underlying delegation of authority ? Know the cases where an agent can delegate his authority to other ? Know the consequences of the appointment of sub-agent ? Know that how an agency can be terminated ? Understand irrevocable agency. 15.2 DEFINITIONS OF AGENT AND PRINCIPAL The two terms— 'agent' and 'principal'—have been defined in
Section 182 of the Contract Act
as follows: "
An agent is
a
person employed to do any act for another or to represent another in dealings with third persons.
The
person for whom such act is done, or who is represented,
is called
the
principal.
The
contract
which creates the relationship
of 'principal' and 'agent' is called
an 'agency'.
Thus
where A appoints B to buy ten bags of sugar
on his behalf, A is the 'principal,' B is the 'agent' and the
contract between the two is 'agency.'
If, in pursuance of the contract of
Agency 172 Self-Instructional Material NOTES agency, the 'agent' purchases the bags of sugar from C, a wholesale dealer in sugar, on credit, then in the eye of law the 'principal' and the wholesale dealer are brought into direct contractual relations and the contract of purchase is enforceable both by and against the 'principal.' It will be seen
that under
a contract of agency the
agent is authorised to establish privity of contract between the principal (
his employer) and a third party. As such the function of
an agent is essentially to bring about contractual relations between the principal and third parties.
In a way, therefore, an agent is merely a connecting link. After entering into a contract on behalf of the principal with a third party, the agent drops out and
ceases to be a party to the contract and the contract binds the principal and the third party
as if they have made it themselves. 15.3 GENERAL RULES OF
AGENCY There are two important general rules regarding agency, viz., 1.
Whatever a person competent to contract may do by himself, he may do through an agent,
except for acts involving personal skill and qualifications. In fact, where the work to be done is obviously personal, no agent can be employed. For example, a person cannot marry through an agent, cannot paint a picture through an agent, and so on. 2. "
He 'who does through another, does by himself." In other words, 'the acts of
the agent are,
for all legal purposes, the acts of the principal.'

Section 226 provides to the same effect: "
Contracts entered into
through an agent, and obligations arising from acts done by an
agent, may be enforced in the same manner, and will have the same legal consequences, as if
the contracts had been entered into and
the acts done by the principal
in person."
Illustrations (
appended to Sec. 226). (
a)
A buys goods from B,
knowing that he is an agent for their sale, but not knowing who
is
the principal. B's principal is the person entitled to claim from
A the price of the goods and A
cannot, in a suit by the principal, set off against that claim a debt due to himself from B. (b) A
being B'
s agent,
with authority
to receive money on his behalf, receives from C a sum of money due to
B.
C is discharged of his obligation
to pay the sum in question to
B. 15.3.1
Test of Agency
Agency exists 'whenever
a person has the authority to act on behalf of
the other and to create contractual relations between that other and third persons.' When this kind of power is not enjoyed, the relationship is not one of agency. Thus
a person is not an agent merely because he gives another advice in matters of business (
Mahesh Chandra vs Radha Kishore 1).
Similarly,
a person rendering personal service to his master or working in his factory cannot be called an agent because in these cases he is not acting for another in dealings with third persons. It is only when one acts as a representative of
the other in business dealings so as to create contractual relations between that other and third
persons, that he is an agent and there is an agency (Krishna vs Ganapathi 2). 15.3.2 Distinction between Agent and Servant
A servant acts under the direct control and supervision of his employer,
that is,
he has to act according to the orders of the master in every particular case. He does not create relations between his employer and third persons and cannot bind the master to third parties. If, for some purpose, he is authorised to bind the master, then to that extent he is an agent. 1 (1908), 12 Cal. W.N. 28. 2 A.I.R. (1955), Mad. 648.
Agency Self-Instructional Material 173 NOTES An agent
is not subject to
the direct control and supervision of the principal. He has
often a large discretion
to act
within the scope of his authority.
A 'principal' directs the agent "as to what is to be done" while a 'master'
has
the
further right to direct "how the work is to be done."
Thus a very minute difference exists between the two. Further,
an agent is appointed to bring the principal into contractual relations with third

parties. An agent as such is not a servant but a servant is generally for some purposes his master's agent, the extent of agency depending upon the duties or position of the servant (Laxminarayan Ram Gopal & Sons Ltd. vs Hyderabad Govt. 3). 15.3.3 Distinction between Agent and Independent Contractor An independent contractor is one who is employed to perform certain specified work but the manner and means of performance are entirely left to his discretion. He is free to do the specified job independently of the employer's control or interference. Such a contractor also differs from an agent. The main point of distinction is that while the contractor does not represent his employer in relation to other persons and as such cannot bind the employer by contracts entered into with others, the agent, on the other hand, does represent his employer in relation to other
persons and can bind the employer (his principal) by contracts entered into with other persons within the scope of his authority. 15.3.4
Who may Employ
an Agent?
According
to
Section 183, "
any person
who is of
the age of majority according to the law to which he is subject, and who is of sound mind,
may employ
an agent."
As such
any person competent to contract may employ an agent and
a minor,
a lunatic or a drunken person cannot employ an agent. 15.3.5
Who may be an Agent?
Section 184 lays down in this regard
that "
as
between the principal and third persons
any person may become an agent."
Thus even a minor or a person of unsound mind
can
be
appointed as agent. It is so because
the act
of the agent is the act
of
the principal and
therefore
the principal is liable to third parties for the acts
of
a minor agent. Of course, in appointing
a minor or a person of unsound mind as an agent,
the
principal
runs a great risk because he cannot hold such an agent liable for his misconduct or negligence. No Consid- eration is Necessary " 15.3.6 No Consideration is Necessary "
No consideration is necessary to create an
agency" (Sec. 185).
The fact that the principal has agreed to be represented by the agent is a sufficient 'detriment' to the principal
to support the contract of agency,
i.e., to support the promise by the agent to act
in that capacity. It is to be noted, however, that
a gratuitous agent is not bound to do the work entrusted to him
by his principal. But once he begins the work, he is bound to complete it. Usually an agent is paid remuneration for his services. 15.4 KINDS
OF

AGENTS From the point of view of the extent of their authority,
agents may be classified into: 1.
General agent.
A general agent is one who is employed
to do all acts connected with a particular business or
employment,
e.g., a manager of a firm.
He can bind the principal by doing any thing which falls within the ordinary scope of that business, whether he is 3 A.I.R. (1954), S.C. 364.
Agency 174 Self-Instructional Material NOTES actually authorised for any particular act or not, is immaterial, provided the third party acts bonafide. Third parties may assume that such an agent has power to do all that which is usual for a general agent to do in the business concerned. 2.
Special agent. A
special agent is one
who is employed to do some particular act or represent his principal in some particular transaction,
e.g., an agent employed to sell
a
motor car.
As soon as the act is performed, the authority of such an agent comes to an end.
If a special agent does any thing outside his authority, the principal is not bound by it, and third parties are not entitled to assume that the agent has unlimited powers. They should, therefore, make proper enquiry as to the extent of his authority before entering into any contract with him. 3. Universal agent. A universal agent is said to be one whose authority is unlimited, i.e., who is authorised to do all the acts which the principal can lawfully do and can delegate. He enjoys extensive powers to transact every kind of business on behalf of his principal.
Another classification. From the point of view of the nature of work performed by them,
agents may be classified into: 1.
Mercantile agents. A mercantile agent is
one
who has
authority either to sell goods or to buy goods or to raise money on the security of goods. [
Sec. 2(9) of the Saie of
Goods Act]. The various kind of mercantile agents are as follows: (a)
Factor. A factor is
a mercantile agent
to whom goods are entrusted for sale. He
enjoys wide discretionary powers
in relation to the sale of
goods.
He sells the goods in his own name upon such terms as he thinks fit. He
may pledge the goods as well. (b)
Commission agent. A
commission agent is
a
mercantile agent who buys or sells goods for his principal on
the best possible terms in his own name and who receives commission for his labours.
He may have possession of goods or not. (
c)
Del credere agent. He
is one who in consideration of an extra commission, guarantees
his principal that the third persons
with whom he enters into contracts
on behalf of the principal shall perform their financial obligations,
that is, if the buyer does not pay, he will pay.
Thus, he occupies the position of a surety as well as of an agent. (d)
Broker. He is one who is employed to make contracts for the purchase and sale of goods.
He

is not entrusted with the possession of goods. He simply acts as a connecting link and brings the two parties together to bargain and if the transaction materialises he becomes entitled to his commission called brokerage. He makes contracts in the name of his principal. 2. Non-mercantile agents. They include advocates, attorneys, insurance agent, wife, etc. 15.5 CREATION OF AN
AGENCY An agency may be created in any one of the following ways: 1.
Agency by Express Agreement. Normally
agency is created by an express agreement, specifying
the scope of
the authority of agent. The agent may, in such a case, be appointed either by word of mouth or by an agreement in writing (
Sec. 187).
However, in certain cases, e.g., to execute a deed for sale or purchase of land, the agent must be appointed by executing a-formal '
power of attorney'
on a stamped paper. 2.
Agency by Implied Agreement. Implied agency arises
when there is no express agree- ment appointing a person as an
agent, but instead the existence of agency
is
inferred from the circumstances of the case, or from the conduct of the parties
on a particular occasion, or from the
relationship between parties (Sec. 187). Such an agency may take the follow- ing forms:
Agency Self-Instructional Material 175
NOTES (
a) Agency by estoppel; (b) Agency by holding out; (c) Agency by necessity.
We shall deal with each of these in turn. (a) Agency by estoppel. Such an agency is based on the 'doctrine of estoppel' which
may briefly be stated
thus, "
Where a person by his words or conduct has wilfully
led another to believe that certain
set of
circumstances or facts exists, and that other person has acted on that belief, he is
estopped or
precluded from denying the truth of such statements, although such
a state of things did not in fact
exist." Section 237 of the Contract Act, which deals with agency by estoppel, also provides to the same effect. The Section lays down that "
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 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 agent's authority."
We may sum up thus, an agency by estoppel is created when the alleged principal
by his conduct or by words spoken or written, leads wilfully
the other contracting party into an honest belief that the supposed agent had authority to act as such and bind the principal. Such a principal will be estopped from denying subsequently his agent's authority, although the agent did not in fact possess any authority whatever. Illustrations. (a) T
tells M in the presence and
within the hearing of N that he (7) is N's agent. N does not contradict this statement
and keeps quiet.
Later on M enters into a transaction with T believing honestly that T is N's agent. N is bound by
this transaction and
he will be estopped from denying the existence of the agency, even though such an agency did not in fact exist. Notice that by virtue of the doctrine of estoppel an apparent or ostensible agency becomes as effective as an agency deliberately created. (b)

A consigns goods to B for sale and gives him instruction not to sell under a fixed price. C, being ignorant of B's instruction, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. [Illustration (a) to Section 237] (b) Agency by holding out. Such an agency is based on the "doctrine of holding out" which is a part of the law of estoppel. In this case also the alleged principal is bound by the acts of the supposed agent, if he has induced third persons to believe that they are done with his authority. But, unlike an 'agency by estoppel', an 'agency by holding out' requires some affirmative or positive act or conduct by the principal to establish agency subse- quently. Thus, where an employer has been accustomed to pay for goods bought on his behalf by his employee from P, the employer may be liable for a purchase made in the customary manner, even though it is made, by the employee fraudulently after he has left the employment. The employer's conduct in 'holding out' his employee to be his agent (paying for purchases made by the employee on previous occasions) estops him from denying that his authority was not still in existence. It may be noted that where the agent is 'held out' as having only a 'limited authority' to do acts, the principal is not bound by an act outside the authority. (c) Agency by necessity. In certain circumstances the law confers an authority on one person to act as agent for another without any regard to the consent of the principal. Such an agency is called an agency of necessity. 4

Bowstead has rightly observed: "An agency by necessity is conferred by law in certain cases, where a person is faced with an emergency in which the property or interests of another are in imminent danger, and it becomes necessary in order to preserve the property or interests, to act before the instructions of the owner can be obtained. The law assumes the consent of the owner to the creation of the 4 C.f. Anson's Law of Contract, 23 Ed. p. 553.

 NOTES relationship of principal and agent." Thus, the conditions which enable a person to act as an agent of necessity of another are as follows: (i) There should be a real necessity for acting on behalf of the principal. (ii) It should be impossible to communicate with the principal within the time available. (iii) The alleged agent should act bonafide in the interests of the principal. Generally the 'agency by necessity' arises in the following cases: (i) Where the agent exceeds his authority, bonafide, in an emergency. For example, where A consigns fruits to B at Allahabad with directions to send them immediately to C at Varanasi, and B, finding that the fruits are perishing rapidly, sells them at Allahabad itself for the best price obtainable, the sale will bind the principal and the agent cannot be held liable for exceeding his authority as under the circumstances of the case there arises agency of necessity. (ii) Where the carrier of goods acting as abailee, does any thing to protect or preserve the goods, in an emergency, although there is no express authority in that regard. Thus a master of a ship is entitled, in cases of accident and emergency, to sell or pledge the goods in order to save their value and the sale or pledge will bind the cargo owners. Similarly, a land carrier of goods, in case of accident or emergency, becomes an agent of necessity, for example, if a public carrier develops an engine trouble, the driver can pledge a part of the goods loaded thereon in order to raise the money necessary for repairs and the pledge will be binding on the owner of goods. Notice that in these cases it is not practicable to communicate with the principal. (iii) Where a husband improperly leaves his wife without providing proper means for her sustenance. In a special circumstance the case of husband and wife also provides an instance of agency by necessity. When the wife has been deserted by the husband and thus forced to live separate from him, the wife is regarded as the agent of necessity of the husband and she has the authority of pledging her husband's credit for necessaries even against her husband's wishes. However, this rule does not apply where the wife improperly leaves the husband. It is relevant to state that in the ordinary course of things there is an implied agency between the husband and wife and the wife is presumed to have implied authority to pledge her husband's credit for necessaries suiting to the couple's joint style of living. But a husband enjoys no corresponding right to pledge his wife's credit for necessaries. 3. Agency by Ratification Ratification means the subsequent adoption and acceptance of an act originally done without instructions or authority. Thus where a principal affirms or adopts the unauthorised act of his agent, he is said to have ratified that act and there comes into existence an agency by

ratification retrospectively. Section 196 deals with
the effect of 'ratification.' It provides that "
where acts are done by one person on behalf of another, but without his knowledge or authority,
he may elect to ratify or
to disown such acts.
If he ratifies
them, the same effects will follow as
if they had been performed by his authority."
Illustration. A buys 5 bags of wheat on behalf of B. B did not appoint A as his agent. B may, upon hearing of the transaction, accept or reject it. If B accepts it, the act is ratified and A becomes his agent with retrospective effect.
Ratification relates back to time of contract. As observed above, ratification has got retrospective effect. By ratifying the unauthorised act of the agent, the principal becomes bound by the act as if it had been originally done
by his authority. Thus ratification amounts
Agency Self-Instructional Material 177 NOTES to 'prior authority'. It relates back to the original making of the contract.
This means that the agency comes
into existence from the moment the agent acted and not from the
time when the principal ratified. Illustration.
The managing director of a company,
purporting to act as agent on company's behalf, but without its authority, accepted an offer
made by L, the defendant, for the purchase of some sugar works belonging to them.
L,
subsequently withdrew the offer but the company ratified the managing director's acceptance. Held, L was bound. The ratification, related back to the time of managing director's acceptance, and so the
withdrawal of the offer was inoperative. An offer once accepted cannot be withdrawn. (Bolton vs Lambert 5)
Ratification may be express or implied.
Section 197 provides; "
Ratification may be expressed or may be implied in the conduct of the person on whose
behalf the acts are done."
Illustrations (appended to
Sec. 197). (
a)
A, without authority, buys goods for B. Afterwards B sells them to C on his own account.
B's
conduct implies a ratification of the purchase made by A
for him. (b)
A,
without B's authority, lends B'
s money to C. Afterwards B accepts interest on the money from C.
B's conduct implies a ratification of the loan.
Essentials of a valid ratification. A valid ratification must fulfil the following
conditions: 1.
The agent must
purport to act as agent for a principal who is in contemplation.
The agent must expressly contract as an agent for a principal in the knowledge of third parties. The principal must be named or must be 'identifiable' and it is not sufficient to indicate simply that he is acting as agent of some one. The word 'identifiable' here means that there must be such a description of the principal as shall amount to a reasonable designation of him, for example, it would cover the expressions like "on behalf of the Vice-Chancellor, Delhi University" or "on behalf of my elder brother." Thus, to be valid, a ratification must be done by the person on whose behalf the agent professed to act. An undisclosed principal cannot step in and ratify acts done by a third person. Similarly, a person entering into a contract in his own name cannot later shift it on to a third party. 2. There should be an act capable of ratification. The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void. Thus, the share- holders
of a company cannot ratify an ultra vires contract made by the directors. 3.
The principal must be in existence. For a
valid ratification it is essential that
the principal must be in existence at the time when the
original contract is made,

because rights and obligations cannot attach to a non-existent person. Thus contracts, entered into by promoters of a company on its behalf before its incorporation, cannot be ratified by the company after it comes into existence. The Specific Relief Act, however, provides for certain exceptions where a company can ratify its pre-incorporation contracts. 6 4.
The principal must be competent to contract.
The principal
must have contractual capacity both at the time of original contract and at the time of ratification.
Thus a
person cannot ratify a contract made
on his behalf during his minority. Similarly, a person cannot ratify a contract of insurance made by an unauthorised agent on his behalf after he has become aware that the event insured against has in fact occurred, because he could not himself insure in such circumstances (Grover & Grover vs Mother 7). 5.
The principal must have
full knowledge of material facts. Section 198 declares: "
No
valid ratification can be made by a person whose knowledge of facts of the case is materially defective."
Thus to constitute a valid ratification, the principal must, at the time of ratification, have full knowledge of all material facts or give such an unqualified acceptance that the inference may be drawn that he intended to ratify the contract whatever the facts may be. 5 (1889), 41 Ch. D. 295. 6 See Sections 15 (h) and 19 (e) of the Specific Relief Act, 1963. 7 (1910), 2 K.B. 401.
Agency 178 Self-Instructional Material NOTES 6. Whole transaction must be ratified. Ratification must be of the whole contract. Once a part is accepted, it is an implied acceptance of the whole (Sec. 199). There cannot be partial rejection and partial ratification. The principal cannot reject the burdens attached and accept only the benefits. 7. Within reasonable time. A ratification to be effective must be made within a reasonable time after the original contract is made. Where a time is expressly fixed for the performance of the contract, ratification must be made within that time. 8. Ratification must not injure a third person (Sec. 200). A ratification
cannot be effective where its effect is
to subject
a third person to damages, or terminate any right or interest of a third person.
Illustrations (appended to
Sec. 200). (a)
A, not being authorised thereto by B,
demands on
behalf of B, the delivery of a chattel, the property of B,
from C, who is in possession of it. This demand cannot
be ratified by B, so as to make C liable for
damages for his refusal to deliver. (b)
A holds a lease from B,
terminable on three months' notice. C, an unauthorised person, gives notice of termination to A.
The notice
cannot be ratified by B, so as to be binding on A. 15.6
EXTENT OF
AGENT'S AUTHORITY The authority of an agent means his capacity to bind the principal
to
third parties.
The agent can bind the principal only if he acts within the scope of his
authority. The
scope of an agent's authority is determined by
his: 1.
Actual authority. An agent can do all such acts
as
have been assigned to him either expressly or impliedly and thereby
bind the principal
to third parties by acts done within
the scope of his 'actual' or 'real' authority (Secs. 186 and 226).
The
authority

is said to be
express when it is given by words spoken or written.
The
authority
is said to be
implied when it is inferred from the circumstances of the case
or the ordinary course of
dealings (
Sec. 187). 2.
Ostensible or apparent authority. An agent can also bind the principal to third parties
by acts done within his apparent authority; (although the act is in excess of his actual authority);
provided the third party acts bonafide and without knowledge of the limitation of the agent's apparent authority (Watteau vs Fenwick 8). Thus 'actual' and 'apparent' authority stand on the same footing. Ostensible authority means an authority which the third parties dealing with the agent can presume to be with the agent in relation to a particular business
ordinarily. In other words, such an authority implies authority to do an act usually necessary in the course of conducting similar business in accordance with the customs and usages of the particular place, trade or market. Thus if it is the usual practice of hotel managers to purchase liquors and cigarettes, then purchases of this nature shall be deemed within the scope of the manager's apparent authority and the principal will be bound by such purchases, notwithstanding limitations, as between the principal and agent, put upon that authority (
Watteau vs Fenwickg 9)
Section 188 which deals with the extent of agent's authority lays down the scope of an
agent's apparent authority in these words: "An agent having an authority to do an act
or to carry on a business
has authority to do every lawful thing which is necessary in order to do such act,
or which is usually done in the course of conducting such business." The following illustrations are appended to the Section: Illustrations. (
a)
A, is employed by B,
residing
in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose
of recovering the debt, and may give avalid discharge for the same. 8 (1893), 1
Q.B. 346. 9 Ibid.
Agency Self-Instructional Material 179 NOTES (
b)
A constitutes B,
his agent, to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purpose of carrying on the business.
In normal times, therefore,
the scope of an agent's authority is determined by his '
actual' as well as 'apparent' authority. Although the apparent authority of an agent may be curtailed by the principal but such a curtailment is ineffective vis-a-vis the principal and third parties unless the third parties have notice of it. Even if an act of the
agent is
in excess of his actual authority, the principal will be bound by the act
if it is within the scope of the agent's apparent authority,
provided the third parties act bonafide. Thus, if a principal delivers goods to a 'factor' with instructions that they are not to be disposed of but are to be retained pending further instructions; and the factor, in breach of his authority, sells the goods to a third party who acts bonafide for value, then the principal (owner) is estopped from disputing the validity of the transaction since it is within the scope of apparent authority of a factor to dispose of the goods of which he is in possession. 3.
Authority
in
emergency.
An agent
has authority, in an emergency, to
do all such acts

for the purpose of protecting his principal from loss
as would be done by a person of ordinary prudence in his own case, under similar circumstances (
Sec. 189).
The
following illustrations are appended to the Section:
Illustrations. (a) An agent for sale may have goods repaired if it be necessary. (b)
A
consigns provisions to B at Kolkata, with directions to send them immediately to C at Cuttack.
B
may sell the provisions at Kolkata, if they
will not bear the journey to Cuttack without
spoiling. 15.7
DELEGATION OF AUTHORITY
Section 190 provides that "
an
agent cannot lawfully employ another to
perform acts which he has expressly or impliedly undertaken to perform personally,
unless by
the
ordinary custom of trade a subagent may, or from the nature of agency, a subagent must, be employed."
Accordingly
an agent cannot delegate his powers or duties to another without the express authority of the principal, except in certain cases (
which are discussed in the next paragraph). This Section is based on the well-known maxim of Roman law, viz., "delegatus nonpotest
delegare," that is "a delegate cannot further delegate."
An agent,
being himself a delegate of his principal, cannot pass on that delegated authority to someone else. As a rule, he must not depute another person to do that which he has undertaken to do
personally. The reason for this rule is that confidence in the integrity and competence of a particular person is at the root of a contract of agency. But there are exceptions to this general rule. In the following cases the agent can delegate his authority to another (i.e., can appoint a subagent) and bind the principal: 1.
Where the principal has expressly permitted delegation of such power. 2. Where the principal has impliedly, by his conduct, allowed such delegation
of authority, e.g.,
where the principal knows that the agent intends to delegate
his authority but does not object to it. 3. Where by the ordinary custom of trade a subagent may be employed.
Thus stock exchange member brokers generally appoint clerks to transact business on behalf of their clients. 4. Where the very
nature of agency makes it necessary to appoint a subagent. For example, a manager of a shop may employ sales assistant. 5. Where the acts to be done are purely ministerial and do not involve the exercise of discretion, e.g., clerical or routine work. 6. Where unforeseen emergencies arise rendering appointment of the sub-agent necessary.
Check Your Progress 1. What do you understand by the terms agent and principal. 2. Differentiate agent and contractor.
3. Define agency by estoppel. 4. What are the essentials of the valid ratification?

If a sub-agent is appointed in any of the above circumstances, then he is called
as "properly appointed
sub-agent." 15.7.1
Sub-Agent "
A sub-agent is
a
person employed by, and acting under the
control of, the original agent in the
business of the agency" (
Sec. 191). Thus a

person employed by an agent is called a sub-agent. A sub-agent acts under the control of the original agent as for the relation in between themselves is that of agent and principal. In other words the original agent acts as principal for the sub-agent. Consequences of the appointment of sub-agent. The legal effects of
the appointment of a sub-agent as between the principal and the sub-agent inter se and as regards third parties depend upon whether the sub-agent has been properly or improperly
appointed. A sub- agent is
said to be properly appointed when the
appointment is made under any of the recognised exceptional circumstances discussed under the preceding heading. The appointment is said to be improper when it is made without any justification for such appointment. Where a sub-agent is properly appointed.
In such a case, as per Section 192, the following consequences
emerge: (
a)
The principal is bound and
liable to third parties
for
the acts of the
sub-agent,
as if he were an agent originally appointed by
the principal. (
b)
The
agent is responsible to the principal for the acts of the sub-agent.
For example, if any moneys are due on the sub-agent, the agent is responsible for the same and the principal cannot sue the sub-agent on that account. It is so because in the eye of law
there is no privity of contract between the principal and the
sub-agent and therefore, in general, the principal cannot claim against the sub-agent for negligence (Calico Primers Association vs Barclays Bunk 10). (
c)
The sub-agent
is responsible for his acts to the agent
and not to the principal. But in case
the sub-agent is guilty of fraud or wilful wrong,
he is directly liable
to the principal. In
such a case the principal has the choice to sue either the agent or the sub-agent (Nensukhdas vs Birdichanu 11).
Where a sub-agent is improperly appointed. Where the appointment of a sub-agent is made without authority and without any justification, as per Section 193, the following consequences arise: (
a)
The principal is not represented by such sub-agent and hence he
is not liable
for
the acts of the sub-agent. (b)
The agent is responsible for the
acts of the sub-agent
to the
principal
as well as to the third parties. (c) The
sub-agent is not responsible to the principal
at all. He cannot be held liable by the principal even for fraud or wilful wrong. He is responsible for his acts only to the agent (his employer). 15.7.2 Substituted Agent Section 194 deals with the appointment of a substituted agent.
Accordingly, “when an agent has an express or implied authority of his principal
to name another person to act for the principal and the agent names another person accordingly, such person is not a sub- 10 (1931), 145
L.T. 51. 11 (1917), 19 Bom. L.R. 948.

Agency Self-Instructional Material 181 NOTES agent but a substituted agent of the principal in respect of the business which is entrusted to him". Thus an agent simply names or appoints a substituted agent at the request of the principal and thereafter drops out altogether from the scene. The substituted agent is directly responsible to the principal and a privity of contract is deemed between him and the principal. Illustrations (appended to Sec. 194). (
a)
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. (
b) A authorises B, a merchant in Calcutta, to recover
the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co.,
for the recovery of the money. D is not a sub-agent, but
a
full-fledged agent of A. Section 195 imposes a duty on the original agent to act with reasonable care while naming a substituted agent. The Section lays down
that "
in selecting such 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 the acts or negligence of the agent
so
selected."
Thus the original agent must act with reasonable care in selecting a substituted agent. If he makes the selection carelessly, he becomes liable
to the principal for the negligence of the agent so selected.
It may by noted, however, that the original agent is not required to guarantee the integrity or solvency of the substituted agent. Illustrations (appended to Sec. 195). (
a)
A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor
of good reputation
to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost.
The surveyor, but
not the agent, is liable to A, the principal. (
b) A
consigns goods to B, a merchant, for sale. B, in due course, employs an auctioneer in good credit to sell
the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds. (
B
would have been responsible to A for the proceeds if the auctioneer so employed were a known man of doubtful credit).
15.7.3
Duties of Agent An agent has the following duties towards the principal: 1. Duty to follow principal's directions or customs (Sec. 211).
The first duty of every agent is to act within the scope of
the authority conferred upon him
and perform the agency work according to the directions given by the principal.
When the agent
acts otherwise, if any loss be sustained, he

must make it good to
the
principal, and if any profit accrues, he must account for it.
Illustrations. (a)
Where the principal instructed the agent to warehouse the goods at a particular place and the agent warehoused them at a different warehouse which was equally safe, and the goods
were destroyed by fire without negligence, it was held that the agent was liable for the
loss because any departure from the instructions makes the agent absolutely liable (Lilley vs Dotihleday l2). (b)
An agent being
instructed to insure goods neglects to do so. He
is liable to compensate the principal in the event of their being lost (
Pannalal Jankidas vs Mohanlal 13).
If the principal has not given any express or implied directions, then it is the duty of the agent
to
follow the custom prevailing in the same kind of business
at the place where the agent conducts business.
If the agent
makes any departure, he does so at his own risk. He must make good any loss so sustained by the principal. 12 (1881), 7 QBD 510. 13 A.I.R. (1951) S.C. 144.
Agency 182 Self-Instructional Material NOTES Illustrations (appended to Sec. 211). (a) A,
an agent, engaged in
carrying for B a
business, in which it is the custom to invest from time to time at interest,
the moneys
which may be in hand, omits to make such
investments. A must make good to B the interest usually obtained by such investments. (b)
B, a broker, in whose business it is
not the
custom to sell on credit, sells goods of
A
on credit
to C, whose credit at the time was very high.
C, before payment, becomes insolvent. B must make good the loss to
A,
irrespective of his good intentions. 2.
Duty to carry out the work with reasonable skill and diligence (Sec. 212).
The
agent must
conduct the business of
the
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.
Further, the agent
must act with reasonable diligence
and
to
the best of his skill. If the agent does not work with reasonable care, skill (
unless the principal has notice of his want of
skill)
and diligence, he must
make compensation to his
principal in respect of 'direct consequences' of his own neglect,
want of skill or misconduct.
But

he is not
so liable for indirect or remote losses. Illustrations (appended to Sec. 212). (
a)
A, a merchant in Kolkata, has an agent B,
in London, to whom
a sum of money is paid on
A'
s
account, with orders to remit. B retains the money for a
considerable time.
A, in consequence of not-receiving the money, becomes insolvent.
B
is
liable for
the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss
such as loss
by variation of rate of exchange, but nothing further. (b)
A,
an agent for the sale of goods, having authority to sell
goods
on credit, sells to B on credit, without making
the proper and usual enquiries 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. (
c)
A, an insurance broker, employed by
B
to effect an insurance on a ship,
omits to see that the
usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good
the loss
to B. (d) A,
a merchant in England, directs B, his agent at Mumbai, who accepts
the
agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise. 3.
Duty to render accounts (Sec. 213). It is the
duty of an agent to keep proper accounts of his principal's money or property
and render them to him
on
demand, or periodically if so provided in the agreement. 4.
Duty to communicate (
Sec. 214).
It is the
duty of
an agent,
in cases of difficulty,
to use all reasonable diligence
in communicating
with his principal,
and

in
seeking to obtain his instructions,
before taking any steps
in
facing the difficulty or emergency. 5. Duty not to deal on his own account (Secs. 215 and 216).
An
agent must not
deal on his own account in the business of agency;
i.e., he must
not himself buy
from or sell to his principal goods he is asked to sell or buy on behalf of his principal;
without
obtaining the consent of his principal after disclosing all material facts to him.
If the agent violates this rule,
the
principal may repudiate the transaction where it can be shown
that
any material fact has been knowingly concealed by the agent, or that the dealings of the agent have been
disadvantageous to
the
principal. The
principal is also entitled to
claim from the agent
any benefit which may have resulted to him from the transaction.
Illustrations. (a)
A, directs B to sell A's estate. B buys
the estate for himself in the name of C. A, on discovering that B
has
bought the estate for himself may repudiate the sale, if he can show that
B
has dishonestly concealed any material
tact or that the sale has been disadvantageous to him. [
Illustration (a)
appended to Section 215].
Agency Self-Instructional Material 183 NOTES (b)
A directs B to sell A'
s
estate. B, on looking over the
estate before selling it. Finds a mine on the estate which is unknown to A.
B
informs A that he wishes to buy the estate for himself but conceals the discovery of the mine. A
allows B to buy, in ignorance of
the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either
repudiate or adopt the sale at his option. [
Illustration (b)
appended to Section 215] (c)
A directs, B, his agent, to buy a certain house for him. B tells A
that
it cannot be bought and buys the house for himself,
A
may, on discovering that B has bought the house,
compel him to sell it to A at the price he gave for
it. [
Illustration appended
to
Section 216]. 6. Duty not to make any profit out of his agency except his remuneration (

Secs. 217 and 218). An agent stands in a fiduciary relation to his principal and therefore he must not make any profit (secret profit) out of his agency. He must pay to his principal all moneys (including illegal gratification, if any) received by him on principal's account. He can, however, deduct
all moneys due to himself in respect of his remuneration
or/and expenses properly incurred.
If his acts are not bonafide, he will lose his remuneration
and will have to account for the secret profit to his principal. 7.
Duty on termination of agency by principal's
death or insanity (
Sec. 209).
When
an
agency is terminated by the principal dying or becoming of unsound mind,
the agent must
take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him. 8.
Duty not to
delegate authority (
Sec. 190).
Subject to six exceptions stated earlier (under the heading Delegation of Authority), an agent must not further delegate his author- ity to another person, but perform the work of agency himself. 14 15.7.4
Rights of Agent An agent has the following rights against
the principal: 1. Right
to receive remuneration (
Secs. 219 and 220). The agent is entitled to receive his agreed remuneration,
or if nothing is agreed, to a reasonable remuneration, unless he agrees to act gratuitously. In the absence of any special contract, the right to claim remuneration arises only when the agent has done what he had undertaken to do.
It is important that the agent can claim remuneration once he has completed his work even though
the contract is never executed on account of breach
either by the principal or the third party.
For example, where
an agent is appointed to secure orders for the manufacturer, he can claim commission on orders actually obtained by him although the manufacturer is unable to execute them
owing to a strike by
the workmen. Effect of misconduct.
An agent
who is guilty of misconduct in the business of
the
agency
is not entitled to any remuneration in respect of that part of the business which he has
misconducted.
In addition, he is liable to compensate the principal for any loss caused by the misconduct. Illustrations (appended to Sec. 220). (
a)
A employs B to recover 1,00,000 rupees from C, and to lay it out on good security.
B recovers
the 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 bad, whereby
A loses 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 he must make good the
loss of 2,000 rupees to A. (b)
A employs B to recover Rs 1,000 from C. Through B's misconduct the money is not recovered (
the debt might have become time-barred because of B's negligence or leniency).
B is entitled to no remuneration for his services and must make good the loss

to A. 14 For further details see Delegation of Authority discussed earlier in this Unit.
Agency 184 Self-Instructional Material NOTES 2.
Right of retainer (Sec. 217).
An agent has
the
right to
retain, out of
any sums received on account of the principal,
all moneys due to himself
in respect of
his remuneration,
or
advances made or expenses properly incurred
by him in conducting
the
business
of agency. 3. Right
of lien (Sec. 221). An agent has the
right
to retain goods, papers and other property, whether movable or immovable, of the principal received by him,
until the
amount due to himself
for commission, disbursements and services in respect of the same
has been paid
or accounted for
to him.
This
right
is, however, subject to a contract to the contrary. Again, this lien of the agent is a “particular lien.” 15
But by a special conract an agent may have a general lien
also. It may be recalled that by virtue of Section 171 factors, bankers, attorneys of High Court and policy brokers have a “ general lien,” 15
in the absence of a contract to the contrary.
It is to be
noted that this
right of lien of the agent is subject to all rights and equities of third parties against the principal, that is, if the agent has sold
the goods, he will have to give delivery to the buyer (London and Joint Stock Bank vs Simmons 16)... 4. Right to be indemnified against consequences of lawful acts. (Sec. 222). An agent has also the
right
to be indemnified
against the consequences
of all lawful acts done by him in exercise of
the authority
conferred upon him.
Illustrations (appended to Sec. 222). (
a)
B, at Singapore, under instructions from A of
Kolkata, contracts with C to deliver certain goods to him. A
does not send the goods to B and C sues B for breach of contract.
B informs A of the suit, and A authorises him to defend the suit. B
defends the suit and is compelled
to pay damages and costs,
and incurs expenses.
A is liable to B for such damages, costs and expenses. (
b)
B,

a broker at Kolkata, 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 costs and incurs expenses.
A is liable to B for such damages, costs and expenses.
It
may be noted that the agent cannot claim indemnity in respect of acts which are apparently unlawful or criminal (Sec. 224). Illustrations (appended
to Sec. 224). (a)
A
employs 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. (
b) B, the proprietor
of a newspaper, publishes, at
A's request, a libel upon C in the paper and A agrees to indemnify
B
against the consequences of the publication and all costs and damages of any action in respect thereof.
B
is sued by C
and has to pay damages and also incurs expenses.
A is not liable to B
upon
the indemnity. 5.
Right
to
be indemnified
against consequences of acts done in good faith (
Sec. 223). An
agent
has a right to be indemnified
against the
consequences of an act
done in good faith though
it turns
out to be injurious to the rights of third persons.
Illustrations (appended to Sec. 223). (
a) A, a decree holder and entitled to execution of B'
s goods, requires the officer of the Court to seize certain goods, representing them to be the goods
of B. The officer seizes the goods,
and is sued by C, the true owner
of the goods. A is liable to indemnify the officer for the sum which he is compelled to pay to C
in consequence of obeying
A's directions. (b)
B, at the request of A,
sells goods in the possession
of
A, but which A had no right to dispose of. B does not know this and hands over the proceeds of the sale to A. Afterwards C, the true owner of the goods, sues B and recovers the value of
the
goods and costs. A is liable to indemnify B for what he has been compelled to pay
to C and for B's own expenses. 15
For further refer Bailment and Pledge. 16 (1892), A.C. 201.

Agency Self-Instructional Material 185 NOTES 6. Right to compensation. (Sec. 225).
The agent has a right to be compensated for injuries sustained
by him
due to the principal's neglect or want of skill.
Illustration (appended to Sec. 225).
A
employs
B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up
and B is
in consequence
hurt. A must make compensation to B. 7.
Right of
stoppage
of goods in transit. An agent has a right to stop the goods in transit to the principal (just like an unpaid seller), if (i) he has
bought goods
either with his own money or by incurring a personal liability for the price and (ii) the principal
has become insolvent. 15.7.5
Rights and
Duties
of
Principal The
duties of an agent are indirectly the rights of a principal and the rights of
an agent
are indirectly the duties of a principal.
The
duties and rights of an agent have already been discussed
in earlier pages. 15.8 PRINCIPAL'S LIABILITY
FOR THE
ACTS
OF
THE AGENT The extent of principal's liability to third parties
for the acts of the agent
is determined by the following rules: 1. When agent acts within the scope of his
actual and apparent
authority.
The
principal is liable for all
acts of the agent
done within the scope of
his '
actual' and 'apparent' (ostensible) authority." 17
The
fact that a particular act of the agent is in excess of his actual authority does not affect the principal's liability and the principal remains liable therefor as usual, provided the act in question is within the scope of the agent's apparent authority and the third party acts bonafide without knowledge of the curtailment.
The principal
is also liable for all such acts of the agent which are
necessary for
protecting the principal from loss in an emergency (Sec. 189). 2. When agent exceeds his actual as well as apparent authority. In this case the principal has option either to disown the unauthorised acts or to ratify the same. Where he ratifies, he becomes
liable for those acts as if he had authorised them originally
but where he opts to disown them, the following rules shall apply: (a) Where the excess is separable from the authorised portion, the principal is liable only for the authorised portion (Sec. 227).
Illustration (to Sec. 227).
A,
being

owner of a ship and cargo, authorises R 18 to procure an insurance
for Rs 4,000 on the ship. B
procures policy for
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. (
If
B had taken only one policy on the ship and the cargo, A would not
have been bound at all). (b)
Where the excess is not separable from the authorised portion,
the principal is not bound by the transaction.
In such a case
the principal is entitled to repudiate the whole transaction and the agent shall be personally liable for that (Sec. 228).
Illustration (to Sec. 228).
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. 3.
Liability for agent's
misrepresentation or fraud (Sec. 238). The principal is liable for misrepresentation made
or fraud committed by the agent acting within the scope of his 17
Sections 186, 226 and 188. For details see Extent of Agent's Authority Discussed earlier in this Unit. 18 B is an insurance broker and broker is a special agent, whereby the third party is under obligation to find his actual authority, B is not A's general agent.
Agency 186 Self-Instructional Material NOTES
actual or apparent authority during the course of the agency business.
For this purpose also the law treats the principal and his agent as one and it is immaterial which of them makes the false statement or commits the fraud. It is to be noted that the only condition of the principal's liability is that the act in question must be done within the course of the agency business and it does not matter whether the agent has done the act for his personal benefit or for the benefit of the principal, or whether the wrongful act was authorised by the principal or not. The principal is not liable for
misrepresentation
made or fraud committed by the
agent in matters which do not fall within
his authority.
Illustration (appended to
Sec. 238). (
a)
A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation,
which he was not authorised by B to make.
The contract is voidable, as between B and C, at the option of C. (
b) A, the captain of B's ship, signs bill of lading without having received on board the goods mentioned therein. The bill of lading is void as between B and the pretended
consignor. 4.
Notice given to agent as notice to principal (Sec. 229).
The principal is bound by the
notice given to or information obtained
by the agent in
the course of the agency business.
Knowledge of the
agent is said to be the knowledge of the principal:
the principal is
said to have constructive notice. But where knowledge is not acquired by the agent in the course of the agency business, it cannot be imputed to the principal.
Illustrations (appended to Sec. 229). (
a)

A is employed by B to buy from C certain goods of which C is the apparent owner.
A buys them accordingly. In the course of the treaty for the sale. A learns that the 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. (b)
A
is employed by B to buy from C certain goods of which C is the apparent owner.
A
was, before he was so employed, a servant of C and then he learnt
that the goods really belonged to D, but B is ignorant of that fact.
In spite of the knowledge of his agent.
B may set off against the price of the goods a debt owing to him from C. (
Notice that in this case
knowledge is not
acquired by the agent in the course of
agency work and hence it does not have the same effect as if it had been given to the principal.) 5. Liability based on the doctrine of estoppel (Sec. 237). Here
the liability of the principal is based on the doctrine of estoppel and not on any real authority. A
principal, who so acts as to make it appear that he has conferred upon his agent authority to make a certain contract, is estopped from disputing the validity of the contract as against a person who dealt for value with the agent in the bonafide belief that the authority had actually been given. Such a
principal is bound by the acts of the agent although the agent did not
in fact possess any authority in relation to those acts. Illustratioon. A,
a merchant, writes to B, a customer, that he has authorised his agent C to see him, and, if possible to come to an amicable settlement. A privately gives instructions to C not to settle for less than a certain amount. C settles the claim with B
for an amount less than the amount authorised by A.
A is bound by the settlement, B being ignorant of A's private instructions to C. 15.8.1
Liability of Unnamed Principal Unnamed principal means a principal whose existence is disclosed by the agent but the name is not disclosed. Once it is disclosed by the agent that he is an agent, the contract made by the agent binds the principal and the agent drops out of the transaction despite the fact that the principal for whom he acted has not been named. On being discovered, the legal position
of the unnamed principal is the same as where the principal is named, unless there is a trade custom making the agent personally liable, e.g., in case of stock exchange transactions jobber can make
a broker personally liable.
If, however,
the agent declines to disclose the identity of the principal, he becomes personally liable
on the contract.
Also if the agent could not disclose the identity of the principal,
say, because of his sudden death,
Agency Self-Instructional Material 187 NOTES his estate will be liable to third parties. In both these cases the agent himself is deemed as a contracting party and therefore he is made liable to the third parties. 15.8.2
Liability of Undisclosed Principal Where an agent, having authority to contract on behalf of another,
makes the contract in his own name (as for he is the principal himself),
concealing
not only the name of his principal but also the fact that there is
a principal,
his principal is called "undisclosed principal".
In such a case
neither the existence nor the name of the principal is disclosed
and the agent
gives an impression to the third party
as if he himself is
the contracting party although the agent has authority in fact and is contracting on behalf of another. In the case of an undisclosed principal, the mutual rights and liabilities of the principal, the agent and the third party are as follows: 1.
Since the agent has contracted

in his own name, he is liable to
the third party
personally. The agent
may be sued on the contract and he has the right to sue the third party, if the
undisclosed principal remains undisclosed. (
Of course
as between the principal and the agent, the agent has every right against the principal.) 2.
If the third party
comes to know the existence of the principal before obtaining judgment against the agent, he
may sue either the principal or the agent or both (
Sec. 233). Illustration (appended to
Sec. 233).
A enters into a contract with B to sell him 100
bales of cotton and afterwards discovers that B was acting as agent
for C.
A may sue either B or C, or both, for the price of
the
cotton.
It may be noted that the liability of the principal and agent is "joint and several" in such a case. If the third party elects to sue the agent and the claim remains partially unsatisfied, he may afterwards sue the principal for the balance (T.R. Chettiar vs M.K. Chettiar 19). Further,
if the third party decides to sue the principal, he
must allow the principal the benefit of all payments received by him from the agent. 3.
The principal, if he likes, may intervene and sue the third party for non-performance of the contract. But he cannot exercise this right to
the prejudice of the third party and the third
party has, as against the principal, the same rights as he would have had as against the agent if the agent had been the principal,
e.g., right of set-off
can be claimed by the third party (Sec. 231, para 1). Further, the principal must
allow to the third party benefits
of all payments made by the third party to
the
agent. "
The
principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract" (
Sec. 232).
Illustration (appended to Sec. 232).
A, who owes Rs 500 to B, sells 1,000 rupees worth of rice to B. A is acting as agent
of
C
in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B
to take the rice without allowing him to set-off
A's debt. 4.
If
the principal discloses himself before the contract is completed, the third party may refuse to fulfil the contract, if he can show that
if he had known who was the principal
in the contract or if he had known that the agent was not a
principal, he would not have entered into the
contract (
Sec. 231, Para 2). 15.8.3
Liability of Pretended Agent
A person untruly representing himself to be the authorised agent of another, and thereby inducing a
third party to deal with him as

such agent,
is liable, if his alleged employer does not
ratify his acts,
to make compensation to the other
party in respect of any loss or 19
A.I.R. (1970), Mad. 337.
Agency 188 Self-Instructional Material NOTES damage which the other party has incurred by so dealing (Sec. 235). In addition, such a pretended agent may also be sued for fraud by the aggrieved party. It must be noted that although the pretended agent is liable to make compensation to the other contracting party, but he has no right to proceed against that party for the performance of the contract (Sec. 236). 15.8.4 Personal Liability of Agent to Third Party It has already been observed that
an agent is appointed to bring the principal into contractual relations with third
parties and
the
acts of the agent are the acts of the principal.
As a
rule, therefore,
an agent cannot personally enforce contracts entered into by him on behalf of
the principal, nor can he
be personally held liable for them, unless there is a contract to the contrary (Sec. 230). The principal is the right person to enforce such contracts and to be held liable therefor. There are, however, certain exceptions to this rule, where
an agent is presumed to be personally liable, unless a contract to the contrary
exists. At the very out set it is worth noting that in certain
cases
where
the agent is personally liable, a person dealing with him may hold either him or his principal
or both of them liable (
Sec. 233).
In other words, the liability of the principal and the agent is 'joint and several' in some cases. Even where the agent is personally liable, the principal is also liable to third parties and hence the saying: "The law which superadds the liability of an agent does not detract from the liability of the principal." The third party dealing with an agent who is personally liable can choose between (a) suing both principal and agent, jointly, (b) electing to sue one of them. It is important that a judgment obtained against one only and remaining unsatisfied is no bar to a second suit against the other party, i.e., if the third party sues the agent and obtains no satisfactions, he may afterwards sue the principal because the liability is 'joint and several' (T.R. Chettiar vs M.K. Chettiar 20).
An agent is presumed to be personally liable, unless a contract to the contrary
exists, in the following cases: 1.
Where the agent expressly agrees. If an agent, while contracting with a third party,
expressly agrees to be personally liable on the
contract, he can be held personally liable
for any breach of contract. 2.
Where
the agent acts for a foreign principal. Where
an agent contracts
for the sale or purchase of goods for a merchant
residing abroad,
he is presumed to be personally liable (
Sec. 230). 3.
Where
the agent
acts for an unnamed principal. Where an agent acts for an unnamed principal, he is personally liable
to the
third party,
if he declines to disclose the identity of the principal
or
if he could not disclose the identity of the principal, say, because of his sudden death. 4.
Where

the agent
acts for an undisclosed principal. Where an agent acts for an undisclosed principal
and contracts in his own name, he is personally liable to the third party. But
if the third party comes to know the existence of the principal, he may hold either the agent or the principal or both of them liable. 5. Where the agent
acts for a principal who cannot be sued. An agent is also
presumed to incur personal liability where he contracts on behalf of a principal who, though disclosed, cannot be sued (Sec. 230). For example, where an agent acts for an ambassador or foreign sovereign, he is personally liable. Similarly, where promoters contract for a projected company, they are held personally liable for that, as the company, being non-existent at the time of the contract, cannot be sued. 20 A.I.R. (1970), Mad. 337.
Agency Self-Instructional Material 189 NOTES 6.
Where the agent exceeds his authority. When an agent acts in excess of his real as well as apparent authority,
and in this way commits a breach of warranty of authority, he will be personally liable to the third party for the excess part, if it can be separated from authorised part, otherwise for the whole transaction (Secs. 227 and 228). 7. Where there is a trade usage or custom. An agent also incurs personal liability where there is a trade usage or custom to that effect. For example, a jobber may hold a broker personally liable as per the custom of trade in a
stock exchange. 8.
Where agent's authority is coupled with interest. Where
the contract with the third party relates to a subject-matter in which the agent has a special interest,
agent is personally liable to the extent of his interest
because he is really a principal for that interest. It should be noticed that in second, third, fifth and sixth cases mentioned above, the third party can hold only the agent personally liable and not the principal. 15.9
TERMINATION OF AGENCY An agency may be terminated in any of
the
following ways: A. By act of
the parties, or B. By operation of law.
We will consider these methods one after another. 15.9.1
A. Termination by Act of the Parties An agency comes to an end by act of the parties in the following cases: 1. Agreement.
An agency, like any other contract, can
be terminated at any time by the
mutual
agreement between the principal and
the agent. 2. Revocation by the principal (
Secs. 203-207). Section 203 empowers
the
principal to
revoke the authority of the agent at any time before the agent
has
exercised his authority so as to bind the principal,
unless the agency is irrevocable. 21
Further,
revocation
may be
expressed or implied
in the conduct of the principal (
Sec. 207). Thus where A empowers B to let A'
s house
and afterwards lets the house
himself, it is an implied revocation of B's authority.
Revocation of authority by the principal is,
however, subject to the following conditions: (i) In the case of a continuous agency, the principal may revoke it for the future.
It cannot be revoked with regard to acts already done in the agency.
Again, before revoking the authority for the future, reasonable notice of the same should be given to the agent and also to third parties. If reasonable
notice is not given, the principal will be liable to compensate the agent for

damages resulting thereby (i.e., for the agent's loss of salary if no immediate job is available), and be bound by the acts of the agent with respect to third parties. (Secs. 204 and 206). (ii) Where an agency has been created for a fixed period and the principal
revokes the authority of the agent before the expiry of the period, without sufficient cause, the principal is bound to pay compensation to the agent for the resulting loss, even if the authority is revoked after reasonable notice. (Sec. 205) 3. Renunciation
by the agent. An agency may also be terminated by an express renunciation by the agent
because a person cannot be compelled to continue as agent against his will. But
he must give a reasonable notice of renunciation to the principal, otherwise
he will be liable to compensate the principal for any
damage resulting thereby (Sec. 206). If the 21 See "Irrevocable Agency" heading in the following pages for the various cases in which an agency is said to be irrevocable.
Agency 190 Self-Instructional Material NOTES
agency is for a fixed period and the agent renounces it without sufficient cause before the expiry of the period, he shall have to compensate the principal
for the resulting loss, if any (Sec. 205). 15.9.2
B.
Termination by Operation of Law An agency comes to an end automatically
by operation of law in
the following cases: 1. Completion of the business of agency. An agency
automatically
comes to an end when the
business of agency is completed (Sec. 201). Thus, for example, an agency for the sale of a particular property terminates on the completion
of the sale. Similarly, where a lawyer is appointed to plead in a suit, his authority comes to an end with the judgement. 2. Expiry of time. If the
agent
is appointed for a fixed term, the expiration of the term puts an end to
the agency, even though the business of the agency may not have been completed. 3. Death of the principal or the agent.
An agency is terminated automatically on the death of the principal or the
agent (
Sec. 201). After coming to know about the principal's death although the agency terminates but the agent must take all reasonable steps for the protection of the interests of the late principal entrusted to him (Sec. 209). 4. Insanity of the principal or the agent. An agency also stands terminated when the principal becomes of an unsound mind (Sec. 201). Here also
it is the duty of an agent to protect the interests of the
former principal by taking all reasonable steps (Sec. 209). Likewise when the agent becomes insane during the agency, his authority terminates at once and the agency comes to an end (Sec. 201). It is interesting to mention that a person of unsound mind can be initially appointed as an agent. 5. Insolvency of the principal. An
agency is also terminated by the insolvency of the principal (Sec. 201). Whether the insolvency of an agent puts an end to the agency
or not is a disputed question, Section 201 is silent on this point. 6.
Destruction of the
subject-matter. An agency which is created to deal with certain subject-matter
will be terminated
by the destruction of
that subject-matter. For example, where the agency was created for the sale of a house and the house is destroyed by fire, the agency ends. 7.
Dissolution of a
company. If the principal or agent is an incorporated company, the agency automatically ceases to exist on dissolution of the company. 8.
Principal or agent becomes alien enemy.
If the
principal and agent are nationals of two different countries and a
war breaks out between the two countries, the contract of agency is terminated.
The outbreak of war renders the continuance of

the principal and agent relationship unlawful because now the principal or agent becomes an alien enemy. 15.9.3 When Termination of Agency Takes Effect As between the principal and the agent, termination of agency is effective only when it becomes known to the agent, and so far as the third
parties are concerned termination of agency takes effect when it is made known to them (Sec. 208). For example, in the case of termination of agency by revocation of agent's
authority, the agency comes to an end as between the principal and the agent not from the moment of posting the letter of revocation, but from the time the agent receives the letter of revocation. Although after receiving the letter of revocation the agent's authority ends but he can still bind the principal towards third parties, if the third parties do not know the fact of the termination of agency. Thus the principal must also give a public notice regarding the
fact of the termination of agency in order to make termination effective vis-a-vis third parties as well. Even when the agency is terminated automatically by the death, insanity or insolvency of the principal, knowledge of
Agency
Self-Instructional Material 191 NOTES the agent is essential for completing termination as between him and the principal; and knowledge of third party is essential for making termination effective as between the third party and principal.
Illustrations (appended
to Sec. 208). (
a)
A directs B to sell goods for him, and agrees to give B
five
per cent commission on the price fetched by the goods. A afterwards, by letter, revokes
B's authority.
B,
after the letter is sent, but before he receives it, sells the goods for Rs 100.
The sale is binding on
A, and B is entitled to
five rupees as his commission. (
b)
A, at Chennai,
by letter, directs B
to sell for him some cotton lying in a warehouse in
Mumbai, and afterwards, by letter, revokes his
authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter but not of the second,
for the sale to him, of the cotton. C pays B the money with which B absconds.
C's payment is good as against
A. (
c)
A directs B, his agent, to pay certain money to C A dies and D takes out probate
of
his 'will'. B, after A's death but before hearing
of it,
pays the money to C. The payment is good as against D, the executor. 15.10
IRREVOCABLE AGENCY When the authority given to an
agent
cannot be revoked,
it is
said to be an irrevocable agency. An agency becomes irrevocable
in the following cases: 1. Where the agency is
coupled with interest (
Sec. 202).
Where the
agent has himself an interest in
the subject-matter of agency, the agency
is said to be coupled with interest.
Such an agency is created with the object of protecting or securing any interest of the agent. So where a creditor is employed for valuable consideration
as an agent to collect rents due to the principal (

debtor) for adjusting the amount towards his debt, the principal thereby confers an interest on the agent and the authority cannot be revoked unilaterally during the subsistence of the interest,
in the absence of an express contract to the contrary.
It is important that the doctrine of agency coupled with interest
applies only, if the authority was intended for the protection of an interest of the agent existing at the time of the creation of the agency and it is
not sufficient that it does so incidentally. It, therefore, cannot
apply where the interest arises after the creation of the agency. It
must also be noted that an agency coupled with interest is not terminated even by the death, insanity or insolvency of the principal. Illustrations (appended to Sec. 202). (
a)
A gives authority to
B to sell A's land and to pay himself, out of the proceeds,
the debts due to him from
A.
A
cannot revoke this authority,
nor can it be terminated by his insanity or death. (
b)
A consigns 1,000 bales of cotton to B,
who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances.
A
cannot revoke this authority, nor is it terminated by his insanity or death. 2.
When
revocation would cause the agent personal loss. Where the agent has, in pursu- ance of his authority, contracted a personal liability, the agency becomes irrevocable and the principal cannot revoke the authority unilaterally. This is so because the principal can- not be permitted to defeat rights already established. Illustrations. (a)
A authorises B to buy 1,000 bales of cotton on account of A,
and to pay for it out of A'
s money remaining in B's hands.
B buys 1,000 bales of cotton in his own name so as to make himself personally liable for
the price.
A cannot revoke B's authority
so far as regards payment for
the cotton. [
Illustration (a)
appended to Section 204]. (b) A gives authority to B to pay A's creditor C and places the necessary money in the hands of B for that purpose. Thereupon B informs C that he has received money in his hands for payment of his debt and that C may collect the same any time from him.
A cannot revoke B's authority to pay to C as B has incurred a personal liability.
Check Your Progress 5. What do you understand by delegation of authority? 6. Who is an sub-agent? 7. Describe the liability of pretended agent. 8. What do you understand by irrevocable agency?
Agency 192 Self-Instructional Material NOTES 3. When
the authority has been partly exercised by the agent (Sec. 204). Where the agent has partly exercised his authority, it becomes irrevocable
so far as regards such acts and obligations as arise from
acts already done in the agency.
Illustration (appended to Sec. 204).
A authorises B to buy 1,000 bales of cotton on account of A,
and to pay for it out of A'
s money remaining in B's hands.
B buys 1,000 bales of cotton in
A's name and
so as not to render himself personally liable for the price. A cannot revoke B's authority
so far as regards buying the cotton
but

can revoke B's authority to pay for the cotton. 15.11
TEST QUESTIONS 1. Define the terms "agent" and "principal". Discuss the general rules of agency. What is the test of agency? Is consideration necessary to create an agency? 2. Who is an agent? How does he differ from a servant? Can a minor (i) appoint an agent. (ii) be appointed an agent? 3. What is a contract of agency? What are the different kinds of agents? 4. Briefly explain the various modes by which an agency may be created. 5. What is agency by ratification? What are the requisites of a valid ratification? 6. Define "actual authority" and "ostensible authority" of an agent and explain the extent of an agent's authority. Can an agent delegate his authority to another? If so, under what circumstances? 7. Who is a sub-agent? What are the consequences of the appointment of
a sub
agent? Distinguish between a sub-agent and a substituted
agent. 8.
Briefly explain the duties of
an agent
towards his principal. What are his rights against the principal? 9. Discuss fully the extent of
principal's liability
to third parties for
the acts of the
agent. 10.
Explain the effect of a contract made by an agent
with a third party
when he acts for (a) an unnamed principal, (b) an undisclosed principal. 11. '
The law which superadds the liability of an agent does not detract from the liability of the principal.' Examine the statement, pointing out the circumstances in which the agent is presumed to be personally liable for the contracts entered into by him on behalf of the principal. 12. Describe briefly
the various modes by which an agency may be terminated. When is
agency irrevocable? 15.12
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1.
A
enters into a contract with B for buying B's motor car as agent
of
C and without C's authority. B repudiates the contract before C comes to know of it. C subsequently ratifies the contract and sues to enforce it.
How would you decide? [Hint. C is entitled to enforce the contract or claim damages. It is a case of agency by ratification, where
the agency comes
into existence from the moment the agent acted and not from the
time when the principal ratified.
Hence B's repudiation of the contract is inoperative. (Bolton vs Lambert)] 2.
A policeman, thinking that the driver of an omnibus was drunk, ordered him to
discontinue driving, the omnibus being then only a quarter of a mile from its destination.
Agency Self-Instructional Material 193 NOTES The driver and the conductor then authorised a person standing nearby to drive the omnibus home. That person drove the omnibus negligently and injured a boy. The boy claims damages from the owners of the omnibus. Are the owners liable? [Hint The owners are not liable to the boy. It is not a case of agency by necessity (which does not arise if the agent can communicate with his principal) because the owners were only a quarter of a mile away and might have been easily communicated with. There was thus no necessity for the driver and conductor to employ another person.] 3.
A enters into a contract with B to sell him 1,000 bales of cotton and afterwards discovers that B was acting as agent
of C.
Advise A as to the person against whom he should bring a suit for the price of the cotton. [Hint.
A may sue either B or
C or both, for the price of the
cotton.
It is a case of undisclosed principal and the liability of the principal and agent is "joint and several" in such a case (Sec. 233).] 4. A employs P as his agent for selling his (A'
s) watch. P
is instructed to sell the watch for not less than
Rs 80. P buys the watch himself and hands over Rs 80 to A,

who is quite satisfied with the price and does not ask the name of
the buyer. A
discovers the identity of the buyer a few weeks later after
P has resold the watch for Rs 100. Can A claim Rs 20 from P? [Hint. No. A cannot claim Rs 20 from P. According to Sections 215 and 216 of the Contract Act, if the dealings of the agent have not been disadvantageous to the principal, he cannot claim the profit made on subsequent sale by the agent, even though the agent dealt on his own account without first obtaining the consent of the principal.) 5. An agent, authorised by a power of attorney to operate a business but not to borrow money, asked for a loan on a representation that he is authorised to borrow and produced the power of attorney for the perusal of the lender. But the lender did not read it and advanced a loan. Is the principal bound by the loan? [Hint. No, the principal is not bound by the loan because the borrowing by the agent, in the instant case, does not come within his ostensible authority. As the power of attorney was produced for the perusal of the lender, he had constructive notice that the agent had no power to borrow, and therefore he is bound by the restriction on the agent's ostensible authority and cannot recover the loan from the principal (Jacobs vs Morris, 1902, I Ch. 816).] 6.
A, who owes B Rs 10,000, appoints B as his agent to sell his landed property at Delhi and after paying himself (B) what is due to him, to
hand over the balance to A. Can A revoke his authority delegated to B? [
Hint. No, A cannot revoke the authority delegated to B. The doctrine of agency coupled with interest
applies in the instant case.]
Contract of Sale of Goods Self-Instructional Material 195 NOTES UNIT 16 CONTRACT OF
SALE OF GOODS Structure 16.0 Introduction 16.1 Unit objectives 16.2

Test Questions 16.8 Practical Problems 16.0
INTRODUCTION
The law relating to sale of goods is contained in the
Sale of Goods Act, 1930, 1
which came into force on 1
st July, 1930. The Act contains sixty-six
Sections and
extends to the
whole of India except the State of Jammu and
Kashmir.
A few minor amendments in the Act were made by
Sale of Goods (Amendment) Act, 1963.
The general provisions of the Indian Contract Act continue to
be applicable
to the contract of
sale of goods
in so far as they are
not inconsistent with the express provisions of Sale of Goods Act (
Sec. 3). Thus, for example,
the provisions of the Contract Act relating to capacity of the parties, free consent, agreements in restraint of trade, wagering agreements and measure of damages continue to be applicable to a contract of sale of goods. But the definition of consideration stands modified to the extent that in a contract of sale of goods consideration must be by way of 'price,' i.e., only money consideration [Secs. 2(10) and 4].
A contract of sale of goods results, like any other contract, by
an
offer by one party and its acceptance by the other.
Thus,
it
is a consensual transaction.
The parties to the contract enjoy unfettered discretion to agree to any terms they like
relating to delivery and payment of price, etc. The Sale

of Goods Act does not seek to fetter this discretion. It simply lays down certain positive rules of general application for those cases where the parties have failed to contemplate expressly for contingencies which may interrupt the smooth performance of a contract of sale, such as the destruction of the
thing sold, before it is delivered or the insolvency of the buyer, etc.
The
Act leaves the parties free to modify the provisions of the law by express stipulations. 16.1
UNIT OBJECTIVES ? Know the essentials of a contract of sale of goods ?
Understand how 'sale' differs from 'agreement to sell' ? Know how hire-purchase differs from an agreement to sell ?
Know the effects of
perishing of goods at or before making of the contract ?
Be familiar about the various modes of fixing price and about the concept of earnest or deposit 1 Throughout Units 16–20, which deals with the Law of Sale of Goods, the references to Sections, unless otherwise specifically stated, are references to Sections
of
the
Sale of Goods Act, 1930. The word 'Act' wherever used means
the
Sale of Goods Act, 1930.
Contract of Sale of Goods 196
Self-Instructional Material NOTES 16.2 DEFINITION
AND ESSENTIALS
OF
A
CONTRACT OF SALE
Section 4(1)
of the
Sale of Goods Act
defines
a
contract of sale of goods
as—"a contract whereby the seller transfers or agrees to transfer the property in goods to
the buyer for a price."
This definition
reveals the following
essential characteristics of a contract of sale of goods: 1. Two parties. The first essential is that there must be two distinct parties to a contract of sale, viz., a buyer and a seller, as a person cannot buy his own goods. Thus, for example, when students of a hostel take meals with a mess run by themselves on cooperative lines, there is no contract of sale. The students are 'undivided joint owners' of the meals they are consuming. As a matter of fact every member of the mess is consuming his own goods on the basis of understanding that he must restore to the mess what he consumed so that the mess continue to provide meals for its members. An 'undivided joint owner' must
be distinguished from a 'part-owner' who is a joint owner with divisible share.
According to Section 4(1),
there may be a contract of sale between one part-owner and another,
e.g., if
A and B jointly own a typewriter, A may sell his ownership in the typewriter to B, thereby making B sole owner of the goods. Similarly, a partner may buy
the
goods from the firm in which he is a partner
and vice-versa. There is,
however, one exceptional case when a person may buy his own goods.
Where a person's goods
are sold in execution of a decree, he may himself buy
them,
so as to save them from a transfer of ownership to some one else (Moore vs Singer Manufacturing Co. 2). 2. Transfer of property. 'Property' here means 'ownership'. Transfer of property in
the
goods is another essential of a contract of sale of goods.

A mere transfer of possession of the goods cannot be termed as sale.
To constitute
a contract of sale
the seller must either
transfer or agree to transfer
the property in the goods to the buyer.
Further,
the term 'property,'
as used, in the
Sale of Goods Act,
means 'general property' in goods as distinguished from 'special property' [
Sec. 2(11)]. If P who owns certain goods pledges them to R, he has general property in the goods, whereas R (the Pawnee) has special property or interest in the goods to the extent of the amount of advance he has made to the pawnor. Similarly, in the case of bailment of goods for the purpose of repair, the bailee has special interest in goods bailed to the extent of his labour charges. 3.
Goods.
The subject-matter of the
contract of sale must be '
goods',
According to
Section 2(7), "
goods means
every kind of movable property other than actionable claims
and money;
and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale."
Thus every kind of movable property except actionable claim and money
is
regarded as 'goods'.
Goodwill, trade marks, copyrights, patents right, water, gas, electricity, 3 decree of a court of law 4 are all regarded as goods.
Shares and stock are also included in goods. With regard to
growing
crops, grass and things attached to or forming part of the land,
such things are regarded as goods
as soon as they are agreed to be separated from the land. Thus where trees were sold so
that
they could be cut out and separated from the land and then taken away by
the
buyer, it was held that there was a contract for sale of movable property or
goods (Kursell vs Timber Operators & Contractors Ltd. 5).
But contracts for sale of things 'forming part of the land itself' are not contracts for sale of goods. For example, a contract for the sale of coal mine or building-stone quarry is not a contract of sale
of goods. 2 (1904), 1 K.B. 820 (C.A.). 3 Rash Behari vs Emperor, A.I.R. (1936), Cal. 753. 4 Vithaldas vs Jagjivan, A.I.R. (1939), Bom. 84. 5 (1927), 1 K.B. 298.
Contract of Sale of Goods Self-Instructional Material 197 NOTES '
Actionable claims' means claims
which .can be enforced by a legal action
or a suit,
e.g., a book debt (i.
e., a debt evidenced by an entry by the creditor in his Account Book
or Bahi).
A book debt is not goods because it can only be assigned as per the Transfer of Property Act but cannot be sold.
Similarly, a bill
of
exchange or

a promissory note represents a debt, i.e., an actionable claim and implies the right of the creditor to recover its amount from the debtor.
But since these can be transferred under Negotiable Instruments Act by mere
deliv- ery or
indorsement and delivery, such instruments cannot be sold. 'Money' means current money. It is not regarded
goods
because it is the medium of exchange through which goods can be bought. Old and rare coins, however, may be treated as goods and sold as such. It may be
mentioned that
sale of immovable property is governed by the Transfer of Property Act, 1882. 4.
Price. The consideration for a contract of sale
must be money consideration called the 'price.' If goods are sold or exchanged for other goods, the transaction is barter, governed by the Transfer of Property Act and not a sale of goods under this Act. But if goods are sold partly for goods and partly for money, the contract is one
of sale (Aldridge vs Johnson 6). 5. Includes both a 'sale' and 'an agreement to sell.'
The term '
contract of sale'
is a generic term and
includes both
a 'sale' and
an 'agreement to sell' [
as is clear from the definition
of the term as per Section 4(1) given earlier].
Sale.
Where under
a contract of sale the property in the goods
is immediately transferred at the
time of making the contract
from the seller to the buyer, 7 the contract is called a 'sale' [
Sec. 4(3)]. It refers to an 'absolute sale', e.g., an outright sale on a counter in a shop. There is immediate conveyance of the ownership arid mostly of the subject-matter of the sale as well (delivery may also be given in future). It is an executed contract.
An agreement to sell.
Where under a contract of
sale
the
transfer of property in the
goods is to take place
at a future time or subject to some condition thereafter to be fulfilled,
the contract is called 'an agreement to
sell' [
Sec. 4(3)]. It is an
executory contract and refers to a conditional sale. Illustrations. (a)
On 1 January, A agrees with B that he will sell B his scooter
on 15 January for a sum of Rs 3,000. It is an agreement to sell, since
A agrees to transfer the ownership of the scooter to B at a future time. (
b) A agrees to purchase B's car for Rs 50,000 provided B stands surety for him with C. It is an agreement to sell for B. It becomes a sale when the condition is fulfilled by B. (c) B agrees to buy A'
s car for Rs 30,000 and pay for it, if his solicitor approves. It is an agreement to sell
for A and an agreement to buy for B. (d) A buys some furniture for Rs 2,000 and agrees to pay for that in two monthly instalments,
the ownership to pass to him on the payment of
second instalment. There is an agreement to sell for the furniture dealer. '
An
agreement to sell' becomes a 'sale' when the time elapses
or the conditions are fulfilled
subject to

which
the
property in
the goods is to be
transferred [
Sec. 4 (4)]. 6.
No formalities to be observed (Sec. 5). The Sale of Goods Act does not prescribe any particular form to constitute a valid contract of sale. A contract of sale of goods can be made by mere offer
and acceptance. The offer may be made either by the seller or the buyer and the same must be accepted by the other. Neither payment nor delivery is
necessary at the time of making the contract of sale.
Further, such
a contract may be made either orally or in writing or partly orally and partly in writing or may be even implied from the 6 (1857), 7
E. & B. 885. 7 The rules regarding 'transfer of property from seller to buyer' form the subject-matter of C— Transfer of Property.
Contract of Sale of Goods 198 Self-Instructional Material NOTES conduct of the parties. Where articles are exhibited for sale and a customer picks up one and the sales assistant packs the same for him, there has resulted a contract of sale of goods by
the conduct of the parties. 16.2.1 'Sale' and 'Agreement to Sell' Distinguished
The following are the
main points of distinction between a 'sale' and 'an agreement to sell': 1.
Transfer of property (ownership).
In a '
sale'
the
property in goods passes to the buyer immediately
at the time of
making the contract.
In
other words, a sale implies immediate conveyance of property so that
the seller ceases to be the owner of the goods
and the buyer
becomes the owner thereof. It creates
a
jus in rem, i.e., gives right to the buyer to enjoy goods as against the whole world.
In 'an agreement to sell'
there is no transfer of property to the buyer
at the time of the contract.
The conveyance of property takes place later so that the seller continues to be the owner until the agreement to sell becomes a sale
either by the expiry of certain time or the fulfilment of
some condition. Thus where A agrees to buy 50 kg wheat from B and the wheat is yet to be weighed, the transaction is an agreement to sell because as per Section 22,
in such a case the property does not pass to the buyer till the
goods are weighed
and the
buyer has notice thereof. The transaction becomes a sale and
the property in the goods passes to the buyer
after the wheat is
weighed and
the buyer has notice thereof. An agreement to sell creates a jus in personam, that is, it
gives a right to either buyer or seller against the other for any default in fulfilling his part of the agreement.
It is worth noting that this is the basic point of distinction between a 'sale' and 'an
agreement to sell.' All other points of distinction follow from this basic difference, i.e., whether the property in the goods has passed or is yet to pass from seller to buyer. 2. Risk of loss. The general rule is that unless otherwise agreed, the risk of loss prima facie passes with property (Sec. 26). Thus in case

of
sale, if the goods are destroyed the loss falls on the buyer
even though the goods
may never have come into his possession because
the property in
the
goods
has already passed to
the buyer.
On the
other hand,
in case of
an
agreement to sell
where
the ownership in the goods is yet to pass from the seller to the buyer,
such loss has to
be borne by
the seller
even though the goods are in the possession of the
buyer. 3.
Consequences of
breach. In case of
sale, if
the buyer
wrongfully
neglects or
refuses to
pay the price of the goods,
the seller
can sue for
the price,
even though the goods
are still in his possession.
In
case of
an agreement to sell, if the buyer
breaks his promise,
the seller
can only sue for damages and not for
the
price, even
though the goods
are in the possession of buyer
in the possession
of
buyer. 4. Right of
resale.
In a sale, the
property is with the buyer and as such
the seller (
in possession of goods after sale)
cannot resell the goods.
If he does so,
the subsequent buyer having knowledge of the previous sale does not acquire a title to the goods. The original buyer can sue and recover the goods from the third

person as owner, and can also sue the seller for the breach of contract as well as for the tort of conversion. The right to recover the goods from the third person is, however, lost if the subsequent buyer had bought them bonafide without notice of the previous sale (Sec. 30).
In
an agreement to sell, the property in the goods remains with the seller and as such
he can dispose of the goods as he likes
and the
original buyer can sue him for the breach of contract only. In this case,
the subsequent buyer gets a good title to the goods,
irrespective of his knowledge of previous sale. Further, goods forming the subject-matter of an agreement to sell can also be attached in execution of a decree of a court of law against the seller. 5.
Insolvency of
buyer before he pays for the goods.
In a sale, if
the buyer
is adjudged insolvent before he pays for the goods,
the seller,
in the absence of a 'right of lien' over the
Contract of Sale of Goods Self-Instructional Material 199 NOTES goods,
must
deliver the goods to the Official Receiver or Assignee. The
seller
is entitled only to a rateable dividend
for the price
of the goods. But in
an agreement to sell,
in these circumstances,
the seller
may refuse to deliver the goods to the Official Receiver or
Assignee
unless
paid for, as ownership has not passed to the buyer. 6.
Insolvency of
seller
if the buyer has already paid
the price.
In
a sale, if the
seller is adjudged
insolvent, the buyer is entitled
to
recover the goods from the
Official Receiver
or
Assignee,
as the property
in the goods rests with the buyer.
On the other hand,
in an agreement to sell,
if the
buyer
has already
paid the price and
the seller is adjudged insolvent,
the buyer can only claim a rateable dividend (
as
a

creditor) and not the goods because property in them still rests with the seller. 16.2.2 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 goods are delivered to the hire-purchaser for his use at the time of the agreement but the owner of the goods agrees to transfer the property in the goods to the hire purchaser only when a certain fixed number of instalments of price are paid by the hirer. Till that time, the hirer remains the bailee and the instalments paid by him are regarded as the hire-charges for the use of the goods. If there is a 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 received till then, 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.

It may be noted that mere payment of price by instalments under an agreement does not necessarily make it a hire-purchase, but it may be a sale. For example, in the case of "Instalment Purchase Method," there is a 'sale,' because in this case the buyer is bound to buy with no option to return and the property in goods passes to the buyer at once. 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 likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments. 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 an 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 leviable until it eventually ripens into a sale (
K.L. Johar & Co. vs Dy. Commercial Tax Officer 8). 8
A.I.R. (1965), S.C. 1082.
Contract of Sale of Goods 200 Self-Instructional Material NOTES
Hire-purchase and an agreement to sell. A contract of hire-purchase may also be distinguished from "an agreement to sell" (or "an agreement to buy" from buyer's point of view). As already observed, a
hire-purchase agreement
initially is merely an irrevocable offer for sale, that is, under it the owner
is
bound to sell the goods later if the hirer pays all the instalments as agreed, but on the part of the hire purchaser there is an option to buy or to return the goods and the hirer cannot be compelled to buy. 'An agreement to buy', on the other hand, imports a legal obligation to buy and therefore there is no option available to
the
buyer to buy or to terminate the contract in this case. Again, in a hire-purchase agreement, delivery of goods to the hire-purchaser is necessary whereas it is not so in an '
agreement to sell.' 16.2.3 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 property in the goods is 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 the 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 labour and not of sale. In fact, the difference between the two is very minute. Illustrations. (a) A dentist agreed to make a set of false teeth for a lady and fit it into her mouth. Held, it is a contract for the
sale of goods (Lee vs Griffin 9). (b) An order for
making and fixing curtains in a house is a contract of sale of goods, though it involves some work and labour in fixing the same (Love vs Norman Wright (Builders) Ltd. 10). (
c) G engaged an artist to paint a portrait and supplied
the necessary canvas
and paint. Held, it is
a contract for work and labour as the
substance
of the contract is the application of the skill and labour in the production of the portrait (
Robinson vs Graves 11). If the canvas and paint are also to be supplied by the painter, it will become a contract of sale of goods. (d) A contract to take and supply photographs
has been held to be
a contract of sale of goods (
Newman vs Lipnzan 12). 16.3 KINDS
OF GOODS '
Goods' form
the subject-matter of
a contract of sale.
We have already seen the meaning of the term 'goods'
as per Section 2(7).
Goods may be classified into the following types: 1. Existing goods; 2. Future goods;
and 3.
Contingent goods. 1. Existing goods. Goods which are physically in existence
and which are in seller's ownership and/or possession,
at the time of entering the contract of sale are called 'existing goods.'
Where seller is the owner,
he has the general property in them. Where seller is in possession, say, as an agent
or
a pledgee,
he has a right to sell them. Existing

goods may again
be either ‘specific’ or ‘unascertained.’ (a)
Specific goods. Goods identified and agreed upon at the
time
of
the making of the
contract
of sale are
called ‘specific goods’ [
Sec. 2(14)]. It
may be noted that in actual 9 (1861), 1
B. & S. 272. 10 (1944), All. E.R. 618. 11 (1935), 1 K.B. 579. 12 (1951), 1 K.B. 333.
Contract of Sale of Goods Self-Instructional Material 201 NOTES
practice the term ‘ascertained goods’ is used
in the same sense as ‘
specific goods.’
For example, where A agrees to sell
to B a
particular
radio bearing a distinctive number, there is a contract of sale of specific or
ascertained goods. (b) Unascertained goods.
The
goods which are not separately identified
or
ascertained at the time of
the making of
the contract are known as ‘unascertained goods.’
They are indicated or defined only
by description. For example, If
A
agrees to
sell to B one bag of sugar out of the lot of one hundred bags
lying
in
his godown,
it is a sale of unascertained goods because
it is not known which
bag is to
be delivered.
As soon as a particular bag is separated from the
lot
for delivery, it
becomes ascertained or specific goods. The distinction between ‘specific’ or ‘ascertained’ and ‘unascertained’ goods is important in connection with the rules regarding ‘transfer of property’ from the seller to the buyer.
These rules will be discussed later in Chapter 18—Transfer
of Property. 2.
Future goods. Goods
to be
manufactured, produced or acquired by the seller after
the making of
the contract of sale
are called ‘future goods’ [
Sec. 2(6)]. These goods may be either not yet in existence or
be in existence but not yet acquired by the seller.
It is worth noting that there can be no present sale
of
future goods because property cannot pass in what

is not owned by the seller at the time of the contract.
So even if the parties purport
to effect a present
sale of
future goods, in law it operates only as an 'agreement to sell' [
Sec. 6(3)]. Illustrations. (a) A agrees
to
sell to B all the milk that his cow may yield during
the coming year. This is
a contract for the
sale of future goods. (
b) X agrees to sell
to F all the mangoes which will be produced in his garden next
year. It is
contract of
sale of future goods, amounting
to 'an agreement to sell.' (
c) P contracts on 1 January, 1990, to sell to B ten bales of Egyptian cotton to be delivered and paid for on 1 March, 1990.
This is a valid contract of sale, amounting to 'an agreement to sell,' even though P has no cotton bales with him
at the time of making the contract. 3.
Contingent goods.
Goods, the acquisition of which by the seller depends upon
an uncertain contingency are called 'contingent goods' [
Sec. 6(2)]. Obviously they are a type of future goods and therefore a
contract for
the
sale of contingent goods also operates as 'an agreement to sell' and not a '
sale'
so far as the question of passing of property to the buyer is concerned. In other words, like the future goods,
in the case of contingent goods also
the property does
not pass
to the buyer at the time of making the contract.
It
is important to note that a contract of
sale of contingent goods is enforceable only if the event on the happening of which the performance of the contract is
dependent happens, otherwise the contract becomes void.
Illustrations. (a)
A agrees to sell to B a specific rare painting provided he is able
to
purchase it from
its present owner. This is
a contract for the sale of contingent goods. (
b)
X agrees to sell to Y 25 bales of Egyptian cotton,
provided the ship which is bringing them reaches the port safely.
It is a contract for
the
sale of contingent goods. If the ship
is sunk,
the contract becomes void
and the seller is not liable. 16.3.1 Effect of Perishing of Goods Sections 7 and 8 deal with
the effect of perishing of goods on
the rights and obligations
of the
parties
to a contract of sale.

Under these Sections the 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 such has been lost (although they are not physically destroyed), e.g., where cement is spoiled by water and becomes almost stone or where sugar becomes sharbat and thus are unsaleable as cement or sugar;
Contract of Sale of Goods 202 Self-Instructional Material NOTES (
b) loss of goods by theft (Barrow Ltd. vs Phillips Ltd 13) (c) where the goods have been lawfully requisitioned by the government (
Re Shipton, vs Anderson & Co. 14).
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 form 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.
Thus where
A agrees to sell to B ten bales of Egyptian cotton out of 100 bales lying in his godown
and the bales in the godown are completely destroyed by fire, the contract does not become void. A must supply ten bales of cotton after purchasing them from the market or pay damages for the breach.
The effect of perishing of goods may be discussed under the following heads: 1.
Perishing of
specific
goods at or before making of the contract (Sec. 7). This may again be divided into
the following sub-heads: (i) In case of perishing of the ‘whole’ of the goods. Where specific
goods form 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 the contract, the agreement 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. Illustrations. (a) A sold
to B a specific cargo of goods supposed to be on its way from England to Mumbai. It turned out, however, that before the day of the bargain, the ship conveying the cargo had been cast away
and
the goods
were lost. Neither
party was aware of
the fact. The agreement
was held to be void (Hastie vs Conturier 15). (
b)
A agrees to sell
to B a certain
horse.
It turns out that the horse was dead at the time of
bargain, though neither party
was aware of the fact. The agreement is void. (
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 are destroyed or damaged,
the effect of perishing
will depend upon whether the contract is entire or divisible. If it is
entire (i.e., indivisible) and part only of the goods has perished,
the contract 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.
Illustrations. There was a contract for the sale of
a parcel containing 700 bags of Chinese groundnuts of different qualities. Unknown to the seller 109 bass had been stolen

at the time of the contract. The seller delivered the remaining 591 bags and, on the buyer's refusal to take them, brought an action for the price. It was held that the contract,
being
indivisible,
had become void by reason of the loss of the goods and the buyer was not bound to take delivery of 591 bags or pay for the goods (Barrow Ltd. vs Philips Ltd 16). (Note that had there been all bags of the same weight and quality for certain price per bag, the contract would have been divisible and the buyer could only have avoided the contract as to those goods which had actually perished). 2.
Perishing of
specific
goods before sale but
after agreement to sell (Sec. 8).
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 13 (1929), 1 K.B. 574. 14 (1915), 3 K.B. 676. 15 (1853), 5 H.L. Cas. 673 16 (1929), 1 K.B. 574.
Contract of Sale of Goods Self-Instructional Material 203 NOTES
impossibility of performance which makes a contract void. Notice that under Section 7 the agreement is void ab-initio while under this Section the contract becomes void later. 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 (i.e.,
the contract remains valid as regards the part available in good condition).
It must further be noted that 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, as the case may be (Sec. 26). Again, if the risk has passed to the buyer, he must pay for the goods, though undelivered [unless otherwise agreed... risk prima facie passes with the
property (Sec. 26)]. Illustrations. (
a)
A buyer took
a horse on a trial for 8 days on condition that if
found suitable for his purpose the bargain would become absolute.
The
horse died on the 3rd day without any fault of either
party.
Held, the contract, which was in the form of an agreement to sell, becomes void and the seller should bear the loss (Elphick
vs Karnes l7). (b) A, had contracted to erect machinery on M's premises, the price was to be paid on completion. During the course of the work, there was a fire which com-pletely destroyed the premises and the machinery. It was held that both parties were excused from further performance and A was not entitled to any payment as the price was payable on the completion of entire work (Appleby vs Myers. 18).
Effect of perishing of future goods. As observed earlier,
a present sale
of
future goods
always operates as an agreement to sell [
Sec. 6(3)]. As such there arises a question as to whether Section 8 applies to
a contract of
sale
of future goods (amounting to an agreement to sell)
as well? The answer is found in the leading case of Howeil vs Coupland, 19 where it has been held
that

future goods, if sufficiently identified, are to be treated as specific goods, the destruction of which makes the contract void. The facts of the case are as follows: Illustration. 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 fault on his part, a disease attacked the crop and he could deliver only about ten tons. The contract was held to have become void. 16.4 THE PRICE The money consideration for a sale of goods is known as 'price' [Sec. 2(10)]. We have already seen that the price is an essential element in every contract of sale of goods, that is, no valid sale can take place without a price. The price should be paid or promised to be paid in legal tender money, unless otherwise agreed. It may be paid in the form of a cheque, hundi, bank deposit etc. For, it is not the mode of payment of a price but the agreement to pay a price in money that is requisite to constitute a valid contract of sale. Modes of fixing the price. According to Section 9 the price may be fixed by one or the other of the following modes: 1. It may be expressly fixed by the contract itself. This is the most usual mode of fixing the price. The parties are free to fix any price they like and the court will not question as to the adequacy of price. But the sum should be definite. Where an alternative price is fixed, the agreement is void ab-initio as it involves an element of wager (Bourke vs Short 20). Thus, where A agrees to sell his cow to B for Rs. 5,000 if the cow gives 10 kg milk every day but for Rs. 100 only if it fails to do so, there is a wagering agreement void ab-initio. 17 (1880), 5 C.P.D. 321. 18 (1867), L.R. 2 C.P. 651. 19 (1876), 1 Q.B.D. 258. 20 (1856), 5 El. & Bl. 904. Contract of Sale of Goods 204 Self-Instructional Material NOTES 2. It may be fixed in accordance with an agreed manner provided by the contract. For example, it may be agreed that the buyer would pay the market price prevailing on a particular date, or that the price is to be fixed by a third party (i.e., valuer) appointed by the consent of the parties. But in the following cases where the agreement of the parties as to price is uncertain, price is deemed as 'not capable of being fixed' and hence the agreement is void ab-initio for uncertainty: (a) if the price is agreed to be whatever sum the seller be offered by any third party; or (b) if the price is left to be fixed by one of the contracting parties, expressly. Remember that if no price is fixed then the contract is not void for uncertainty because in that case law usually allows market price prevailing on the date of the supply of goods as the price bargained for. 3. It may be determined by the course of dealings between the parties. For example, if the

buyer has been previously paying to a particular seller the price prevailing on the date of placing the order, the course of dealings suggest that in subsequent transactions also the
price as on the date of order will be paid. 4.
If the price is not capable of being determined
in accordance with any of the above modes, the buyer is bound to
pay
to the seller
a 'reasonable price.'
What is a reasonable price is a question of fact
dependent on the circumstances of
each particular case.
Ordinarily, the market price
of the goods prevailing on the date of supply is taken as
reasonable price.
Agreement to sell at valuation (Sec. 10).
Where there is an agreement to sell goods on the terms that the
price is
to
be fixed by the valuation of a third party and such third party
fails to fix the price (either because he cannot value or because he does not want to value), the contract becomes void, except as to part of goods delivered and accepted, if any, under the contract, as regards which the buyer is bound to pay a reasonable price. If, however, any one
of the two parties, namely, the seller
or the buyer, prevents
the
third party from making the valuation, the innocent party may maintain a suit for damages against the party in fault.
Notice that although in this case also the contract becomes void, yet
the
party at fault is bound to compensate the other party for the actual loss suffered by him because of the act of prevention.
It is to be remembered that
unless otherwise agreed, payment of the price and delivery of the goods are concurrent conditions (
Sec. 32). Again, Section 64-A, which provides for "Escalation Clause,"
is
important. As per Section 64-A, unless otherwise agreed, where, after making of the contract and fixing the price but before the delivery of the goods, a new or increased custom or excise duty or sale or purchase tax is imposed and the seller has to pay it, the seller is entitled to add the same to the price. Conversely, if the rate of duty or tax is lowered,
the
buyer would be entitled to a reduction in price. 16.5 EARNEST OR DEPOSIT Money deposited with the seller by the buyer as security for due fulfilment of the contract is called 'earnest' or 'deposit'. Where
the contract is carried through, earnest money counts as part payment and only the balance of the
price is required to be paid. But if the contract goes off because
of
the
fault of the buyer, the seller is entitled to forfeit it and where it falls through because of the default of the seller, the buyer is entitled to recover the
earnest money in addition to damages for breach. If on the breach of the agreement by the buyer, the seller sues him for the breach, the earnest, although forfeited, is
to
be taken into account as diminishing the amount of damages (
Jaganadhayya vs Ramanatha 21). 21 A.I.R. (1955), Orissa 11. Check Your Progress 1. Explain a contract of sale of goods. 2. A mere transfer of posses- sion of the goods cannot be termed as sale. Elucidate. 3. Differentiate sale and an agreement to sell. 4. What are the various modes of fixing of price? 5. What is a document of title to goods?
Contract of Sale of Goods Self-Instructional Material 205 NOTES 16.5.1
Stipulations as to Time Stipulations as to time in a contract of sale
fall under the following two heads: 1. Stipulation relating to time of delivery of goods. 2. Stipulation relating to time of payment of the price. As regards the time fixed for the delivery of goods, time is usually held '

to be
of
the essence of the contract.' Thus if time is fixed for the delivery of goods
and the seller makes a delay, the contract is voidable at the option of the buyer. In case of late delivery, therefore, the buyer may refuse to accept the delivery and may put an end to
the contract. As regards the
time fixed for the payment of the price, the general rule is that 'time is not deemed to be
of
the essence of the contract,'
unless a different intention appears from the
terms of the contract (
Sec. 11). Thus even if the price is not paid as agreed, the seller cannot avoid the contract on that account. He has to deliver the goods if the buyer tenders the price within reasonable time before resale of the goods. The seller may, however, claim compensation for the loss occasioned to him by the buyer's failure to pay on the appointed day. 16.6
DOCUMENT OF TITLE TO GOODS Any document which
is
used in the ordinary course of business
as proof of the possession or control of goods,
or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of
the document to transfer or receive goods thereby represented
is a
document of title to goods [Sec. 2(4)]. Thus a
document of title is a proof of the ownership of the goods. It authorises its holder to receive goods mentioned therein
or to
further
transfer such right to another person by proper endorsement
or delivery. A document
of title to goods
contains an undertaking on the part of the issuing authority to deliver the goods to the holder thereof unconditionally. Although
such a document
can be transferred by mere delivery
or
by endorsement, yet it is regarded as 'quasi negotiable instrument' because the title of
the
transferee (
even if bonafide)
will not be superior to that of the transferor in the case of transfer of such
document.
Bill of lading, dock-warrant, warehouse keeper's certificate, wharfinger's certificate,
railway receipt,
delivery order, etc.,
are popular examples of the documents of title to goods. 16.7
TEST QUESTIONS 1.
What is a

term 'sale' and 'agreement to sell'
and distinguish between the two. Give
examples. 3. (a) 'The contract of sale is consensual and bilateral.' Elucidate. (b) Distinguish between 'sale' and 'agreement to sell'. 4. How would you distinguish between (a) a sale and hire-purchase, and (b) a sale and a contract for work and labour. 5.
Define the term 'goods'. What are the different types of goods? 6.

What is the meaning of 'perishing' of goods under the Sale of Goods Act? What is the effect of perishing of goods on a contract of sale? 7. Define the term 'price.' What are the various modes of fixing the price in a contract of sale? When is price deemed as not capable of being fixed? 8. Write notes on: (a) Earnest money, and (b) Document of title to goods.

Contract of Sale of Goods 206 Self-Instructional Material NOTES 16.8

PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A dealer in radios gives a 'Murphy' radio to a customer on the terms that Rs 100 should be paid by him immediately and Rs 200 more in two monthly equal instalments. It was further agreed that if the radio is found defective the customer may return it within a week but not later. The customer makes default in paying the last instalment. Can the radio dealer take back the ratio on his default? [Hint. No, the radio dealer cannot take back the radio on default by the customer because it is a contract of sale and not of hire-purchase.] 2. A agrees to sell to B 10 bags of wheat Kalyan (superior) out of 100 bags lying in his godown for Rs 6,500. The wheat is completely destroyed by fire. Can B compel A to supply the wheat as per agreement? [Hint. Yes, B can compel A, because the goods forming the subject-matter of the contract in question are unascertained goods, the perishing of which does not affect the contract. A must supply the wheat from elsewhere or pay damages for the breach.) 3. P agrees to sell to Q his two motor cars on the terms that the price was to be Fixed by R, Q takes the delivery of one car immediately, R refuses to oblige P and Q and fixes no price, P asks for the return of the car already delivered whereas Q insists on the delivery of the second car to him for a reasonable price of both the cars. Decide the case. [Hint. The case is governed by Section 10 which provides that if the third party refuses to fix the price, the contract becomes void except as to part of goods delivered and accepted as regards which the buyer must pay a reasonable price. Thus as regards the car already delivered, P cannot ask for its return and must accept a reasonable price for that. As regards the second car, Q cannot insist on its delivery to him since the contract has become void.]

MODULE - 5

Conditions and Warranties Self-Instructional Material 209 NOTES UNIT 17 CONDITIONS AND WARRANTIES Structure 17.0 Introduction 17.1 Unit Objectives 17.2

Test Questions 17.8 Practical Problems 17.0 INTRODUCTION

A contract of sale of goods contains various terms or stipulations regarding the quality of the goods, the price and the mode of its payment, the delivery of goods and its time and place. But all

of them are not of equal importance. Some of these stipulations may be major terms which go to the very root of the contract and their breach may frustrate the very purpose of the contract, while others may be minor terms which are not so vital that their breach may seem to be a breach of the contract as such. In law of sales major terms are called 'conditions' and minor terms are called 'warranties'. From terms of the contract it is necessary to distinguish mere statements of commendation or praise or expressions of opinion made by the seller in reference to his goods. Such commendatory statements are neither 'conditions' nor 'warranties'. They do not form a part of the contract and as a result give no right of action. For example, where a horse dealer, while praising his horse, states that the horse is very lucky and one whosoever shall purchase it must very soon become a millionaire, his statement, being mere commendatory in nature, does not form a part of the contract and its breach (i.e., if the buyer of the horse does not actually become a millionaire later) does not give rise to any legal consequences. 17.1 UNIT OBJECTIVES ? Be clear about the terms 'condition' and 'warranty' ? Learn the
Condition and Warranties implied in a contract of sale of goods ? Grasp the doctrine of caveat emptor ? Understand the exceptions
of the doctrine of caveat emptor 17.2
CONDITION DEFINED
A 'condition'
is a stipulation essential
to the main purpose of the contract, the breach
of which gives
the aggrieved party a right to repudiate the
contract
itself [12(2)]. In addition, he may maintain an action for damages for loss suffered, if any,
on the footing that the whole contract is broken and the seller is guilty of non-delivery (Miller's Machinery Co. Ltd. vs David Way & Son l). 1 (1934), 40 Com. Cas. 204.
Conditions and Warranties 210 Self-Instructional Material NOTES 17.3
WARRANTY DEFINED
A '
warranty' is a
stipulation
collateral
to the main purpose of the contract, the breach
of which gives
the aggrieved party
a right to
sue
for damages
only, and not to
avoid the
contract
itself. [Sec. 12(3)] It will be seen that the
above definitions explain both the meaning and the legal effect of a 'condition' and a 'warranty'. Accordingly, a ' condition' forms the very basis of a contract of sale, the breach of which causes irreparable damage to the aggrieved party so as to entitle him even to repudiate the contract, whereas a 'warranty' is only of secondary importance, the breach of which causes only such damage as can be compensated for by damages. In fact a breach of 'condition' is followed by the same consequence as the breach of a 'condition precedent' in other contracts; namely, the innocent party has a right to rescind the contract, and claim damages.
There is no hard and fast rule as to which stipulation is a condition and which one is a warranty.
Section 12(4) lays down to the same effect, thus, "
whether
a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract.
A
stipulation may be a condition though called a warranty
in the contract."
Thus
the court is not to be guided by the terminology of the parties

but has to look to the intention of the parties by referring to the terms of the contract, its construction and the surrounding circumstances to judge whether a stipulation was a condition or a warranty. The most suitable test to distinguish between the two terms is that
if the stipulation is such that its breach would be fatal to the rights of the aggrieved party, then such a stipulation is a condition and where it is not so, the stipulation is only a warranty.
Illustrations. (a) A man buys a particular horse which is warranted quiet to ride and drive. If the horse turns out to be vicious, the buyer's only remedy is to claim damages. But if instead of buying a particular horse, a man asks a dealer to supply him with a quiet horse and the dealer supplies him with a vicious one, the stipulation is a condition, and the buyer can return the horse and can also claim damages for breach of contract (Hartley vs Hyman 2). (b)
P goes to R, a horse dealer, and says, "I
want a horse which can run at a speed of 30 kilometers per hour."
The horse dealer points out a particular
horse and says, "This will suit you." P buys the horse. Later on P finds that the horse can run only
at a speed of 20
kilometers per hour. There is a breach of condition, P can repudiate the contract, return the horse to R and get back the price. But if P says to R, "I want a good horse." R shows him a horse and says, "This is
a good horse and it can run
at a speed of 30 kilometers
per hour,"
and P buys the horse and finds later on that
it can run at a speed of 20 kilometers per hour
only,
there is
a
breach of warranty because the stipulation made by the seller
did not form the very basis of the contract
and was only subsidiary one. The seller gave the assurance about the running speed of the horse of his own without being asked by the buyer hence it is only of secondary importance.
The above illustrations are a clear proof of the fact that an exactly similar term may be a condition in one contract and a warranty in another depending upon the construction of the contract as a whole. 17.3.1 Condition and Warranty Distinguished The points of distinction between a condition and a warranty may be summed up as under: 1.
As to value.
A
condition
is
a stipulation which is
essential to the main purpose of
the
contract,
whereas
a
warranty is a stipulation
which is collateral to the main purpose of the contract. [
Sec. 12(2)(3)] 2 (1920), 3, K.B. 475.
Conditions and Warranties
Self-Instructional Material 211 NOTES 2. As to breach.
The
breach of a condition gives the aggrieved party the right to repudiate the contract
and
also to claim damages,
whereas
the breach of warranty gives the aggrieved party a right to claim damages
only. 3.
As to
treatment.
A
breach

of condition may be treated as
a
breach of warranty.
But
a
breach of warranty cannot be treated as a breach of condition. 17.3.2
When
Breach of Condition is to be Treated as
Breach of Warranty
Section 13
deals with cases where
a breach of condition
is to
be treated as a
breach of warranty,
as
a consequence of which the buyer loses his right to rescind the contract and
has to be content with
a claim for damages only. These cases are as follows: 1.
Voluntary waiver by buyer. Although on a breach of condition by the seller, the buyer has a right to
treat the contract as repudiated and reject the goods, but he
is not bound to do so. He may instead elect to
waive
the condition, i.e.,
to
treat the breach of condition as a breach of warranty
and
accept the goods
and
sue the seller for damages for breach of warranty. Illustration. A agrees to supply B 10 bags of first quality sugar @ Rs. 625 per bag but supplies only second quality sugar, the price of which is Rs. 600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, accept the second quality sugar and claim damages @ Rs. 25 per bag. 2. Acceptance of goods by buyer. Where the buyer has accepted the goods and subsequently he comes to know of the breach of condition, he cannot reject them, but can only maintain an action for damages. This case does not depend upon the will of the buyer but the law compulsorily treats a breach of condition as a breach of warranty.
Acceptance of only part of the goods. If the buyer has accepted only part of the goods and
the contract is indivisible, he will have
to
treat, the breach of condition as a breach of warranty
and
accept the
remaining part also.
But in case of divisible contracts, he can repudiate as regards remaining goods, if he has accepted only part thereof.
Indivisible contracts are those
where price for a lot, consisting goods of different qualities,
as such is fixed and not fixed per unit or per bag or per ton, etc. Meaning of 'acceptance'. Taking
possession or delivery of the goods does not by itself amount to acceptance.
According to
Section 42,
the buyer is deemed to have accepted the goods: (
i) when he
intimates to the seller that he has accepted
them; or (ii) when
he
does any act in relation to
goods

which is inconsistent with
the ownership
of the seller,
e.
g.,
consumes, uses, pledges or resells the goods
or puts his mark on them, etc.,
or (iii)
when, after the lapse of reasonable time, he retains the goods without intimating the seller that he has rejected
them.
On rejection of goods, however, mere informing the seller is enough and the buyer
is not bound to return the rejected goods actually (
Sec. 43). 17.3.4
Express and Implied Conditions and Warranties
Conditions and warranties may be either express or implied.
They are
said to be express when at the will of the
parties they are inserted in the contract,
and they are said to be implied when
the law presumes their existence
in the contract
automatically though they have not been put into it in express words. Implied conditions
and warranties may, however,
be negatived or varied by express agreement, or
by course of dealing between the parties, or by usage
of trade (
Sec. 62). This provision is merely an application of the general maxim of law, 'what is expressly done puts an end to what is tacit or implied,' and 'custom and agreement over-rule
implied conditions and warranties.'
Conditions and Warranties 212 Self-Instructional Material NOTES 17.4 IMPLIED CONDITIONS
Unless otherwise agreed, the law incorporates into a contract of sale of goods
the
following
implied conditions: 1.
Condition as to title [
Sec. 14 (a)].
In every contract of sale,
the
first
implied condition on the part of the seller is that,
in
the case of
a sale,
he has
the
right to sell the goods
and that,
in the
case of an agreement to sell,
he will have
a
right to sell
the
goods at the time when the property is to pass.
Ordinarily
the
seller has the right to sell the goods

if either he is the owner
of the goods or he
is owner's agent.
As a result of this condition,
if
the seller's title turns out to be defective the buyer is entitled to reject the goods and
to recover his price.
Notice that
in the
case
of breach of condition as to title the buyer has no option
to
treat the breach of condition as breach of warranty
and
accept the goods
and
sue the seller for damages.
In this case he
must
return the goods to the true owner. He can of course recover the price from the seller because of a total failure of consideration.
Illustration. R
purchased a motorcar from D and used
the same
for several months.
D had no title to the car and, therefore, R
was compelled to return the car to the true owner. R sued D to recover back the price
which he had already paid.
He was held entitled to recover the whole of the price paid by him despite the fact that he had used the car for some months (Rowland vs Divall 3). It may be noted that the implied condition as to title makes it obligatory upon the seller that he must not only be the owner but also must be able to uphold the validity of the contract. Thus if the goods sold bear labels infringing the trade mark of another, the seller is guilty of breach of this condition although he had full ownership of the goods. Illustration.
In Niblett vs Confectioner's Materials Co 4 ; the defendants sold to the plaintiff 3,000 tins of condensed milk C.I.F. from New York
to London.
On their arrival in London it was found that 1,000 tins were labelled "Nissly Brand."
Nestle Co.,
another manufacturer of condensed milk, proved that this was an infringement of its trade mark. The plaintiff had to remove all the labels. The tins were in consequence sold at a loss.
The plaintiff sued the defendants for the breach of the condition as to title and claimed compensation for the same. It was held that as the defendants had no right to sell the goods, there being infringement of another company's trade mark, they were bound to pay damages for the loss suffered by the plaintiff. It may further be noted that '
where a seller having no title to the goods at the time of the sale, subsequently acquires the title (
e.g., by paying off the true owner) before the buyer seeks to repudiate the contract,
that title feeds the defective titles of both the original and subsequent
buyers and it will then be too late for the buyer to repudiate the contract (Patten vs Thomas Motors 5). 2.
Condition in a
sale by description. "
Where there is
a contract of
sale
of goods
by description, there is an implied condition that the goods shall correspond with
the
description ..." (
Sec. 15). Lord Blackburn observed: 6 "

If you contract to sell peas, you cannot oblige a party to take beans.
If the description of the article tendered is different in any respect, it is not
the
article bargained for, and the other party is not bound to take it."
It is important that the goods must correspond with the description
whether it is a sale of specific goods or of unascertained goods. Further, the fact that the buyer has examined the goods will not affect his right to reject the goods, if the deviation of the goods from the description is such which could not have been discovered by casual examination, i.e., if the goods show any latent defects. The description may be in terms of the qualities or characteristics of the goods, e.g., long staple cotton, Kalyan wheat, sugar C-30, basmati rice or may simply mention the trade mark, brand name or the type of packing, etc. 3 (1923), 2 K.B. 500. 4 (1921), 3 K.B. 387. 5 (1965), N.S.W.R. 1457 6 In Bowes vs Shand, (1877), 2 A.C. 455.
Conditions and Warranties Self-Instructional Material 213 NOTES Illustrations. (a) Where there was a contract for the supply of 'new singer cars' and one of the cars supplied having
already run a considerable mileage was not new,
there was a
breach of condition on the part of the seller and
the buyer was held entitled to reject the
car (Andrews Bros. vs Singer & Co 7). (b)
M agreed to supply
to L 3,000
tins of canned fruit, to be
packed in cases each containing 30 tins.
M tendered a substantial portion in cases containing 24 tins.
It was held that the mode of packing constituted a part of the description and, therefore, L was entitled to reject the whole consignment (Re Moore & Co., and Landaure & Co 8). 3. Condition in a sale by sample (Sec. 17). When under a contract of sale, goods are to be supplied according to a sample agreed upon, the implied conditions are: (i)
that
the bulk shall
correspond with the sample in quality; (
ii) that
the
buyer shall have
a reasonable
opportunity of comparing the bulk
with
the
sample; (
iii) that
the goods shall be free from any defect,
rendering them
unmerchantable, which would not be apparent on reasonable examination of the
sample.
In
other words, there should not be any latent defect in the goods. If the defect is patent one, that is, easily discoverable by the exercise of ordinary care, and the buyer takes delivery after inspection, there is no breach of implied condition and the buyer has no remedy. Illustrations. (a)
Two parcels of wheat were sold by sample. The buyer went to examine the bulk a week
after. One parcel was shown to him but the seller refused to show the other parcel which was not there in the warehouse. Held, the buyer was entitled to rescind the contract (Lorymer vs Smith 9). (b) Some mixed worsted coatings were sold by sample. The goods when supplied corresponded to the sample but it was found that
owing to a latent defect in the cloth, coats made out of it would not stand ordinary wear and were therefore unsaleable. The same defect existed in the sample also but could not be detected on
a reasonable examination. Held, the buyer
was entitled to reject the cloth (Drummond & Sons vs Van Ingen 10). 4.
Condition
in a
sale by sample as well as by description (

Sec. 15). When
goods are sold
by sample as well as by description,
there is
an implied condition
that the bulk of
the goods shall correspond
both with the sample and with the description. If
the goods supplied correspond only with the sample and not with the description
or vice versa, the buyer
is entitled to reject the goods. The
bulk of the goods must correspond with both.
Illustrations. (a) There was a contract of sale by sample of
seeds described as 'common English sainfoin.' The contract contained a term excluding all warranties express or implied.
The seed was sown and when the crop was ready it was discovered that the seed supplied
and the sample shown were a different and inferior variety known as '
giant sainfoin"
It was held that there was a breach of condition
and
the exemption clause did not protect the sellers.
The buyer was, therefore, entitled to recover damages (Wallis vs Pratt 11). (b)
N agreed to sell G
some oil described as 'foreign refined rape oil,' warranted
only
equal to sample. The
oil
supplied, though corresponded with the sample, was adulterated with hemp oil. Held, that since the oil supplied was not
in accordance with the description the buyer was entitled to
reject the same (Nichol vs Godts l2). 5.
Condition as to fitness or quality [Sec. 16 (1)].
Ordinarily, in a contract of sale
there is no
implied condition
or warranty
as to quality or fitness
for any particular purpose
of goods supplied;
the
rule of law being 'Caveat Emptor 13
that is, let the buyer beware. But an 7 (1934), 1 K.B. 17. 8 (1921), 2 K.B. 519. 9 (1822), 1 B. & C. 1. 10 (1887), 12 A.C. 284. 11
(1911), A.C. 394. 12 (1854), 10 Ex. 191. 13 The doctrine of Caveat Emptor has been discussed separately later in this Unit.
Conditions and Warranties 214 Self-Instructional Material NOTES implied condition is deemed to exist on the part of the
seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them, if
the following conditions are satisfied: (i)
The buyer, expressly or impliedly, should
make
known to the seller
the particular purpose for which the goods are required; and (
ii) The buyer should rely on the
seller's skill
or
judgement; and (
iii) The goods
sold must be of a description which
the seller
deals
in

the ordinary course of his business, whether he be the manufacturer or not. The
purpose must be made known expressly if the goods to be supplied can be used for several purposes,
otherwise the condition as to fitness will not be implied
and the buyer will have no right to reject the goods merely because they are unfit for the specific purpose he had in mind. Illustration. A buyer ordered for the
hessian cloth, which is generally used for packing purposes, without specifying the purpose for which he wanted the same. The cloth was supplied accordingly. On receiving the cloth the buyer found that it was not suitable for packing food products as it had an unusual smell.
Held, that the buyer had no right to reject the cloth as it was suitable for packing purposes alright. The buyer ought to have disclosed his particular purpose to the seller in order to make him liable for the breach of implied condition as to fitness (Re Andrew Yule & Co. 14). The purpose need not be told expressly if the goods are fit for one particular purpose only or if
the nature of the goods itself tells the purpose by implication. In such cases the purpose is deemed to
be made known to the seller impliedly. Illustrations. (a) A, a draper, who had no special knowledge of hot water bottles, went to the shop of a chemist and asked for a hot water bottle.
He was shown an American rubber bottle which the chemist said would not stand boiling water, but was meant for hot water. A bought
the bottle. After a few days, while being used, it burst
and injured his wife. It was found
that
the bottle was not fit
for use
as a hot water bottle.
It was held that since the bottle could be used only for one particular purpose, there was
a breach of implied condition as to fitness and the seller was liable to pay damages (
Priest vs Last 15). (b) Where a buyer demands tinned fruit juice, it is implied from the nature of the product itself that he wants it for consumption and if later on
it is found to contain poisonous matter,
there is a breach of implied condition as to fitness and
the seller
is liable in damages. Sometimes the implied purpose may also be gathered from usage of the trade, e.g., mobiloil for a scooter implies “two T’s mobiloil.”
It is important that the implied condition as to fitness applies only in
the case of sale of goods to a normal buyer. If the buyer is suffering from an abnormality; say, is allergic to particular foods, medicines, dust, etc.,
and it
is not made known to the seller at the time of
sale, this condition does not apply.
Sale under patent or trade name. Proviso to Section 16(1) lays down that
in the case of a
contract for the sale of a specified article under its patent or other trade
name,
there is no implied condition
as to its fitness for any particular purpose.
It is so because in such a case the buyer is
not relying on the skill and judgement of the seller but
relies on the
good reputation that the goods came to acquire and buys them on the strength of that reputation. The seller’s duty is to supply the goods of the same trade name as demanded by the buyer, whether they are fit for any particular purpose or not, is not his concern. Illustration.
The buyer wrote to the seller: “Send me your patent smoke-consuming furnace for fitting up in my brewery.” The seller supplied the furnace
according to the order but the same was 14 A.I.R. (1932), Cal. 879. 15 (1903), 2 K.B. 148.
Conditions and Warranties Self-Instructional Material 215 NOTES found to be not fit for the purpose of the buyer’s brewery. It was held that the seller had performed his part of the contract by supplying his patented furnace and so he was entitled to recover its price from the buyer (Chanter vs Hopkins 16). But the condition as to fitness will apply if the buyer relies on the seller’s skill and judgement

as regards the suitability of the goods for
a particular named purpose and makes known to the seller that he
so relies on him, even though the article is described in the order by its trade name. Illustration. B approached M, a motorcar dealer, and asked for a comfortable car suitable for touring purposes. M recommended his 'Bugatti' car, a trade name and also showed a specimen of the same. B thereupon ordered for a 'Bugatti' car, which was supplied. The car proved to be unsuitable for touring purposes. B claimed to reject the car and recover back the purchase money paid by him.
It was held that he was entitled to do so
because while ordering the car by its trade name he was still relying on the seller's skill and judgement as regards the suitability of the car for the specific purpose (Baldry vs Marshall 17). 6.
Condition as to merchantability [Sec. 16(2)]. This condition is implied only where the sale is by description.
We have already seen that there is an implied condition in such cases, as per Section 15, that the goods should correspond with the description. This subsection lays down another implied condition in such cases, that is, that the goods should be of 'merchantable quality.' But for making this condition applicable, not only that
the sale must be by description, but the following conditions must also be satisfied: (i)
The seller should be a dealer in goods of that description,
whether he be the manufacturer or not; and (ii)
The buyer must not have any opportunity of examining the goods
or there must be some latent
defect
in the goods
which would not be apparent on reasonable examination of the
same.
If the buyer
had an opportunity of making the examination but he avoids to examine, or
if he
has examined the goods, there is no implied condition as
to merchantability
as regards defects which such examination ought to have revealed [
Proviso to
Sec. 16(2)].
The phrase 'merchantable quality' means that the
goods are of such quality and in such condition that a reasonable man, acting reasonably, would accept them
under the circumstances of the case in performance of his offer to
buy those goods,
whether he buys them for his own use or to sell again (
S.S. Mendse vs Balkrishna Chettiar 18). Stated briefly, in order to
be 'merchantable'
the
goods must be such as
are reasonably saleable under the description by which they are known in the market.
Illustrations. (a) Where the underwears supplied contained certain chemicals which could cause
skin disease to a person wearing them next to skin,
it was held that because of such a defect the underwears were not of merchantable quality and the buyer was entitled to reject the goods (Grant vs Australian Knitting Mills Ltd. 19). (b) Where
A purchases a certain quantity of black yarn from
B, a dealer in yarn, and finds it damaged by white ants, the condition as to merchantability
has been broken and A is entitled to reject it as unmerchantable. (
c) R ordered for some 600 motor horns of varying description. Some of the horns were dented and badly polished and R rejected the whole of the consignment. Held, the defects in the horns had rendered them unmerchantable and therefore the buyer was justified in rejecting the whole consignment as the contract is indivisible (Jackson vs Rotax Motor and Cycle Co. 20). 16 (1838), 4 M. & W. 399. 17 (1963), 1 K.B. 260 18 (1963), 2 M.L.J. 140. 19 (1936), A.C. 85. 20 (1910), 2 K.B. 937. Check Your Progress 1. Define the term warranty and explain its significance. 2. What are the various points of distinction between condition and warranty? 3.
Conditions and warranties may be either express or implied. Elucidate.

Self-Instructional Material NOTES (d) A wanted to purchase some glue. The glue was stored in the seller's warehouse in barrels. Every facility was given to A for its inspection but he did not have the barrels opened and simply looked at the outside of the barrels. The glue was bound to have defects which would have been found out if A had inspected the contents of the barrels. It was held that there was no breach of any implied condition as to merchantability and as such A was not entitled to any relief (Thornett vs Beers 21). 7. Condition as to wholesomeness. This condition is implied only in a contract of sale of eatables and provisions. In such cases the goods supplied must not only answer to description and be merchantable but must also be wholesome, i.e., free from any defect which render them unfit for human consumption. Illustrations. (a) F bought milk from A, a dairy owner. The milk was contaminated with germs of typhoid fever. F's wife, on taking the milk, became infected and died of it. A, was held liable in damages (Frost vs Aylesbury Dairy Co. Ltd. 22). (b) The plaintiff bought a bun at a baker's and confectioner' s shop. The bun contained a stone which broke one of the plaintiffs teeth. Held, the seller was liable in damages because he violated the condition of wholesomeness (Chaproniere vs Mason 23). (c) W bought a bottle of beer from H, a dealer in wines. The beer was contaminated with arsenic. W, on taking the beer, fell ill. H was held liable to W for the consequent illness (Wren vs Halt 24). 17.5 IMPLIED WARRANTIES Unless otherwise agreed, the law also incorporates into a contract of sale of goods the following implied warranties: 1. Warranty of quiet possession [Sec. 14(b)]. In every contract of sale, the first implied warranty on the part of the seller is that " the buyer shall have and enjoy quiet possession of the goods." If the quiet possession of the buyer is in any way disturbed by a person having a superior right than that of the seller, the buyer" can claim damages from the seller. Since disturbance of quiet possession is likely to arise only where the seller's title to goods is defective, this warranty may be regarded as an extension of the implied condition of title provided for by Section 14(0). In fact the two clauses of Section 14 [i.e., (a) and (b)] are overlapping and it is not easy to see what additional rights this warranty confers on the buyer over and above those conferred by the implied condition as to title contained in Section 14(a). Illustration. The plaintiff, a lady, purchased a second hand typewriter from the defendant. She thereafter spent some money on its repair and used it for some months. Unknown to the parties the typewriter was a stolen one and the plaintiff was compelled to return the same to its true owner. She was held entitled to recover from the sellers for the breach of this warranty damages reflecting not merely the price paid but also the cost of repair (Mason vs Burningham 25). [Notice that the decision in the instant case would not change if we treat it as a case of breach of condition as to title under Sec. 14(a)]. 2. Warranty of freedom from encumbrances [Sec. 14(c)]. The second implied warranty on the part of the seller is that " the goods shall be free from

any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made." If the goods are afterwards found to be subject to a charge and the buyer has to discharge the same, there is breach of warranty and the buyer is entitled to damages. It is to be emphasised that the breach of this warranty occurs only when the 21 (1919), 1 K.B. 486. 22 (1905), 1 K.B. 608 23 (1905), 21. T.L.R. 633. 24 (1903), 1 K.B. 610. 25 (1949), 2 K.B. 545. Conditions and Warranties Self-Instructional Material 217 NOTES buyer in fact discharges the amount of the encumbrance, and he had no notice of that at the time of the contract of sale. If the buyer knows about the encumbrance on the goods at the time of entering into the contract, he becomes bound by the same and he is not entitled to claim compensation from the seller for discharging the same. Illustration. A, the owner of the watch, pledges it with B. After a week, A obtains possession of the watch from B for some limited purpose and sells it to C. B approaches C and tells him about the pledge affair. C has to make payment of the pledge amount to B, There is breach of this warranty and C is entitled to claim compensation from A. [Notice that in the instant case the buyer (i.e., C) cannot allege breach of implied condition as to title against the seller (i.e., A) because the seller in fact had a title to the goods, though subject to the rights of the pledgee]. 3. Warranty of disclosing the dangerous nature of goods to the ignorant buyer. The third implied warranty on the part of the seller is that in case the goods sold are of dangerous nature he will warn the ignorant buyer of the probable danger. If there is breach of this warranty the buyer is entitled to claim compensation for the injury caused to him. Romer L.J. observed, 26 "I think that, apart from any question of warranty, there is a duty cast upon a vendor, who knows of the dangerous character of goods which he is supplying, and also knows that the purchaser is not, or may not be, aware of it, not to supply the goods without giving some warning to the purchaser of that danger. Illustration. C purchases a tin of disinfectant powder from A. A knows that the lid of the tin is defective and if it is opened without special care it may be dangerous, but tells nothing to C. C opens the tin in the normal way whereupon the disinfectant powder flies into her eyes and causes injury. A is liable in damages to C as he should have warned C of the probable danger. 27 17.6 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 enquiry 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 buys 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 cannot hold the seller liable for the same, as there is no implied undertaking by the seller that he shall supply such goods as suit the buyer's purpose. If, therefore, while making purchases of goods the buyer depends upon 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 the seller. Illustrations. (a) A purchases a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the crriage. Caveat emptor being the rule, A can neither reject the horse nor can be claim any compensation from B. (b) Certain pigs were sold by auction "with all faults." The pigs were suffering from typhoid fever and all of them but one died. They also infected a few of the buyer's own pigs.
It was held that the seller was not bound to disclose that the pigs were unhealthy.
Caveat emptor being the rule, the buyer could not claim damages from the seller (Ward vs
Hobbs 28).
Exceptions.
The doctrine of caveat emptor is subject to the following exceptions: 1.
Where the seller makes a mis-representation
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. 26
In Clarke vs Army & Navy Cooperative Society Ltd. (1903), 1 K.B. 155, at p. 166. 27 Ibid. 28 (1878), 4 A.C. 13. Check Your Progress 4. Explain the implied condition as to title in the context of the contract of sale of goods? 5. What is the doctrine of caveat emptor?
Conditions and Warranties 218 Self-Instructional Material NOTES 2.
Where the seller makes a false representation amounting to fraud and the buyer
relies on it, or
where 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 (Sec. 15). (See implied condition 'in a sale by description' discussed earlier). 4.
Where the
goods are purchased by
description from a seller who deals in
such class of goods and they
are not of 'merchantable quality',
the doctrine of caveat emptor does not apply. But the doctrine applies,
if
the buyer has examined the goods, as regards defects which such examination ought to have
revealed [
Sec. 16(2)]. (See implied condition 'as to
merchantability' discussed earlier). 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 (Sec. 17). (
See
implied condition 'in

a
sale by sample'
discussed earlier). 6. Where
the goods are bought by sample as well as
by description
and the
bulk of
the goods does not correspond both with the sample
and with the description,
the buyer is entitled to reject the goods (
Sec. 15). (
See
implied
condition '
in a sale by sample as well as by description'
discussed earlier). 7.
Where
the
buyer makes known 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 [Sec. 16(1)]. (See 'condition as to fitness or quality' discussed earlier). 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 emptor does not apply and
the
seller is liable in damages [Sec. 16(3)]. 17.7 TEST
QUESTIONS 1.
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? 2.
Explain briefly
the
implied conditions and warranties in a contract of sale
of goods. 3. (
a) What are the differences between 'conditions' and 'warranties'? (b) P bought
a car from Q who had no title to it. P used the car for several months. After that the true owner came forward and demanded
the car. State the rights of P and the true owner of the car. 4. State the doctrine of caveat emptor and explain the exceptions to it. 5. "
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.
Conditions and Warranties Self-Instructional Material 219 NOTES 17.8
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your
answers: 1. Worsted coating
of quality equal to sample was sold to tailors who could not stitch it into coats owing to some latent defect in its texture. The
tailors
had examined the cloth before effecting the purchase. Are they entitled to damages? [Hint.

In a contract of sale by sample there is an implied condition that the goods shall be free from any latent or hidden defect (Sec. 17). As this implied condition is broken in the instant case, the tailors are entitled to recover damages.] 2. Soda-water was supplied by S to B in bottles. B was injured by the bursting of one of the bottles. Can B claim damages from S? [Hint. B can claim damages from S for the injury as the bottle is not of merchantable quality and there is a sale of goods by description. (Refer to Condition as to Merchant- ability.)] 3. M was shopping in a self-service super market. He picked up a bottle of orange squash from a shelf. While he was examining it, the bottle exploded in his hand and injured him. Can M claim damages for the injury? [Hint. M cannot claim damages because a warranty or condition as to merchantability does not arise unless there is a sale. As there was no sale (since M may decide not to buy and put back the bottle in the shelf), there was no implied condition.] 4. A agrees to supply to B a certain quantity of timber of half-inch thickness. The timber actually supplied varies in thickness from one-third inch to five-eighth inch. The tim- ber is merchantable and commercially fit for the purpose for which it was ordered. B rejects the timber. Is his action justified? [Hint. Yes, B is entitled to reject the goods. The facts of the given case are similar to Arcos Ltd., vs E.A. Ronaasen & Son, 1933, A.C. 470, in which case Lord Atkin observed: "If the contract specifies conditions of weight, measurement and the like, those conditions must be complied with. A ton does not mean about a ton, or a yard about a yard. Still less, when you descend to minute measurements, does half an inch mean about half inch. If the seller wants a margin he must, and in my experience does, stipulate for it."] 5. A lady, who knew that her skin was abnormally sensitive, bought a tweed coat and developed skin trouble by using it. She did not disclose to the seller that her skin was abnormally sensitive. Is the seller liable for breach of implied condition as to fitness or quality? [Hint. The implied condition as to fitness or quality is with regard to the suitability of the goods to a normal buyer. If the buyer is suffering from an abnormality and does not inform the seller about the same, this implied condition does not apply. Hence in the given case there is no breach of implied condition as to fitness and as such the seller is not liable. (Griffths vs Peter Conway Ltd., 1939, I All. E.R. 685).]

Transfer of Property Self-Instructional Material 221 NOTES UNIT 18 TRANSFER OF PROPERTY Structure 18.0 Introduction 18.1 Units objectives 18.2 Essentials of Transfer of Property 18.3 Rules Regarding Transfer of Property 18.4 Essentials of Valid Appropriation 18.5 Rule of Transfer of Title on Sale 18.6 Test Questions 18.7 Practical Problems 18.0 INTRODUCTION Sale is primarily the transfer of property in goods by the seller to the 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 the custody over the goods. So the property in goods may pass from the seller to the buyer but the goods may be in possession of the seller either as unpaid seller or as a bailee for the buyer. In other cases the property in goods may still be with the seller although the goods may be in possession of the buyer or his agent or a carrier for transmission to the buyer. 18.1 UNIT OBJECTIVES ? Be aware of the importance of knowing the exact time when property in goods passes from seller to buyer ? Understand the general rules regarding the transfer of

property ? Know the essentials of valid appropriation ? Understand the rule relating to transfer of title on sale ? Understand the various provisions under which non-owner may pass
to the buyer a better title than he himself has. 18.2
ESSENTIALS OF TRANSFER OF PROPERTY
The precise moment of
time
at which
property in goods passes from the seller to
the buyer
is
of great importance
from various points of view. Of these the following require special notice: 1.
Risk 'prima-facie' passes with property. As a general rule the risk of the
loss of goods is prima-facie in the person in whom property is Section 26 provides to the same effect, thus, "
Unless otherwise agreed, the goods remain at the seller's risk until the
pro-perty
therein is transferred to the buyer, but when the property therein is transferred
to buyer, the goods are at the buyer's risk
whether delivery has been made or not."
Thus,
if after the
contract the goods are destroyed or damaged the question who is to bear the loss is to be decided not on the basis of possession of the goods but on the basis of ownership of goods.
Whosoever is the owner of the goods at the time of loss
must bear the loss.
Illustration.
A buys goods from B and property has passed to him, but the goods remain in B's warehouse.
Before delivery of goods to A, there is a fire in B's warehouse and all the goods are destroyed. A must bear the loss and pay the price of goods to B, if he has not paid it so far.
Transfer of Property 222 Self-Instructional Material NOTES The opening words of Section 26, namely, 'unless otherwise agreed' are of great significance. These words imply that 'risk passes with property' is not an absolute or inflexible rule, but a prima-facie one. Risk is no test of property passing. There is nothing to prevent the parties from contracting that risk shall from even before passing of property or vice-versa. The proviso to Section 26 also lays down an
exception to the rule that 'risk follows ownership.' It provides that where delivery of
the goods
has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault
as regards any loss which might not have occurred but for such fault.
Illustration. A contracted to purchase 30 tons of apple juice from B.
B crushed the apples and Filled 30 tons of juice in casks and kept them ready for delivery. After a few casks had been delivered. A refused to take further deliveries. The juice became putrid and had to be thrown away. Held, although the property in good was still with B, yet the loss had to be borne by A (Demby Hamilton & Co. Ltd. vs Border 1). 2. Action against third parties. If after the contract of sale, the goods have been damaged by a third party,
it is only the person in whom the property vests who can take action against
the wrongdoer. 3.
Suit for price. Generally speaking
the seller can only sue
for the
price
if
the property in goods has passed to
the
buyer. 2 4.
Insolvency of the seller or
the buyer.
In
the event
of

insolvency of either the seller or the
buyer, the answer to the question whether
the Official Receiver or Assignee can take over the goods
or not, shall depend upon whether the property in goods
was with the party
who has become insolvent. For
example,
if the seller becomes insolvent before giving delivery
of the goods but
the property in goods has already passed to the buyer
who has paid the price, the Official Receiver can have no claim against the goods. 18.3 RULES REGARDING TRANSFER OF PROPERTY
We shall be studying
the
rules regarding transfer of property under
the following two
heads: 1. Transfer of property in specific or ascertained goods. 2. Transfer of property in unascertained and future goods.
18.3.1
Transfer of Property in
Specific
or Ascertained
Goods
Where there is
a contract for the
sale of
specific
or ascertained goods
the
property in them is transferred to the buyer
at such time as the parties to the contract intend it to be transferred.
For the purpose of ascertaining the intention of the parties
regard 'Shall be had to
the
terms of the contract, the conduct of the parties and the circumstances of the
case [
Sec. 19(1) (2)]. Thus, in the case of
specific goods, the transfer of property takes place when the parties intend to pass it.
The parties may intend to pass the property at once at the time of making of
the contract or when the goods are delivered or when the goods are paid for. It is only when the intention of the parties cannot be judged from their contract or conduct or other circumstances that the rules laid down in Sections 20, 21, 22 and 24 apply [Sec. 19(3)]. These rules are as follows: 1 (1949). I All E.R. 435. 2 As anexception
to this general rule. Section 55(2) provides that where
price is payable '
on a day certain'
and
the buyer wrongfully neglects or refuses to pay such price,
the seller may sue him for
the price
although the property in the goods has not
passed
and the
goods have not been appropriated to the contract.
Transfer of Property Self-Instructional Material 223 NOTES 1.
When goods are in a deliverable state (Sec. 20). Where there is an unconditional (
i.e., not subject to any condition precedent to be fulfilled by the parties)
contract
for the sale of specific goods in a deliverable state,

the
property in the goods
passes to the buyer
as soon as
the contract is
made,
and it is immaterial whether
the time of payment of
the price or the time of delivery of the goods, or both are postponed.
Illustration. (a)
A buys a bicycle for Rs 300 on a month's credit and
asks the shopkeeper to send it to his house. The shopkeeper agrees
to do so. The bicycle immediately becomes the property of A. (
b) P buys a table for Rs 100 on a week's credit and arranges to take delivery of
the table the next day. A fire broke out in the furniture mart the same evening and the table is destroyed.
The property in the table has passed to P and he
is bound to pay
the price.
The
goods are said to be in a 'deliverable state' when they are in
such
a
state that the buyer would, under the contract, be bound to take delivery of
them [
Sec. 2(3)]. For example, in illustration (b) above, if the seller has to polish the table to make it acceptable to the buyer, it is not in a deliverable state until it is so polished, and the buyer does not acquire property at the time of the contract. 2.
When goods have to be put into
a deliverable state (
Sec. 21).
Where there is
a contract for the
sale of specific goods
and
the seller is bound to
do 'something' to the goods
for the purpose of
putting
them into
a deliverable state,
the property does not pass until such thing is done
and the buyer has notice
thereof.
The
word 'something'
here means an act like packing the goods, or loading them on rail or ship, or filling them in containers or polishing them in order to give a finished shape, etc. It is to be noted that merely putting the things in a deliverable state would not result in
the
transfer of property in the goods from the seller to the buyer.
It is
further necessary that the
buyer must have notice thereof, i.e., the fact that the goods have been put in a deliverable state must come to the knowledge of the buyer in some way or the other. Illustration. A agrees to sell to B the
whole of turpentine oil lying in a cistern. It is further agreed that the oil is to be put into casks

by A and then B is to take them away. Some of the casks are filled in the presence of B, but before any are removed or the remainder filled, the whole is destroyed accidentally by fire. B must bear the loss of oil which had been put into the casks because in all these casks the property has passed to him as nothing further remained to be done to them by the seller. But the property in the casks not filled up remained in the seller, at whose risk they continued (Rugg vs Minett 3).
3.
When the goods have to be measured etc.,
to ascertain price (Sec. 22).
Where there is a contract
for the
sale of
specific goods in a deliverable state, but
the
seller is bound to weigh, measure, test or do
some other act
or thing
with reference to
the
goods for the purpose of ascertaining the price, the property
does not pass until such
act or thing
is done
and the buyer has notice thereof.
Illustration. A sold to B 289
bales of goat skins, each bale containing Five dozens, and the price was for certain sum per dozen skins. It was the duty of A to count the goat skins in each bale. Before A could do the same, the bales were
destroyed by fire. Held,
that the property in the goods had not passed to the buyer (
i.e., B) as something still remained to be done by the seller (i.e., A) for ascertaining the price, and as such the loss caused by fire had to be borne by the seller (i.e., A) (Zagury vs Furnell 4) It may be noted that
if the seller 'has done all what he was required to do
under the contract and nothing remains to be done by him,
the property passes to the buyer even if the buyer has to do something for his own satisfaction. 3 (1809), 11
East 210. 4 (180'3). 2 Camp. 240.
Transfer of Property 224 Self-Instructional Material NOTES Illustration. A contracted with B to sell him 975 maunds of rice, the whole content of a certain 'golah'. B paid the entire price but agreed to remove the rice after weighing (for his own satisfaction) before a certain date. After delivery was taken of a part of the rice the other part was destroyed by fire. Held, the ownership had passed to the buyer because nothing remained to be done by the seller to ascertain the price, and therefore B, the buyer, must suffer the loss (Shoshi Mohun Pal vs Nobo Kristo Poddar 5). 4.
When
goods are delivered
on approval (
Sec. 24).
When
goods are delivered to the buyer
on approval or 'on sale or return,' or on other similar terms,
the property therein
passes to the buyer: (
i) When he signifies his approval or acceptance to the seller
or does any other act adopting the transaction,
e.g., uses the goods, pledges the goods or resells them; (
ii)
If he
does not signify his approval or acceptance to the seller but
retains the goods, without giving notice of rejection,
beyond
the time fixed for the return
of goods,

or if no time
has been fixed, beyond a reasonable time.
Illustrations. (a) A
delivered
a horse to B on the terms of 'sale or return, within 8
days.' The horse died
on the third day
without any fault
on the part of B Held, A
was to bear the loss as the horse was still his property when it perished (Elphick vs Barnes 6). (
b) A delivered a horse to B on trial for 8 days. B continued to retain the horse even after the expiry of 8 days without giving notice of rejection to A. B had automatically become the owner of the horse on the expiry of 8 days. 18.3.2 Transfer of Property in Unascertained and Future Goods The rule relating to transfer of property in unascertained and future goods 7 is contained in Sections 18 and 23. These Sections provide that where goods contracted to be sold are not ascertained or where they are
future
goods,
the
property in goods does not pass
to the buyer unless
and until the goods are ascertained
or
unconditionally appropriated to the contract
so as to bring them
in a deliverable state,
either
by the seller
with the assent of
the buyer or by the buyer with the assent of the seller.
Such assent may be expressed or implied, and may be given
either before or after the appropriation
is made.
It must be
noted that the above rule (as contained in Secs. 18 and 23) is a fundamental rule and it applies irrespective of what the parties intended. Until goods are ascertained or appropriated there is merely 'an agreement to sell.' Thus a sale often quintals of wheat from a granary containing a large quantity, has not the effect of transferring property in the ten quintals to the purchaser. It amounts only to 'an agreement to sell.' It is only when ten quintals are appropriated to the contract by the seller and the buyer has notice thereof, that property shall pass from the seller to the buyer. The process of ascertainment or appropriation consists in earmarking or setting apart goods as subject-matter of the contract. It involves separating, weighing, measuring, counting or similar acts done in relation to goods with an intention to identify and determine the specific goods to be delivered under the contract. The distinction between 'ascertainment' and 'appropriation' is that
whereas 'ascertainment' can be a unilateral act of the seller, that is, he alone may set apart the goods, 'appropriation' involves the element of mutual consent of the seller and the
buyer. 18.4 ESSENTIALS OF VALID APPROPRIATION The following points should be noted as regards a valid or proper appropriation of the goods: 5 (1878), 4 1.L.R.Cal. 801. 6 (188G). 5 C.P.D. 321. 7 Future goods are always unascertained goods. Check Your Progress 1. What do you understand by transfer of property in goods? 2. Describe distinction between transfer of possession and transfer of property in goods. 3. Explain the distinction between 'ascertainment' and 'appropriation'.
Transfer of Property Self-Instructional Material 225 NOTES (i) The appropriation must be of goods answering the contract description, both as to quality and quantity. (ii) The appropriation must be intentional, i.e.,
it must be made with intention to appropriate goods to specific contract,
and it must not be due to mere accident or mistake. (iii)
The appropriation must
be made
either
by the seller

with the assent of the buyer or by the buyer
with the assent of the
seller.
Assent
of the other party is thus necessary; whether before or after the appropriation
is made;
for a valid appropriation. (iv)
The appropriation must be unconditional, i.e., the seller should not reserve to himself
the right of disposal of the goods
until and unless certain conditions are
fulfilled.
Delivery to carrier [Sec. 23(2)].
A seller
is deemed to have unconditionally appropriated
the goods to
the
contract
where
he
delivers the goods to a carrier or other bailee (
whether named by the buyer or not)
for the purpose of transmission to the buyer,
and does not reserve the right of disposal.
Thus delivery
to a carrier
without reserving the right of disposal is a delivery to the buyer and the property passes at once at the time of delivery to the
carrier. For example, if goods have been loaded on rail and railway receipt is taken in the name of the buyer and the same is sent to him direct, the ownership is passed immediately on delivery to the railway company. But if the railway receipt, instead of sending direct to
the buyer, is sent to the bank with instruction to deliver it to the buyer on payment of the price,
the right of disposal is said to have been reserved and no property passes to the buyer on delivery
to the railway company.
Reservation of right of disposal (Sec. 25). Reservation of the right of disposal
means reserving
a
right to dispose of the goods until certain conditions (like payment of the price) are fulfilled.
When the seller reserves
such a right the property in the goods does not pass until
those conditions are fulfilled. The seller may reserve such a right expressly while making a contract or while making appropriation of unascertained goods. He may also reserve this right by implication, for example, when the seller while transporting goods takes the railway receipt or the bill of lading in his own name or where the seller has taken the R/R or B/L
in the name of the buyer but has delivered the same to his bank with the instructions that the document is to be delivered to the buyer only when he makes payment of the price or accepts the bill
of exchange, the right of disposal is said to be reserved impliedly. 18.5 RULE OF TRANSFER OF TITLE ON SALE The general rule relating
to the transfer of title on sale is that “
the
seller cannot transfer to the buyer of goods a better title than he himself has.”
If
the title of
the seller is defective the buyer’s title will also
be
subject to the same defect. Section 27 also lays down to the same effect and
provides
that “

where goods
are sold by a person who is not the owner thereof
and who does not sell them under
the authority or with the consent of
the owner, the buyer acquires no better title to
the goods than the seller had....”
This
rule is
expressed by
the maxim, “nemo det quod non habet, “ which means
that no one can
give what he has not
got.
The
general rule aims at protecting the interests of the true owner and is deemed necessary in the larger interest of society.
So if a thief disposes of
stolen property, the buyer acquires no title though he may have purchased the goods
bonafide for value, and
the
real owner of the goods is entitled to recover possession of goods without paying anything to the buyer.
Similarly, where a hirer of goods under a hire purchase agreement sells them before he had paid all the instalments, the buyer, though acting in good faith, does not acquire the pro- perty in the goods against the true owner and, on default of payment by the hirer, the true owner can recover the goods from the buyer (Whiteley & Co. vs Hilts 8). 8 (1918), 2 K.B. 808.
Transfer of Property 226 Self-Instructional Material NOTES Thus
a
buyer cannot get a good title to the goods unless he purchases the goods from
a person who is the owner thereof or who sells them under the authority or with the consent of the owner. 18.5.1
Transfer of Title by Non-Owners The above general rule as to title is subject to
the
following exceptions where
the buyer gets a better title to the goods than what the seller
himself possesses: 1. An unauthorised sale by
a mercantile agent (
Sec. 27).
A
mercantile agent means an
agent having in the customary
course of business as such agent
authority either to sell goods, or to consign goods
for the purposes of sale,
or to buy goods, or to raise money on the security of goods [
Sec. 2(9)]. Thus as a
rule a mercantile agent
having an authority to sell goods conveys a good title to the buyer. But by virtue of this provision (proviso to Sec. 27) a mercantile agent can convey a good title to the buyer even though he sells goods without having any authority from the principal to do so, provided
the following conditions are satisfied: (a)
he
should
be
in
possession of the
goods or documents of title to
the goods
in his capacity as mercantile agent and
with the consent of the owner, (b) he should sell the goods while acting in the

ordinary course of business, (c) the buyer
should act in good faith
without having any notice,
at the time of the contract,
that the agent has
no authority to sell.
Illustration. F
entrusted his car to
a mercantile agent for sale at
a
stated price and not below that. The agent sold it to S, a bonafide purchaser, below the reserve price and misappropriated the proceeds.
S resold the car to K, the defendant. Held, S obtained
a good title to the car from the mercantile agent
and he conveyed a good title to K and therefore F
was not entitled to recover the car from K (Folkes vs King 9). 2. Transfer of title by estoppel (Sec. 27).
In the words of Lord
Halsbury: "
Estoppel arises when you are precluded from denying the truth of anything, which you have represented as a fact, although it is not a fact."
Thus,
estoppel means that
a person who
by his conduct or words leads another to believe that certain
state of affairs
existed, would be estopped from denying later on that such a state of affairs did not exist. The basis of estoppel is that it would be unfair or unjust to allow a party to depart from a particular state of affairs which he has permitted another person to believe to be true (Central Newbury Car Auctions Ltd. vs Unity Finance Ltd. 10). Sometimes the doctrine of estoppel may estop or preclude the true owner from denying seller's right to sell the goods and thus an innocent buyer may have a good title despite the want of authority of the seller.
When the true owner of
the goods by his conduct or words or by any
act or omission
leads the buyer
to believe that the seller is the
owner
of the goods or has the authority to sell
them, he cannot afterwards deny the
seller's authority to sell.
The buyer in such a case gets a better title than that of the seller.
In reference to sale of goods, estoppel may arise in any of the following ways. 11 (i) The owner standing by, when the sale is effected, or (ii) still more, by his assisting the sale, or (iii) by permitting goods to go into the possession of another with all the insignia of possession thereof and apparent title, or (iv) if he has otherwise acted or made representations so as to induce the buyer to alter his position to his prejudice. 9 (1923), 1 K.B. 282. 10 (1956), 3 All E.R. 904. 11 Pollock and Mulla—Sale of Goods Act and Partnership Act, p. 120.
Transfer of Property Self-Instructional Material 227 NOTES Illustration. M, the owner of a wagon allowed one of his employees K, to have his name painted on it. M did so for the purpose of inducing the public to believe that the wagon belonged to K. C purchased the wagon from K in good faith. C acquires a good title as M is estopped from denying K's authority to sell (O'Connor vs Clark 12). 3. Sale by a
joint owner (Sec. 28).
If one of several joint owners of goods has the
sole possession of them by permission of the co-owners,
the
property in the goods is transferred to any person who buys them from such joint owner
in
good faith without notice
of the fact that the seller has no authority to sell.

It may be noted that in the absence of this provision (i.e., Sec. 28)
the buyer would have obtained only the title of the co-owners and would have become merely a co-owner with the other co-owners.
Hence the provision
constitutes an exception to the rule — "no one can give what he has not got." Illustration. A, B and C are
three brothers. They own a cow in common. B and C entrust the work of looking after the cow to A and leave the cow in A's possession. A sells the cow to D. D purchases bonafide for value. D
gets
a good title. 4.
Sale
by person in possession under voidable contract (
Sec. 29). When
a person has obtained possession of
the
goods
under a voidable
contract
and he sells those goods before
the contract has been rescinded, the buyer
of such goods acquires
a good title
to them
provided
the buyer acts
in good faith and without notice of
the
seller's
defect
of title.
The Indian Contract Act also provides to the same effect when it lays down that the right to avoid a voidable contract exists only so long as the interests of a third person have not intervened. If before it is exercised the interests of a third person have intervened, i.e., the buyer has sold the goods to a sub-buyer, the latter, if acting bonafide gets a good title and the original vendor cannot claim the goods back from the sub-buyer. Illustration.
A, by misrepresentation induces B to sell and deliver to him a
cow. A
sells the cow to C before B has rescinded the contract. C purchases
the cow
in good faith and
without notice of the seller's
defective title.
C acquires a good title.
It is to be noted that this Section (Sec. 29) does not apply unless there is a contract. Thus it does not apply to a contract originally void or where goods have been obtained by theft. 5.
Sale by Seller in possession after sale [Sec. 30(1)].
Where
a seller,
after
having sold the
goods, continues to be in
possession of the goods or of
the documents of title
to them
and again sells or pledges them either himself
or through
a mercantile agent,
he will convey
a good title to

the buyer
or
the pledgee provided the buyer or
the pledgee acts
in good faith and without notice of the
previous sale.
For
the
application of this exception it is essential that the possession of
the seller
must be as seller and not as hirer or bailee. 6.
Sale by buyer in possession after '
agreement to buy' [Sec. 30(2)]. Where a
buyer has agreed to buy
the goods and
has obtained
possession of the same or the documents of title to
them with the consent of the
seller,
resells or pledges the
goods
either himself
or through a mercantile agent, he will convey a good title to the buyer
or
the pledgee provided
the person receiving the goods
acts
in good faith and without notice
of
any lien or other right of the original seller
in respect of those goods.
It is to be noted that a person who has got merely 'an option to buy,' as in
a hire-purchase agreement, cannot convey a good title to
a sub-buyer, however bonafide, for 'an option to buy' is not 'an agreement to buy' (Belsize Motor Supply Co. vs Cox 13).
In order to make this exception applicable
it is essential that the person must have obtained possession of the goods under 'an agreement to sell' (
i.e., under 'an agreement to buy' from the buyer's point of view). Illustration. (a) A buys some furniture and agrees to pay for that in two monthly instalments,
the ownership to pass to him on payment of the second instalment.
Having obtained possession
of the furniture, A, sells the furniture to B before paying the second instalment. B buys the furniture 12 170
Pa St. 318. 13 (1914), 1 K.B. 244. Check Your Progress 4. Explain the rule of transfer of title on sale. 5. What do you understand by transfer of title by estoppel?
Transfer of Property 228 Self-Instructional Material NOTES bonafide. Subsequently A does not pay the second instalment. The furniture dealer cannot take back furniture from B, who obtains a good title to the same. The dealer can, of course, sue A for the breach of the contract and claim damages. (
b) A agreed to buy a car and pay for it, if his solicitor approved. A obtained possession of the car and sold
the same to B. But the solicitor subsequently disapproved of the transaction. It was held that B, the bonafide buyer, got a good title, because A agreed to 'buy (Marten vs Whale 14). 7. Resale
by an unpaid seller [Sec. 54(3)].
Where an
unpaid seller,
who
has exercised his
right of lien or stoppage in transit,
resells the
goods (

of which ownership has passed to
the buyer), the subsequent buyer acquires a good title thereto
as against the original buyer,
even though the resale may not be justified in the circumstances,
i.e.,
no notice of the resale has been given to the original buyer. 8.
Exceptions under other Acts. Other Acts also contain some provisions under which a non-owner may pass
to the buyer a better title than he himself has.
For example, (
a) Sale by finder of lost goods under certain circumstances (Sec. 169, The Indian Contract Act). 15 (b) Sale by pawnee or pledgee under certain circumstances (Sec. 176, The Indian Contract Act). 15 (c) Sale by Official Receiver or Assignee in case of insolvency of an individual and Liquidators of companies. These persons are not owners of the properties they deal in, but convey a better (good) title to the buyers than they themselves possess. (d) Under the Negotiable Instruments Act, a holder in due course gets a better title than what his endorser had.
In other words,
a person who takes a negotiable
instrument in good faith
and for value
becomes the true owner
even if he takes it from a thief or finder. 18.7
TEST
QUESTIONS 1.
Why is
it important to know the exact time when the
property in goods passes from
a seller to buyer? Explain with examples
the rules regarding the transfer of ownership of goods from seller to buyer. 2.
State
the rules
in regard
to the passing of property from a seller to a buyer in a contract for
the sale of goods. 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.
What are
rules as
to the passing of property from a seller to a buyer in a contract for
the sale of
unascertained
and future goods? 5. (a) “Risk prima facie passes with property.” Comment. (b)
Explain
what is meant by reservation of the right
of disposal in sale of goods. 6. “
Nemo Det Quod Non Habet” (No one can give
what he has not
got).
Comment, giving exceptions to this rule. Illustrate your answer. 7. “
A seller cannot convey a better title to the buyer than he himself
has.”
Discuss this rule of law and point out the exceptions. 8. “
No one can give a better title than what he himself
possesses.” Discuss this rule
with reference to sale of goods. 14 (1917), 2 K.B. 480. 15 For details refer Bailment and Pledge.

Transfer of Property Self-Instructional Material 229 NOTES 9. Discuss the various provisions of law under which a non-owner can convey a good title to a buyer. 18.8 PRACTICAL PROBLEMS Attempt the following problems, giving reasons:
1.
A
sells to B a horse which is to be delivered to B the next week. B is to pay the price on delivery.
A
asks his servant to keep the horse separate from other horses. The horse,
however,
dies before it is delivered and paid for. Who shall bear the loss? [
Hint.
It
is a contract of
sale of specific goods in a deliverable state
and therefore the
property in the horse passes to
B at once at the time of contract. Hence B should bear the loss]. 2.
On 6th May, A entered into a contract for the sale of 100 bags of wheat to B and received Rs 2,500 in part payment of the price. The goods were not with the seller at that time but had been despatched from Hapur on 4th May. A had received the R/R which he endorsed in favour of B on 6th May. The goods never reached the destination as they were burnt on 7th May while
in transit. Who shall bear
the loss? [Hint. B has to bear
the loss as
the property in the goods had passed to him
at once at the time of endorsement of the R/R in his name, i.e., on 6th May while the loss occurred on 7th May]. 3. X sells a car by auction to Y, who is the highest bidder. Y offers to pay for the car by a cheque and he is allowed to do so provided he signs a document stating that the property in the car would not pass to him until the amount of the cheque has been credited to the seller's account. The cheque is subsequently dishonoured. X asks Y to return back the car as he has not become the owner of the car because the cheque given by him
has been dishonoured. Is X's contention justified? [Hint. No, X's contention is not justified. The
property in the car had passed on the fall of hammer, a subsequent agreement that the property would not pass until the cheque is realised is of no effect and therefore X having lost his title to the car cannot recover back the same from Y. X 's only remedy is to sue Y for the price. Delivery and payment are concurrent conditions. X was, therefore, entitled to refuse delivery of car until paid and could have exercised his 'right of lien' as an unpaid seller. But once he has given the delivery of car, his 'right of lien' is lost, since lien is lost once possession is lost.] 4. A sells to B the whole content of a certain heap of wheat, which according to A contains 10 quintals. B gets the wheat weighed for his own satisfaction. When the wheat is being weighed, there is a fire and the whole of the wheat is destroyed.
Can A recover the price of wheat from B? [Hint. Yes, A can recover
the price from B. It
is a
contract of sale of specific goods in a deliverable state (
as nothing remained to be done by the seller to ascertain the price), and, therefore,
the property
passes to the buyer as soon as the contract is
made.
When the buyer gets something done for his own satisfaction, the passing of property is not affected by that and Sec. 20 applies to such a case alright]. 5. A gives
some diamonds to B on sale or return basis. On the same day B
gives those diamonds to C on sale or return and from him they are lost.
Who shall bear the loss? [Hint. B must bear the loss because by transferring the diamonds further he has adopted the transaction
and the property in them has, therefore, passed to him].
Performance of Contract of Sale Self-Instructional Material 231 NOTES UNIT 19 PERFORMANCE OF CONTRACT OF SALE Structure 19.0 Introduction 19.1 Unit Objective 19.2

Delivery 19.3 Rules as to Delivery of Goods 19.4 Acceptance of Delivery by Buyer 19.5

Test Questions 19.6 Practical Problems 19.0 INTRODUCTION “
It
is
the duty
of the seller to deliver the goods
and of
the buyer
to accept and pay
for them,
in accordance with
the
terms
of
the contract of sale” (
Sec. 31). Thus,
the
performance of a contract of sale
implies delivery of goods by the seller and acceptance of the delivery of goods and payment for them by the buyer, in accordance with the
contract. The parties are free to provide any terms they like in their contract about
the time, place and manner of delivery of goods, acceptance thereof and payment of the price. But if the parties are silent and do not provide any thing regarding these matters in the contract then the rules con- tained in the Sale of Goods Act
are applicable. 19.1 UNIT OBJECTIVE Be familiar with the rules relating to delivery of goods and acceptance of goods. 19.2 DELIVERY
Delivery of goods
means
voluntary transfer of possession
of goods from one person to another [
Sec. 2(2)].
If transfer of possession of goods
is not voluntary, i.e., possession is obtained under pistol point or by theft, there is no delivery. 19.2.1 Modes of Delivery
Delivery of goods may be made in any of the following ways: 1. Actual
delivery. Where the goods are physically handed over by the seller (or his authorised agent)
to the buyer (or his authorised agent), the delivery is said to be actual.
For example, the seller of a
car hands over the car to the buyer, there is actual delivery of the goods. 2. Symbolic delivery. Here the goods remain where they are (probably because they are bulky),
but the means of obtaining possession of goods is delivered. For example,
the
seller hands over to the buyer
the key of the godown where the goods are
stored,
or transfers
a document of title (i.e., bill of lading or railway receipt) to the buyer
which will entitle him to obtain the goods. 3. Constructive delivery or delivery by attornment. Such a delivery takes place when the person
in possession of the goods
of the seller acknowledges, in accordance with the seller’s order, that he holds the goods on behalf
of the buyer

and the buyer has assented to it. Note that in such a delivery all the three parties, namely, the seller, the person holding the
Performance of Contract of Sale 232 Self-Instructional Material NOTES seller's goods and the buyer, must concur. For example, where the seller hands over the 'delivery order' to the buyer and the warehouseman, who was holding the goods as a bailee of the seller, agrees and acknowledges to hold them
on behalf of the buyer, there is a constructive delivery. Similarly,
where
the seller after selling the
goods agrees to hold them on behalf of the buyer
as his bailee
there is deemed to be delivery of
the goods to the buyer. 19.3
RULES AS TO DELIVERY OF GOODS The rules regarding delivery of goods
are as follows: 1.
Delivery may be either actual or symbolic or constructive (
Sec. 33).
Delivery
of goods sold may be made by doing anything which the parties agree
shall be treated as delivery or
which has
the effect of putting
the
goods in the possession of the buyer or
of any person authorised to hold them on his behalf.
Thus, the delivery of
the
goods may be either actual, or symbolic or constructive. (
These terms have already been explained
under the preceding heading.) 2.
Delivery and payment are concurrent conditions (Sec. 32).
Unless otherwise agreed,
delivery of
the
goods and payment of the price are concurrent conditions,
that is,
the seller should be ready and willing to deliver the goods to the buyer
in
exchange for
the
price and
the buyer should be ready and willing to pay the price
in exchange for
possession of
the goods
simultaneously, just like in a cash sale over a shop counter. Illustration.
A contracts to sell to B 10 bags of sugar for Rs 9,000.
A need not deliver the goods unless B is ready and willing to pay for the goods on delivery, and B need net pay for the goods unless A is ready and willing to deliver them on payment. 3.
Effect of
part delivery, when property in goods is to pass on
delivery (Sec. 34).
A
delivery of part of the goods, in progress of the delivery of the whole, has the same effect, for the purpose of passing the property in
such goods, as a delivery of the whole.
In other words, when a delivery of part of the goods has been made with
the intention of

delivering the rest also, the property in the whole of the goods is deemed to pass to the buyer as soon as some portion is delivered. Illustration. A ship arrives with a cargo consigned to X, the buyer of the cargo, upon the condition that the property is to pass to him on delivery. The captain begins to discharge it, and delivers over part of the goods to X in progress of the delivery of the whole. Here, the delivery of the portion of the goods to X is equivalent to the delivery of the whole of the cargo and the property in the whole of the goods passes to X, the buyer (Dixon vs Yates 1). But when a part of the goods is delivered with the intention of severing it from the whole, it is not regarded as delivery of the whole of the goods and the property is deemed to pass to the buyer in that portion of the goods only which has been delivered. Illustration. If in a contract for the sale of a stack of hay the buyer is permitted to remove only a part of it, this does not amount to delivery of the whole as it shows an intention to separate the part delivered from the rest of hay (Bunnery vs Poynz 2) It may be emphasised that the above stated rules are applicable only when passing of property has been made dependent on delivery of the goods. It fact these rules are declaratory of the general law relating to transfer of property (which has already been discussed in the preceding chapter). 4. Buyer to apply for delivery (Sec. 35). Although it is the duty of the seller to deliver the goods according to the contract, yet he is not bound to deliver them until the buyer applies for delivery. It is the duty of the buyer to demand delivery, and if he fails to do so, he cannot blame the seller for the non-delivery. The parties may, however, agree otherwise. 1 5B. & Ad. 313. 2 (1833). 4 B. & Ad. 568.

5. Time of delivery [Sec. 36(2) & (4)]. Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time. Further, demand of delivery by the buyer or the tender of delivery by the seller should be made at a reasonable hour. What is a reasonable hour is a question of fact. 6. Place of delivery [Sec. 36(1)]. The place of delivery may be stated in the contract of sale, and where it is so stated, the goods must be delivered at the named place during business hours on a working day. But where

no place is mentioned
in
the contract, the following rules
must be followed: (i)
In
the
case of '
sale,'
the
goods are to be delivered at the place at which they are
at the time of
the sale. (
ii) In "an
agreement to sell,"
the goods
are to be
delivered at the place where they are at the time of
the agreement to sell. (
iii) In
the case of future goods,
the
goods are to be delivered at
the place at which they are
manufactured or produced.
Where the seller of
goods
agrees to deliver them at his own risk
at a place other than
that where
they are when sold, the
buyer must, nevertheless, unless otherwise agreed,
take any risk of deterioration in the goods necessarily incidental to the course of transit (
Sec. 40). 7.
Delivery of goods where they are
in
possession of a
third party [Sec. 36(3)].
Where
the goods
at the time of sale are in
the
possession of
a
third person, there
is no
delivery
by
the seller
to
the
buyer
unless and until such third
person acknowledges
to the buyer that he holds
the goods on
his
behalf.

Such a delivery is known as “constructive delivery” or “
delivery by attornment” and requires
the consent of all the three parties,
the seller, the buyer and the person having possession of the goods. Where the seller
hands over the ‘delivery order’
to the buyer, there is no delivery unless the seller’s agent holding the goods has assented thereto.
But
where the goods have been sold by the transfer of the document of title to goods, railway receipt or bill of lading,
the buyer is deemed to be in possession of the goods represented by such document, and the assent of the third party
is not required. 8.
Expenses of delivery [Sec. 36(5)].
Unless otherwise agreed, the expenses of and
incidental to
putting the goods into a deliverable state must be borne by the seller. 9.
Delivery of wrong quantity
or different quality (Sec. 37). As already observed, a seller is duty bound
to deliver the goods to the buyer strictly in accordance with the terms of the contract.
A defective delivery, i.e., delivery of a quantity less or more than that contracted for or delivery of
goods
mixed with the
goods of a
different description not included in the contract,
entitles
the buyer: (
i) to reject the whole,
or (ii) to accept the whole, or (iii) to accept the quantity
and quality he ordered and reject the rest of the goods
so delivered. Remember that
in case of rejection of goods because of defective delivery
the
buyer
is not bound to return them to the seller,
but
it is
sufficient if he intimates to
the seller that he
refuses to accept
them (
Sec. 43). Further,
the right to reject the goods is not equivalent to right to cancel the contract. If the buyer rejects the goods,
the seller has a right to
tender again goods of contract quality and quantity subject to the terms and conditions
of
the contract
and the buyer is bound to accept the same (
Vilas Udyog Ltd. vs Prag Vanaspati 3). 3
A.I.R. (1975). Guj. 112.
Check Your Progress 1. What do you understand by the term ‘delivery of goods’? 2. What do you understand by symbolic delivery of goods?
Performance of Contract of Sale 234 Self-Instructional Material NOTES Where the buyer accepts the goods, he must pay for what he has actually accepted, at the contract rate. In case
the buyer has accepted short delivery he is entitled to claim damages for the same from
the seller. If, however, the deficiency or
excess is so small as to be negligible, the court does not take account of
that, and the buyer must accept the goods. This is based on the maxim that “the law does not take trivial deviations into account.”
The above provisions

are subject to any usage of trade, special agreement
or course
of dealing between the parties [
Sec. 37(4)]. 10. Instalment deliveries (Sec. 38).
Unless otherwise agreed,
the
buyer of goods is not bound to accept delivery
thereof by
instalments.
If the parties so agree
then only the delivery of the goods may be made by instalments. When the parties agree that the delivery is to be made by instalments and each instalment is
to be separately paid for, and either buyer or seller commits a breach of contract
in respect of one or more instalments, there arises a question as to whether such a breach amounts to a breach of the whole of the contract or a breach of only a part of it? The answer to this question
depends upon
the terms of the contract and the circumstances of the case.
Unless otherwise agreed the following two factors must be borne in mind in deciding the whole matter: (
a) The quantitative proportion
which the breach bears to the contract as a whole, and (b) the degree of probability
of the repetition of the breach (Maple Flock Co. Ltd. vs Universal Furniture Products Ltd. 4).
Generally, failure to deliver or pay for one instalment does not amount to a breach of the whole contract, unless from the special circumstances of the case (e.g., the factory is closed because of a labour strike or the buyer becomes insolvent) it can be inferred that similar breaches will be repeated. Illustration. A sold to B 1,500
tons of meat of a specified quality to be shipped 125 tons monthly in equal weekly instalments. After about half the meat was delivered and paid for, B discovered that it was not of the contract quality and
could have been rejected, and therefore he refused to take further deliveries. Held, that B was entitled to do so (Robert A. Munroe & Co. Ltd. vs Mever 5). (If B might have discovered the defect just after first instalment, he would not have been allowed to repudiate the whole contract but only the damages for the loss in that particular instalment delivery would have been allowed). 11.
Delivery to carrier or wharfinger (Sec. 39). Where
the seller is authorised or required to send
the goods
to the buyer,
delivery of the goods to a carrier,
whether named by the buyer or not,
for
the purpose of transmission to the buyer,
or
delivery of the goods
to a wharfinger for safe custody, is prima facie deemed to be a delivery of
the goods to the buyer.
Seller's duty.
Unless the buyer requires to despatch the goods at owner's risk, it is the duty of the seller, when he delivers the goods to the carrier or wharfinger, to
enter into a reasonable contract
on behalf of the buyer for the safety
of the goods,
and if he fails to do so, and the goods are lost or damaged,
the
buyer may decline to treat the delivery to the carrier or wharfinger as
a
delivery to himself, or may hold the seller
responsible in damages.
Sea transit.
Unless otherwise agreed, where goods are sent by the seller to the buyer
by a route

involving sea transit,
where it is usual to insure,
the seller must inform the buyer in time to
get the goods insured
during their sea
transit, and
if the seller fails to do so, the goods shall be
deemed to be at his risk during such sea transit. 12.
Liability of buyer for neglecting or
refusing to take
delivery of goods. (Sec. 44).
When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and
the buyer does not within a reasonable time after such request take delivery
of the goods, he becomes liable to the seller for any loss occasioned by his neglect or refusal to take delivery,
and
also
for
a
reasonable charge for the care and custody of the goods. 4 (1934),
I K.B. 148. 5 (1930), 2 K.B. 312. Check Your Progress 3. What do you mean by instalment delivery? 4. P of Singapore agreed to sell 700 tons of sugar to Q of India to be shipped in July 2006. P puts the sugar on ship in May 2006. Is the buyer bound to accept the consignment?
Performance of Contract of Sale Self-Instructional Material 235 NOTES 19.4 ACCEPTANCE OF DELIVERY BY BUYER
The mere fact that the buyer has taken the delivery of the goods does not amount to acceptance of
them.
According to
Section 42, the buyer is deemed to have accepted the goods
in
either of the following
circumstances, namely: 1.
When he
intimates to the seller that he has accepted the goods.
Before intimating about acceptance the buyer has a right, under Section 41, to examine and test the goods in order to be sure as to whether they are in conformity with the contract
regarding quality etc. He may even use the goods, if it is necessary for the purpose of testing, e.g., in the case of a horse sale conditioned to run at 25 kilometers per hour it is necessary to use the horse for ascertaining, whether the horse is in conformity with the contract. But if he is not satisfied, he must act promptly to inform the seller about rejection. 2.
When he
does any act in relation to
the goods
which is inconsistent with the ownership of the seller,
e.
g.,
consumes, uses, pledges or resells the goods
or puts his mark on them. Illustrations. (a) Where the buyer having seen that samples drawn from bulk were inferior to the samples originally shown to him, offered the goods for sale by auction at reduced price and the auction having failed to produce a purchaser,
the buyer purported to reject the goods, it was held that the buyer could not
do so as he had in law 'accepted' the goods (Parker vs Palmer 6). (b) Where the buyer
took delivery of wheat and sold a part of it, and afterwards found that the wheat was not
of contract
quality and therefore sought to reject it, it was held that he had lost the right of rejection as he had accepted the wheat by a dealing inconsistent with the rights of the seller, in so far as he had sold out a portion of it (Hardy & Co. vs Hillerns and Fowled 7). 3.
When, after the lapse of a reasonable time, he retains the goods without intimating the seller that he has rejected
them.
What is reasonable time is a question of fact.

If time for rejection is stipulated, rejection must be within that period. It may be mentioned that on rejection of goods because of defective delivery, mere informing the seller is enough and the buyer
is not bound to return the rejected goods to the seller (
Sec. 43). 19.5 TEST QUESTIONS 1. Define
the term 'delivery' as used in a contract of sale
and discuss the rules relating to
delivery
of goods. 2. "
It
is
the duty
of the seller to deliver the goods
and of
the buyer
to accept and pay
for them
in accordance with the
terms of
the
agreement." Elucidate. 3. (a)
State the rights of a buyer in case of (i)
short delivery, (
ii) delivery in excess of contract quantity, and (iii) delivery of contract goods mixed with other goods. (b) "Delivery does not amount to acceptance of goods."
Comment. 4. Enumerate the rights and duties of the buyer in respect of
the sale of goods. 19.6 PRACTICAL PROBLEMS Attempt the following problems, giving reasons
for your answers: 1.
A sells to B 100 bags of wheat which are locked up in a godown. A hands over
to B
the key of the godown. Does it constitute delivery of the goods to B? [Hint. Yes,
this is a delivery to D, being a symbolic delivery.] 6 4 B. & Ad. 387. 7 (1923), 2 K.B. 490.
Performance of Contract of Sale 236 Self-Instructional Material NOTES 2. X of Cochin agreed to sell 400 tons of rice to Y of Calcutta to be shipped in November or December 1995. X puts the rice on ship on 20 October, 1995. Is the buyer bound to accept the consignment? [Hint. The buyer is not bound to accept the consignment because the seller has not complied with the stipulation as to time of delivery and time of delivery of goods being of the essence of all mercantile contracts, an essential term of the contract has been broken.] 3. P
of Delhi writes to R of Bombay to send him a book by parcel post. R accordingly sends the book by parcel post. The parcel is lost on the way. Can R recover its price from P? [Hint. Yes,
R can recover the price of the book from P because as per Section 39 of the Sale of Goods Act,
delivery to the carrier (i.e., the
post office) is delivery to
the buyer and the buyer becomes the owner thereafter who should bear the loss.] 4.
P sold barley
to B by sample, delivery to be made at T railway station. B
sold the barley to X. The barley was delivered at T railway station and
B, after inspecting a sample of it, sent it on to X. X rejected it as not being according to sample, whereupon B seeks to reject the goods. Will
B succeed? [Hint. B cannot reject the barley, as by reselling those goods to X and ordering to send them to X, he had in law 'accepted' the goods.]
Remedial Measures Self-Instructional Material 237 NOTES UNIT 20 REMEDIAL MEASURES Structure 20.0 Introduction 20.1 Unit Objectives 20.2
Rights of Unpaid Seller 20.3 Buyer's Rights Against Seller 20.4 Auction Sale 20.5
Test Questions 20.6 Practical Problems 20.0 INTRODUCTION The term 'unpaid seller' is defined as
the seller to whom the full price of the goods sold has not been paid. The legal
definition of an unpaid seller
is given
in

Section 45 of the Sale of Goods Act, 1930 as:
The
seller of goods is deemed to
be an 'unpaid seller' (
a)
when the
whole of
the price has not been paid
or
tendered; or (b) where
a bill of exchange or other negotiable instrument
has been
received as
a conditional payment,
i.e., subject to the real- ization thereof, and the same has been dishonoured. This unit discusses the various provisions of the Act regarding the rights of an unpaid seller, a buyer's rights against the seller and auction sale. 20.1 UNIT OBJECTIVES
? Understand the concept of an 'unpaid seller' and remedies available to
an 'unpaid seller' ? Be clear about
the right of lien and right of stoppage in transit
as to when these two rights can be exercised ? Know the rights of buyer and the seller in case of breach of contract ? Know
the rules
of the auction sale 20.2 RIGHTS OF UNPAID SELLER 20.2.1
Unpaid Seller Defined
The
seller of goods is deemed to be an 'unpaid seller' (
a)
when the
whole of
the price has not been paid
or
tendered; or (b) where
a bill of exchange or other negotiable instrument
has been
received as
a conditional payment,
i.e., subject to the realisation thereof, and the same has been dishonoured.
The term 'seller' here
includes any person who is in the position of a seller,
as,
for instance,
an agent of the seller to whom the bill of lading had been endorsed,
or a consignor
or agent who has himself paid, or is directly responsible for, the price. (
Sec. 45)
This definition emphasises
the following characteristics
of an 'unpaid seller': 1.
He must sell goods on cash terms
and not on credit, and he must be unpaid. 2. He must be unpaid either wholly or partly. Even if only a portion of the price, however small, remains unpaid, he
is
deemed to be an unpaid seller. Where the price is paid through a bill of exchange or other negotiable instrument,
the same must be dishonoured. 3. He must not refuse to accept payment when tendered. If the price has been tendered by
the buyer but the seller wrongfully refuses to take the same, he ceases to be an unpaid seller.

Rights of an Unpaid Seller An unpaid seller has two-fold rights, viz.: I.
Rights
of unpaid seller against the goods,
and
II. Rights of unpaid seller against the buyer
personally.
We shall now examine these rights
in detail. I.
Rights
of
Unpaid Seller against the
Goods
An unpaid seller has the following
rights against the
goods
notwithstanding the fact that
the property in the goods has passed to
the buyer: 1.
Right
of
lien; 2. Right of stoppage of goods in transit; 3. Right of resale [
Sec. 46(1)]. 1.
Right
of lien (
Sec. 47) 'Lien'
is
the right to
retain possession of goods
and refuse to
deliver them to
the
buyer until the
price
due in respect of them
is paid or tendered.
An unpaid seller in possession of
goods sold is entitled to exercise his lien on
the goods
in
the following
cases: (a)
where
the goods have been sold without any stipulation as
to
credit; (
b)
where
the goods have been
sold on
credit, but the term of credit has expired: (c) where the buyer
becomes insolvent, 1
even though the period
of
credit may not
have yet expired.
In the case of buyer's insolvency the lien exists even though
goods had been sold on

credit and the period of credit has
not
yet expired.
When the
goods are sold on credit the presumption
is that
the buyer
shall keep his
credit good. If, therefore, before payment
the buyer becomes insolvent, the seller is entitled to exercise this right and hold the goods as security for the price.
The
effect of buyer's insolvency is that all stipulations as to credit are put to an end and the seller has a right to say, "I will not deliver the goods until I see that I shall get my price paid" (Griffiths vs Perry 2).
The unpaid seller's lien is a possessory lien, i.e., the
lien
can be exercised as long as the seller remains in possession
of the goods.
He
may
exercise his right of lien
notwithstanding that he is in possession of the goods as agent
or bailee for
the
buyer [
Sec. 47(2)].
Transfer of property in the goods or transfer of documents of title to the goods 3 does not affect the exercise of this right, provided the goods remain in the actual possession of the seller.
In fact when property
has passed to the buyer then only retaining of goods is called technically 'lien.'
Where
the property in goods has not passed to the buyer
and the
title is still with the seller then it is, strictly speaking, anomalous to say that the seller has a lien against his own goods.
The seller's lien when property has not
passed to the buyer is termed as 'a
right of withholding delivery. ' Accordingly, Section 46(2) provides: "
Where
the
property in goods has not passed
to the buyer, the unpaid seller
has, in addition to
his other
remedies,
a right of withholding
delivery
similar to and coextensive
with his rights of
lien and stoppage in transit
where the property has passed to the buyer." 1
The
term insolvent here does not mean a person who has been adjudged insolvent under the Insolvency Law. In Sale of Goods Act "
a person
is
said to be insolvent
who has ceased
to pay his debts in the ordinary course of business, or cannot pay his debts

as
they become due, whether he has committed an act of insolvency or not" [
Sec. 2(8)]. 2 (1859),
I E. & E. 680. 3 But
if the buyer has transferred the documents of title to a bonafide purchaser,
the seller's lien is defeated (Sec. 53).
Remedial Measures Self-Instructional Material 239 NOTES This
right of lien
can be exercised only for the non-payment of
the price and not for any other charges,
e.g., maintenance or custody
charges, which the seller may have to
incur for storing the goods in exercise of his lien for the price. 4 This right of lien
extends to the
whole of the
goods in his possession even though part payment
for those goods
has already been made. In other words the
buyer is not entitled to claim delivery of
a portion of the
goods on payment of a proportionate price. Further,
where
an
unpaid seller has made
part delivery of the goods, he may exercise his right of lien on the remainder,
unless such
part delivery has been made
under such circumstances as to show
an agreement to
waive the lien (
Sec. 48). Also, the
lien can be exercised even though
the
seller
has obtained a 'decree' for the price of the goods [
Sec. 49(2)].
When lien is lost? As already observed, lien
depends on physical
possession of goods.
Once the possession is lost, the lien is also lost.
Section 49 accordingly provides that
the unpaid seller of goods
loses his lien thereon
in
the following cases: (
a)
when
he
delivers the goods
to a carrier or other bailee for
the purpose of
transmission to the buyer
without reserving the right of
disposal
of the
goods;
or (b)

when
the buyer or his agent lawfully obtains possession of the goods;
or (c)
when the seller
expressly or impliedly waives his right of lien.
An implied waiver takes place
when
the seller grants fresh term of credit or allows the buyer to accept a bill of exchange payable at a future date
or assents to a sub-sale 5 which the buyer may have made.
It may be noted that right of lien, if once lost, will not revive if the buyer redelivers the goods to the seller for any particular purpose. Thus, where a refrigerator after being sold was delivered to the buyer and since it was not functioning properly, the buyer delivered back the same
to the seller for repairs, it was held that the seller could not exercise his lien over the
refrigerator (Eduljee vs John Bros. 6). 2.
Right
of Stoppage of Goods
in Transit
The right of stoppage in transit means the right of stopping
further
transit
of the
goods while they are
with
a carrier for the purpose
of transmission to the buyer,
resuming possession
of them and retaining possession until
payment
or tender of the price.
Thus, in a sense
this right
is an extension
of the right of lien because it entitles the seller to regain possession even when
the seller has parted with the
possession
of the goods.
When can this right be exercised? (
Sec. 50). An unpaid seller can exercise this right
only when: (a)
the buyer becomes insolvent.
The buyer
is said to be insolvent when he
has ceased to pay his debts in the ordinary course of business, or cannot pay his debts
as they become due,
whether he
is declared an insolvent or not [Sec. 2(8)]; and (
b)
the property
has passed to the buyer. If property has not passed to the buyer
then
this right is termed as the "right of withholding delivery [Sec. 46(2)]; and (c) the goods
are in the course of transit. This means that goods must be neither with the seller nor with the buyer nor with their agent. They should be in the custody of a carrier as an independent middleman (i.e., in his own right as a carrier), e.g., railways and common carriers whose business is to transport goods of others. The carrier must not be either seller's agent or buyer'
s agent. Because if he is seller's agent, the goods are still in the hands of seller in the eye of law and hence there is no transit, and if he is buyer's agent, the buyer gets

delivery in the eye of law and hence question of stoppage does not arise. 4 Section 46 (1) (a) and 47 (1). 5 Section 53 (1). 6 A.I.R. (1943), Nag. 249.

Duration of transit (Sec. 51). Since the right of stoppage in transit can be exercised only so long as the goods are in the course of transit, it becomes necessary to know as to when the transit begins and when it comes to an end. When the transit comes to an end the right of stoppage cannot be exercised. According to Section 51, goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent takes delivery of them. Thus the transit continues so long as the goods are not delivered to the buyer or his agent, no matter whether they are lying at the destination with the carrier awaiting transmission or are in actual transit. The goods are still deemed to be in transit if they are rejected by the buyer and the carrier or other bailee continues in possession of them, even if the seller has refused to receive them back. The transit is deemed to be at an end and the seller cannot exercise his right of stoppage in the following cases: (a) When the buyer or his agent takes delivery after the goods have reached destination. (b) When the buyer “or his agent obtains delivery of the goods before their arrival at the appointed destination. (c) When the goods have arrived at their destination and the carrier acknowledges to the buyer or his agent that he holds the goods on his behalf. (

d) When the goods have arrived at their destination but the buyer instead of taking delivery requests the carrier to carry the goods to some further destination
and
the carrier agrees to take them to the new destination. (e)
When
the carrier wrongfully refuses to deliver the goods
to the buyer
or his agent. (
f) When
part delivery of the goods has been made to the
buyer
with an intention of delivering the whole of the goods, transit will be at an end for the remainder of the goods also
which are yet
in
the course
of
the transit. How right of stoppage
is exercised (Sec. 52). The unpaid seller may exercise his right of stoppage in transit
either: (
a)
by taking actual possession of the
goods, or (b) by giving notice
of his claim
to the carrier
or other
bailee
in whose possession the
goods are. Such notice may be given either {
a)
to
the person in actual possession of the goods, or (b) to his principal. In
the
latter case, notice must be
given
well in
advance to enable the principal to communicate with
his agent
or servant in time,
so as
to prevent delivery
to
the buyer.
It is the duty of the carrier, after receiving due notice, not to deliver the goods to the buyer but to redeliver them to, or according to the directions of the seller. If by mistake he delivers the goods to the buyer, he can be made liable for conversion. The expenses of redelivery are to be borne by the seller. 20.2.3 Lien and Stoppage in Transit Distinguished The main points of distinction between these two rights of an unpaid seller are as follows: 1. The seller's lien attaches when the buyer is in default, whether he be solvent or insol- vent. The right of stoppage in transit arises only when the buyer is insolvent. 2. Lien is available only when the goods are in actual possession of the seller while right of stoppage

is available when the seller has parted with possession and the goods are in the custody of an independent carrier. Remedial Measures Self-Instructional Material 241 NOTES 3. The right of lien comes to an end once the seller hands over the possession of the goods to the carrier for the purpose of transmission to the buyer. On the other hand, the right of stoppage in transit commences after the seller has delivered the goods to a carrier for the purposes of transmission to the buyer and continues until the buyer has acquired their possession. 4. The right of lien consists in retaining the possession of the goods while the right of stoppage consists in regaining possession of the goods. Effect of Sub-sale or Pledge by Buyer upon the "Two Rights of the Unpaid Seller" Discussed Above (Sec. 53) The unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition (e.g., pledge) of the goods which the buyer might have made. For example, P sells certain goods to R and delivers them to a carrier for transmission to R. Before the goods reach their destination P comes to know that R has become insolvent. In the meanwhile R sells those goods to Q. The sale of goods between R and Q will not affect the right of P to stop them in transit. But there are two exceptional cases when these two rights of the unpaid seller are affected by a sale or other disposition (e.g., pledge) of the goods by the buyer. These exceptions are: (i) When the seller has assented to the sale or other disposition (e.g., pledge) which the buyer may have made. (ii) When a document of title to goods (e.g., a bill of lading or railway receipt) has been issued or transferred to a buyer, and the buyer transfers the document to a person who takes the document in good faith and for consideration, then, (

a)
if such last mentioned transfer
was
by way of sale,
the unpaid seller's right of lien or stoppage
in transit
is
defeated,
and (
b)
if such last mentioned transfer was
by way of pledge,
the unpaid seller's right of lien or stoppage in transit
can only
be
exercised subject to the rights of the
pledgee.
But in this case
the unpaid seller may require the pledgee to satisfy his claim against the buyer first out of any other goods or securities
of the buyer in
the hands
of the pledgee. 3.
Right of
Resale The
right of resale is
a very valuable right given to an unpaid seller.
In
the absence of this right, the unpaid seller's other rights against the goods, namely, 'lien' and 'stoppage in transit,' would
not have been
of much use
because these
rights only entitle the unpaid seller to retain the goods until paid by the buyer. If the buyer continues to remain in
default, then should the seller be expected to retain the goods indefinitely,
specially when the goods are perishable? Obviously, this cannot be the intention of the law. Section 54, therefore, gives
to the unpaid seller a
limited right to
resell the
goods
in the following cases: (
a) where the goods are of a perishable nature;
or (b) where
such a right is
expressly reserved
in the contract in case the buyer should make a default; or (
c)
where
the seller has given a
notice to the buyer of his intention to resell and the buyer does not pay
or tender the price within a reasonable time.
If on a resale
there is a
loss to the seller,
he can recover it from the defaulting buyer. But
if there is a surplus on the resale, the seller can keep it with him because the buyer cannot be allowed to take advantage
of his
own wrong.
If, however, no notice of resale [as required in case (c)

above] is given to the buyer, the right of seller to claim loss and retain surplus, if any, is reversed. In other words, if the unpaid seller fails to give notice of resale to the buyer, where neither the goods are of perishable nature nor such a right was expressly reserved, he cannot recover the loss from the buyer and is under an obligation to hand over Remedial Measures 242 Self-Instructional Material NOTES the surplus, if any, to the buyer, arising from the resale. Thus, it will be seen that giving of notice to the buyer, when so required, is very necessary to make him liable for the breach of contract. It is so because such a notice gives an opportunity to the buyer either to pay the price and have the goods, or, if he cannot pay, to supervise the sale to see that the same is properly made. It is important that absence of notice, when so required, affects the rights of the unpaid seller himself only as discussed above and it does not affect the title of the subsequent buyer who will acquire a good title to the goods. Section 54(3) specially declares— " Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title thereto as against the original buyer, notwithstanding that no notice of the resale has been given to the original buyer."

II. Rights of Unpaid Seller against the Buyer Personally The unpaid seller, in addition to his rights against the goods as discussed above, has the following three rights of action against the buyer personally: 1. Suit for price (Sec. 55). Where property in goods has passed to the buyer; or where the sale price is payable ' on a day certain', although the property in goods has not passed; and the buyer wrongfully neglects or refuses to pay the price according to the terms of the contract, the seller is entitled to sue the buyer for price, irrespective of the delivery of goods. Where the goods have not been delivered, the seller would file a suit for price normally when the goods have been manufactured to some special order and thus are unsaleable otherwise. 2. Suit for damages for non-acceptance (Sec. 56). Where the buyer wrongfully neglects or

refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. The seller' s remedy in this case is a suit for damages rather than an action for the full price of the goods. The damages are calculated in accordance with the rules contained in Section 73 of the Indian Contract Act, that is, the measure of damages is the estimated loss arising directly and naturally from the buyer's breach of contract. Where the goods have a ready market the principle applicable is that the seller may recover from the buyer damages equal to the difference between the contract price and the market price on the date of the breach of the contract. Thus, if the difference between the contract price and market price is nil, the seller can get only nominal damages (Charter vs Sullivan 7) But where the goods do not have any ready market, the measure of damages will depend upon the facts of each case. For example, in Thompson Ltd. vs Robinson 8 the damages were assessed on the basis of profits lost. In that case, T Ltd., who were car dealers, contracted to supply a motorcar to R. R refused to accept delivery. It was found as a fact that the supply of cars exceeded the demand at the time of breach and hence in a sense there was no market price on the date of breach. Held, T Ltd., were entitled to damages for the loss of their bargain viz., the profit they would have made, as they had sold one car less than they otherwise would have sold. To take another illustration, if the goods have been manufactured to some special order and they are unsaleable and have no value at all for other buyers, then the seller may even be allowed the full price of the goods as damages. 3. Suit for special damages and interest (Sec. 61). This Section entitles the seller to sue the buyer for 'special damages' also for such loss " which the parties knew, when they made the contract, to be likely to result from the breach of it." In fact the Section is only declaratory of the principle regarding 'special damages' laid down in Section 73 of the Indian Contract Act. The Section also recognises unpaid seller's right to get interest at a reasonable rate on the total unpaid price of the goods sold, from the time it was due until it is actually paid. (Telu Ram Jam vs Agganval & Sons 9). 7 (1957), 2 Q.B. 117. 8 (1955), Ch. 177. 9 A.I.R. (1991) P.&H. 140. Check Your Progress 1. What do you understand by unpaid seller? 2. Explain briefly the right of stoppage in transit of the unpaid seller. 3. The unpaid seller' s lien is possessory lien. Elucidate. Remedial Measures Self-Instructional Material 243 NOTES 20.3 BUYER'S RIGHTS AGAINST SELLER The buyer has the following rights against the seller for breach

of contract: 1.
Suit for
damages
for non-delivery (
Sec. 57).
Where
the seller wrongfully
neglects or
refuses to
deliver the goods to the buyer, the buyer may sue
the seller for damages for non-
delivery.
The
damages are
assessed in accordance with the rules contained in Section 73
of the Indian Contract Act, that is,
the measure of damages
shall be the estimated loss directly and
naturally resulting, in the ordinary course of events, from the
seller's breach of contract.
If the
goods in question have a ready market the measure of damages is
prima facie to be ascertained by
the difference between the contract price and market price on the date
of
breach.
Section 61 entitles the buyer to sue the seller for 'special damages' also for
such loss
which
the seller knew
when they made the contract to be likely to result from the breach
of it. 10
Illustration. 11
A, having contracted with B to supply B with 1,000
tons of iron at Rs 100 a ton, to be delivered at a stated time, contracts with
C for the purchase of 1,000 tons of iron at Rs 80 a ton, telling C that he does so for
the
purpose of performing his contract with B. C fails to perform his contract with A, who cannot procure other iron, and B in consequence rescinds the contract. C must pay to A Rs 20,000 being the profit which A would have made by the performance of his contract with B. 2.
Suit for specific performance (Sec. 58).
Where there is breach of
a
contract for the
sale of specific
or ascertained goods,
the
buyer
may file a suit for
the specific performance of the contract.
This remedy is discretionary and will only be granted when damages would not be an adequate remedy, for instance, the subject-matter of the contract is rare goods, say, a picture by a dead painter. 3.
Suit for damages
for breach of warranty (Sec. 59).
Where there is
a breach of warranty by the seller,
or where

the
buyer elects or is compelled to treat breach of condition as breach of warranty,
the buyer
is
entitled to
file a suit for damages
if the price has already been paid. But if the buyer has not yet paid the price he may
ask the seller for a reasonable reduction in price. Here also
damages are
to be ascertained in accordance with the provisions of Section 73 of the
Indian Contract Act.
Thus,
the loss arising directly and naturally from the breach, i.e., the difference between the value of the goods as delivered,
and the value they would have had if the goods had answered to the warranty,
can be recovered. 4.
Suit for rescission of
contract and for damages for breach of 'condition'. The
breach of 'condition' entitles the buyer to treat the contract as repudiated [Sec. 12(2)]. Accordingly,
where there is a breach of 'condition' by the seller, the buyer
is entitled to
file a suit for rescission of the contract. Also, he may claim damages for loss suffered on the footing that the whole
contract is broken and the seller is guilty of non-delivery (Millar's Machinery Co. Ltd. vs David Way & Son 12). 5.
Suit for recovery of the price together
with interest (Sec. 61). If
the buyer has already paid the price of the goods to the
seller and the
goods are not delivered or they
are stolen one, he can sue the seller for
the refund of the price and also for the interest at reasonable rate from the date of payment to the date of refund. 10
Special damages' are also allowed under
Section 73
of the Indian Contract Act. 11 Illustration (j) to Section 73 of the Indian Contract Act. 12 (1934), 40
Com. Cas. 204. Check Your Progress 4. Explain
the rights of unpaid seller against the buyer personally. 5. What are the buyer's rights against the seller
for breach of contract?
Remedial Measures 244 Self-Instructional Material NOTES 20.4 AUCTION SALE In an auction sale, the auctioneer invites
bids from prospective purchasers and sells the goods to the highest bidder. Section 64 lays down the following rules
relating to an
auction sale: 1.
Where
goods are put up for
sale
in lots, each lot is prima facie deemed to be
the
subject of a separate contract of sale. 2.
The sale
is complete
when the auctioneer announces its completion by the fall of the hammer or in other customary manner,
say, by saying words like "one, two, three" or "going, going, gone;"
and,
until such announcement is made, any bidder may retract his bid.
On the

other hand, the auctioneer is also not bound to accept the highest bid if he feels that it is much below his expectation. Of course, his not accepting the highest bid would injure his business reputation because it is the custom of trade that goods must be sold to the highest bidder. In the language of the Contract Act, a notice or advertisement of an auction sale is simply 'an invitation to an offer.' The bid constitutes the 'offer,' and the fall of hammer constitutes the 'acceptance.' An offer can always be withdrawn before its acceptance, and need not necessarily be accepted. In this connection, it may be of interest to note
that the auctioneer has the right to make the auction subject to any conditions he likes (
The Coffee Board vs Famous Coffee and Tea Works 13). Thus, if the auctioneer expressly announces that biddings once made cannot be withdrawn, then that will hold good and the normal contractual rule, i.e., an offer may be revoked before its acceptance will
not apply. 3.
The seller or any one person on his behalf can bid at the auction,
provided such a right to bid has been expressly reserved at the time of notifying the auction sale. (The employment of a second puffer is fraudulent even if the right to bid is expressly reserved).
If the seller makes use of pretended bidding to raise the price
without expressly notifying about the same, the
sale may be
treated as fraudulent by the buyer and he may avoid the contract on that ground. 4.
The sale may be notified to be subject to a reserved or upset price
It is
a price below which the auctioneer will not sell,
and if he by mistake knocks down the lot for less than the reserved price, no valid contract come into existence and he can refuse to deliver the goods to the highest bidder (Rainbow vs Hawkins 14).
Where the sale is '
without reserve' the goods must be sold to the highest bidder,
irrespective of
the bid amount. But it is only a usage or custom of the trade because otherwise the auctioneer is free to accept or reject any offer or bid made to him. 5. A '
knock out' agreement between intending buyers not to bid against each other is not illegal (
Lachman Dass & Others vs Sita Ram & Others 15). 6. The
auctioneer
cannot sell goods on credit or accept payment by means of
a bill of exchange.
Also, he cannot be compelled to accept i cheque for the purchase price. 20.5 TEST QUESTIONS 1. Who is an unpaid seller of goods and what are his rights against the goods? Has he any remedy against the buyer personally? 2. Define unpaid seller. What are his rights under the Sale of Goods Act? 13 (1965), A.I.R. Mad. 14. Also see
M. Lachia Setty & Sons Ltd. vs Coffee Board, A.I.R. (1981) S.C. 162. 14 (1904), 2
K.B.322. 15 A.I.R. (1975), Delhi. 159.
Remedial Measures Self-Instructional Material 245 NOTES 3. What is meant by
an unpaid
seller?
Explain the nature of
the right of lien and the right of stoppage of goods in transit
of an unpaid seller.
How are these rights affected by
a sub-sale or pledge by the buyer? 4.
What is meant by the unpaid seller's right of stoppage of goods in transit? Show how it differs from the unpaid seller's lien. 5.
Distinguish between an unpaid seller's lien and stoppage of goods in transit. When can
the unpaid seller resell the goods? 6.
Discuss the remedies available to a buyer against the seller for breach of contract. 7.
Stoic
the rules regarding sale by auction. 20.6 PRACTICAL PROBLEMS Attempt the following problems, giving reasons: 1. A sells
goods to B. B pays to A through a cheque.
Before B could obtain the delivery of goods, his cheque has been dishonoured by the bank. A,
therefore, refuses to give delivery of the goods

until paid.
Is A's action justified? [Hint. Yes, A's action is justified, because
the right of lien
is linked with possession and not with title
or passing of property.] 2.
A sells goods to B and transfers him the document of title to the goods. B pays A through a cheque.
In fulfilment of a contract of sale B transfers that document
of title to C. Before C could obtain the delivery of goods, B's cheque has been dishonoured by the bank.
Hence A gives instructions to stop delivery of the goods to C until paid.
Is A's action justified? [Hint. No, A's action is not justified. An unpaid seller's right of lien
is defeated against transferee who takes a document of title in good faith and for consideration (Sec. 53).] 3.
A
sells and consigns to B goods of the value of
Rs 10,000 on credit.
B assigns the railway receipt to C
to secure a specific advance of
Rs 5,000
on the railway receipt.
Before the goods reach the destination B becomes insolvent.
A
gives notice to stop the goods in transit
but C claims them.
Can A stop the goods in transit? [Hint. Yes, A can stop the goods in transit but subject to
the pledge of C. C can recover the
amount of pledge from the goods or from A. Hence
A can stop the goods in transit only when he pays Rs 5,000 to C (
Sec. 53).] 4. P
sells to R a quantity of wheat lying in P's warehouse.
It is agreed that
three months' credit shall be given
to R. R
allows the wheat to remain in P's warehouse. Before the expiry of
the three months
R becomes insolvent and the Official Assignee demands delivery of the wheat from P without offering to pay the price. Is P entitled to retain the goods
until paid? [Hint. Yes, P is entitled to retain the goods as security for the price until he is paid.
In the case of buyer's insolvency the lien exists even though
goods had been sold
on credit and the period of credit has
not
yet expired,
provided the
goods are still in possession of the seller (Sec. 47).] 5. A sells certain goods to B, the property in the goods is to pass to B on delivery which is to take place on 1st August, 1987, and the payment to be made by B on 1st June, 1987. B refuses to pay the price on the due date on the plea that the property in the goods has not passed to him. Can A sue
B
for the price before the delivery of the goods takes place?
Remedial Measures 246 Self-Instructional Material NOTES [
Hint. Yes, A can sue B for the price,
where the sale price is payable 'on a day
certain,' the
seller can sue the buyer on his default, irrespective of passing of property and delivery of goods (Sec. 55).] 6. A attended an auction sale and made a bid of Rs 600 for a typewriter
but withdrew the offer before the fall of the hammer. One of the conditions of the sale
which A had read was that biddings once made, shall not be withdrawn. A was sued for Rs 600, his being the highest bid. Decide. [Hint. A is liable to pay Rs 600 because as per the conditions of the auction no bid can be withdrawn.
The auctioneer has the right to make the auction subject to any conditions he likes (

The Coffee Board vs Famous Coffee and Tea Works, A.I.R. 1965 Mad. 14).] 7.
At an auction sale, A makes the highest bid for a flower vase. Purporting to accept the
bid the auctioneer strikes the hammer, but
strikes the vase and breaks it. Who is to bear the loss? Would your decision differ if the auctioneer had struck the table, on which
the
vase was kept, with the hammer and the vase fell down and broke
into
pieces? [Hint. The loss in both the cases is to be borne by the owner of the
flower vase,
because at the time of the completion of the contract, namely, striking the hammer, the goods forming the subject matter of the contract have perished, and as such impossibility of performance at the time of contract renders the agreement void ab-initio.]
MODULE - 6
Negotiable Instruments Self-Instructional Material 249 NOTES UNIT 21 NEGOTIABLE INSTRUMENTS Structure 21.0 Introduction 21.1 Unit Objectives 21.2 Promissory Note 21.3 Bill of Exchange 21.4 Cheque 21.5 Hundis 21.6 Test Questions 21.7 Practical Problems 21.0 INTRODUCTION
The law relating to "negotiable instruments" is contained in the Negotiable Instruments Act, 1881.
The Act extends to the whole of India. The Negotiable Instruments Act, 1881, has been amended for more than a dozen times so far. The latest in the series are: (i)
the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988 (
effective from 1st April, 1989), and (ii) the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 (effective from 6th February, 2003). The Amend- ment Act, 1988, besides making a few minor amendments, inserted a new chapter (Chap- ter XVII) in the Negotiable Instruments Act. This Chapter comprised five Sections—Sec- tions 138 to 142—relating to 'the law of dishonour of a cheque'. To further amend 'the law of dishonour of a cheque', the Amendment Act, 2002, has amended Sections 138, 141 and 142 and also inserted five new Sections—Sections 143 to 147 —in the aforestated Chapter XVII. The Amendment Act, 2002 has also amended a few other Sections. The Negotiable Instruments Act, 1881, as amended up-to-date, deals with
three
kinds of negotiable instruments, i.e., Promissory Notes, Bills of Exchange and Cheques,
these
being in most common use.
The provisions of the Act also apply to 'hundis' (an instrument in oriental language), unless there is a local usage to the contrary. Other documents like Treasury Bills,
dividend warrants, share warrants, bearer debentures. Port Trust or Improvement Trust Debentures, Railway bonds payable to
bearer, etc., are also recognised as negotiable instruments either by mercantile custom or under other enactments like the Companies Act, 1956, and therefore, Negotiable Instruments Act is applicable to them. 21.1 UNIT OBJECTIVES ? Understand essential characteristics of negotiable instruments which make them different from an ordinary chattel ? Note the instruments which are recognized as negotiable instruments by statute ? Understand the essential requirements of a promissory note ? Understand the essentials of bill of exchange ? Know the distinction between Promissory note and Bill of exchange ? Be familiar with the definition of a cheque ? Learn the distinction between a cheque and bill of exchange
Negotiable Instruments 250 Self-Instructional Material NOTES 21.1.2 Definition
The word negotiable means 'transferable by delivery,' and the word
instrument means '
a written document
by which a right
is created in favour of some person.' Thus,
the term "negotiable instrument"
literally means 'a
written document
transferable by delivery.'
According to
Section 13
of
the Negotiable Instruments

Act, “a
negotiable instrument means
a
promissory note, bill of exchange or cheque payable either
to order
or
to bearer.” “
A
negotiable instrument
may be made payable to two or more payees jointly, or it may be made payable in the alternative to one
of two, or one or some of several payees” [Section 13(2)]. The
Act, thus, mentions three kinds of negotiable instruments, namely notes, bills and cheques and declares that to be
negotiable they must be made payable in any of the follow- ing forms: (a)
Payable to order.
A note, bill or cheque
is
payable to order which is expressed to be ‘payable
to a particular person
or his order.’
For example, (i) Pay A, (ii) Pay A or order, (iii) Pay to the order of A, (iv) Pay A and B, and (v) Pay A or B are various forms in
which an instrument may be made payable to order. But it should not contain any words prohibiting transfer, e.g., ‘Pay to
A
only’ or ‘Pay to A and none else’ is not treated as ‘payable to order’ and
therefore such a document shall not be treated as negotiable instrument because its negotiability has been restricted. It
may be noted that documents containing express words prohibiting negotiability remain valid as a document (i.e., as an
agreement) but they are not negotiable instruments as they cannot be negotiated further. There is, however, an
exception in favour of a cheque. A cheque crossed “Account Payee only” can still be negotiated further, of course, the
banker is to take extra care like a blood-hound in that case. (b)
Payable to bearer. ‘
Payable to bearer’ means ‘payable to any person whosoever bears
it.’
A note, bill or cheque
is payable to bearer
which is expressed to be so payable
or on which the
only or last endorsement is an endorsement in blank.
Thus, a note, bill or cheque
in the form “Pay to A or bearer,” or “Pay A, B or bearer,” or “Pay bearer” is
payable to bearer. Also, where an instrument is originally ‘payable to order,’ it may become ‘payable to bearer’ if endorsed
in blank by the payee. For example, a cheque is payable to
A. A endorses it merely by putting his signature on the back and delivers to B with the intention of negotiating it (without
making it payable to B or B’s order). In the hands of B the cheque is a bearer instrument. Section 31 of the Reserve Bank
of India Act. It is important to note that the above definition is
subject to
the provisions of Section 31 of the Reserve Bank of India Act, 1934,
which as amended by the Amendment Act of 1946, provides as under: 1. No person in India
other than
the Reserve Bank or the Central Government can make or issue
a promissory note ‘payable to bearer.’ 2.
No person in India
other than the Reserve Bank or the Central Government can draw
or accept a bill of exchange ‘
payable to bearer on demand.’ 3. A cheque ‘
payable
to bearer on demand’
can be drawn on a person’s account with
a banker.

The effect of the above provisions is that (i) A promissory note cannot be originally made 'payable to bearer,' no matter whether it is payable on demand or after a certain time. It must be made 'payable to order' initially. However, on being endorsed in blank it can become 'payable to bearer' or 'payable to bearer on demand' subsequently and it shall be valid in that case. (ii) A bill of exchange may be originally made 'payable to bearer' but it must be payable otherwise than on demand (say, payable three months after date) in that case. If it is 'payable on demand' then it must be made 'payable to order.' However,
Negotiable Instruments Self-Instructional Material 251 NOTES
on being endorsed in blank subsequently, it can become 'payable to bearer on demand.' (iii) A cheque drawn on a bank can be originally made 'payable to bearer on demand' and it shall be valid. In fact cheques are always payable on demand. The object of the above provisions of the Reserve Bank of India Act is to prevent private persons from infringing the monopoly of the Reserve Bank and the Government of Note Issue in India.
For, if individuals are allowed to issue instruments 'payable to bearer on demand,' then there may be some one so rich and well known person whose bills of exchange and promissory notes may be taken as currency notes. A currency note bears the words 'I promise to pay the bearer the sum of Rupees 10, 50 or 100,' as the case may be. The general public is, therefore, prohibited to issue such notes or bills.
Section 32 of the Reserve Bank of India Act, 1934, makes the issue of such bills or notes a criminal offence and declares them illegal and unenforceable at law. Accordingly, 'a promise to pay A or bearer' or 'a promise to pay the bearer' is not enforceable at law and the document containing such a promise is illegal and void. More comprehensive definition. The definition given in Section 13 of the Negotiable Instruments Act does not set out the essential characteristics of a negotiable instrument. Possibly the most expressive and all encompassing definition of negotiable instrument had been suggested by Thomas which is as follows: 1 "
A negotiable instrument is one which is, by a legally recognised custom of trade or by law, transferable by delivery or by endorsement and delivery in such circumstances that (a) the holder of it for the time being may sue on it in his own name and (b) the property in it passes, free from equities, to a bona fide transferee for value, notwithstanding any defect in the title of the transferor." 21.1.2
Characteristics of a Negotiable Instrument An examination of the above definition reveals the following essential characteristics of negotiable instruments which make them different from an ordinary chattel: 1. Easy negotiability. They are transferable from one person to another without any formality. In other words, the property (right of ownership) in these instruments passes by either endorsement and delivery (in case it is payable to order) or by delivery merely (in case it is payable to bearer), and no further evidence of transfer is needed. 2. Transferee can sue in his own name without giving notice to the debtor.
A bill, note or a cheque represents a debt, i.e., an "actionable claim" 2 and implies the right of the creditor to recover something from his debtor.
The creditor can either recover this amount himself or can transfer his right to another person. In case he transfers his right, the transferee of a negotiable instrument is entitled to sue on the instrument in his own name in case of dishonour, without giving notice to the debtor of the fact that he has become holder.
In case of transfer or assignment of an ordinary "actionable claim" (i.e., a book debt evidenced by an entry by the creditor in his account book or bahi), under the Transfer of. Property Act, notice to the debtor is necessary in order to make the transferee entitled to sue in his own name, otherwise he has always to join his transferor, i.e., the original creditor before he can recover his claim from the debtor. 3. Better title to a bona fide transferee for value. A bona fide transferee of a negotiable instrument for value (technically called as a holder in due course) gets the instrument 'free from all defects.'
He

is not affected by any defect
of title of the transferor or any
prior 1 Thomas, Commerce: Its Theory and Practice. 2 An "actionable claim" is a right
which can be enforced by action in a Court of law,
e.g., book debts. It is designated in English Law as "chose in action" by way of distinguishing such personal property from tangible chattels.
Negotiable Instruments 252 Self-Instructional Material NOTES party. Thus,
the general rule of the law of transfer of title applicable in the case of ordinary chattels
that 'nobody
can transfer a better title than that
of his own'
does not apply
to negotiable instruments. A man may sell to another a stolen radio set but the true owner may claim back the radio set from the buyer even though he may have got it in good faith for consideration. The result would have been different if instead of the radio set a negotiable instrument, say, a bill of exchange made payable to bearer, had thus been transferred, in which case the transferee would have obtained a good title. It is relevant to state that such instruments which restrict transferability (although otherwise appearing as negotiable instruments), i.e., bearing words like 'Pay only', 'Pay to A and none else' etc., are treated like ordinary chattels and not like negotiable instruments. Hence the transferee takes such instruments subject to all equities and his title shall not be better than that of the transferor. 4. Presumptions. Certain presumptions apply to all negotiable instruments. These presumptions shall be discussed later in this Chapter. 21.1.3 Examples of Negotiable Instruments The following instruments have been recognised as negotiable instruments by statute or by usage or custom: (i) Bills of exchange; (ii) Promissory notes; (iii) Cheques; (iv) Government promissory notes; (v) Treasury bills; (vi) Dividend warrants; (vii) Share warrants; (viii) Bearer debentures; (ix) Port Trust or Improvement Trust debentures; (x) Hundis; (xi) Railway bonds payable to bearer, etc. 21.1.4 Examples of Non-negotiable Instruments These are (i) Money orders; (ii) Postal orders; (iii) Fixed deposit receipts; (iv) Share certificates; (v) Letters of credit. 21.1.5 Examples of Quasi-negotiable Instruments There are some instruments called as document of title, e.g., (i) bills of lading; (ii) dock warrants; (iii) railway receipts and (iv) wharfinger certificates, which, like a negotiable instrument, are capable of being transferred by endorsement and/or delivery, but the transferor of such documents cannot give to the holder any better title to the goods than he himself possesses. Such instruments are termed as 'quasi-negotiable instruments' and the provisions of the Negotiable Instruments Act do not apply to them. 21.1.6 Presumptions as to Negotiable Instruments Sections 118 and 119 lay down the following presumptions in respect of negotiable instruments, unless the contrary is proved: (a)
that every negotiable instrument was made, drawn,
accepted, indorsed or transferred
for consideration; (b) that every negotiable instrument
bearing a date was made or drawn on
such date; (c)
that
every bill of exchange
was accepted within a reasonable time after its date and before its maturity; (
d)
that every transfer of a
negotiable instrument was made before its maturity; (
e)
that
the endorsements appearing upon a
negotiable
instrument were made in the order in which they appear
thereon; (
f)
that a lost
negotiable instrument was duly stamped; 3 3 No stamp duty is prescribed for cheques under the Indian Stamp Act.
Negotiable Instruments Self-Instructional Material 253 NOTES (g)
that the holder of a negotiable instrument is a holder in due
course;
but
this presumption would not arise where

it is proved that the holder has obtained
the instrument from its lawful owner, or from any person in lawful custody thereof, by
means of an offence, fraud or
for unlawful consideration and in such a case
the holder has to prove that he is a holder in due course; (
h) that the instrument was dishonoured, in case a suit upon a dishonoured instrument is filed with the court and the fact of 'protest' is proved.
The above presumptions are rebuttable by the defendant. 21.2
PROMISSORY NOTE 21.2.1 Definition
According to
Section 4 "
a promissory note is an instrument in writing (
not being
a bank note or
a
currency note)
containing
an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of,
a certain person, or to the bearer
of the
instrument.
Before analysing the essentials of
a promissory note
as contained in this definition, the following facts are worth noting: (i) A promissory note payable 'only to a particular person" is valid if it satisfies the requirements of the definition, but it shall not be a negotiable instrument within the meaning of the Negotiable Instruments Act as its transferability is restricted. To put it differently, it would appear from the above definition that negotiability is not essential to the validity of a promissory note as an instrument. (ii) As observed earlier, under
Section 31 of the Reserve Bank of India Act, 1934, no person in
India except
the Reserve Bank or the Central Government can make or issue
a promissory note payable to bearer. Accordingly, a promissory note cannot be
originally made 'payable to bearer.' Thus, the words 'or to the bearer of the instrument' included in the above definition have become redundant and ineffective. In fact these words ought to have been deleted after the passing of the Reserve Bank of India Act, 1934. (iii) Bank notes (i.
e., promissory notes issued by a banker payable to bearer on demand) and currency notes (i.e.,
promissory notes issued by
the Reserve Bank of India
or the Central Government
payable to bearer on demand) are excluded from the definition of a promissory note
because both of them are treated as money. The issue of bank notes, however, is now prohibited by the Reserve Bank of India Act. But Government promissory notes, which are issued by the Government for raising loans, are within the definition. (iv)
The person who makes the promise to pay is called the 'maker.' He is the debtor and must sign the document. The person to whom payment is to be made (i.e., the creditor) is called the 'payee.' 21.2.2
Essentials of a Promissory Note
From the definition given in the Act it follows that to be a valid promissory note, an instru- ment must fulfil the following essential requirements: 1.
It must be in writing. A promissory note has to be in writing. An oral promise to pay does not become a promissory note. The writing may be on any paper, on any bahi or book.
It may be in pencil or in ink and includes printing or typing. No particular form of words is necessary,
even a promise contained in a letter will suffice, provided the other
Negotiable Instruments 254 Self-Instructional Material NOTES requirements of Section 4 are complied with. Ofcourse the words used must import a clear undertaking to pay, but
it is not necessary that the word 'promise' should be used (Balmukund vs Munnalal 4). The
following is the usual form of a promissory note: Rs 1,000 Delhi, 25 July, 2004 Sixty days after
date I promise to pay to Mr. J.N. Vaish

or order the sum of rupees one thousand only with interest thereon at 12 per cent per annum for value received. Revenue Stamp Sd. Ram Kishore Illustrations. A signs the instruments in the following terms: (a) "I promise to pay B or order Rs 500". 5 (b) " I acknowledge myself to be indebted to B Rs 1,000 to be paid on demand, for value received." 6 Both the above Instruments are valid promissory notes. 2. It must contain a promise or undertaking to pay. There must be a promise or an undertaking to pay. The undertaking to pay may be gathered either from express words or by necessary implication.

A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such. Illustrations. A signs the instruments in the following terms: (a) "Mr B I.O.U. (1 owe you) Rs 1,000." 7 (b) "I am liable to pay to B Rs 500." (c) "I have taken from B Rs 2,000 and I am accountable to him for the same with interest."

The above instruments are not promissory notes as there is no undertaking or promise to pay. There is only an acknowledgement of indebtedness. Where, however, the acknowledgement of indebtendness contained in the document is in a defined sum of money payable on demand, there is a valid promissory note even though the words 'promise to pay' may not have been used. It is so because the phrase 'payable on demand' necessarily implies 'a promise to pay at once or immediately." Illustration. Where A signs the instrument in the following terms: "I, acknowledge myself to be indebted to B in Rs 1,000, to be paid on demand, for value received," there is a valid promissory note. 8 3. The promise to pay must be unconditional. Certainty is very necessary in the commercial world. As such a promissory note must contain an unconditional promise to pay. The promise to pay must not depend upon the happening of some uncertain event, i.e., a contingency or the fulfilment of a condition.

It must be payable absolutely. If an instrument contains a conditional promise to pay, it is not a valid promissory note and will not become valid and negotiable even after the happening of the condition (Hill vs Halford 9). 4 A.I.R. (1970), Punj. 516. 5 Illus. (b) to Sec. 4. 6 Illus. (a) to Sec. 4. 7 Illus. (c) to Sec. 4. 8 Illus. (b) to Sec. 4. 9 Illus. (f) to Sec. 4.

Negotiable Instruments Self-Instructional Material 255 NOTES Illustrations. A signs the instruments in the following terms: (a) "I promise to pay B Rs 500 seven days after my marriage with C." 10 (b) "I promise to pay B Rs 500 on D's death, provided D leaves me enough to pay that sum.'" 11 (c) "I promise to pay B Rs 500 as soon as I can." The above instruments are not valid promissory notes as the payment is made dependent upon the happening of an uncertain event which may never happen and as a result the sum may never become payable.

But a promise to pay is not conditional if the amount is made payable at a particular place or after a specified time or on the happening of an event which must happen, although the time of its happening may be uncertain (Sec. 5, para 2). Thus, if A signs an instrument stating: "I promise to pay B Rs 500 seven days after C's death,", the promissory note is valid because it is not considered to be conditional, for it is certain that C will die, though the exact time of his death is uncertain. 4.

It must be signed by the maker.
It is imperative that the promissory note should be duly authenticated by the 'signature' of the maker. 'Signature' means the writing or otherwise affixing a person's name or a mark to represent his name, by himself or by his authority with the intention of authenticating a document.
The
signature may be in any part of the instrument and need not necessarily be at the bottom. The intention to sign, however, must in all cases be proved. It may be in pencil or in ink. When the maker of a pronate is illiterate, his thumb mark is sufficient. But facsimile impressions, whether affixed in printing or by perforation or in some other form, and impressions by a rubber stamp are not recognised as signatures unless the parties specifically agree to treat them as such. 5.
The maker must be a certain person. The instrument itself must indicate with certainty who is the person or are the persons engaging himself or themselves
to pay.
In case a person signs in an assumed name, he is
liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. Where there are
two or more makers,
they
may bind themselves jointly or jointly and severally. But
alternative promisors are not permitted in law because of the general rule that "where liability lies no ambiguity must lie." Thus a Note in the form "I Alok Kumar promise to pay" and signed by Alok Kumar or also Satish Chandra is a good note as against Alok Kumar only. 6.
The payee must be certain. Like the maker the payee of a pronote must also be certain on the face of the instrument. A note
is valid even if the payee is misnamed or indicated by his official designation only (Sec. 5, para 4), provided he can be ascertained by evidence. It
may be made payable to two or more payees jointly or it may be made payable in the alternative to one
of two, or one or some of several payees [
Sec. 13(2)]. Thus alternative payees are permissible in law. But it must be made payable to order originally. A note originally made payable to bearer is illegal and void as per Reserve Bank of India Act, 1934. Also,
a note in favour of fictitious person is illegal and void,
for it is
teated as payable to bearer.
A pronote made payable to the maker himself is a nullity, the reason being the same person is both the promisor and the promisee. 7. The sum payable must be certain. For a valid promissory note it is also essential that the sum of money promised to be payable must be certain and definite. The amount payable must not be capable of contingent additions or substractions.
Illustrations. A signs instruments
in the following terms: (
a) "I
promise to pay B Rs 500
and all other sums which
shall be due to him." 12 10 2
B.P. 413. 11 Illus. (g) to Sec. 4. 12 Illus. (d) to Sec. 4.
Negotiable Instruments 256 Self-Instructional Material NOTES (
b) "I
promise to pay B Rs 500, first deducting thereout any money which he may owe me." 13 (
c) "I promise to pay B Rs 500 and all fines according to
rules." (d) "I promise to pay B
Rs 100 on or before 15 August, 2004, and a similar sum monthly every succeeding month."
The above instruments are invalid as promissory notes because the exact amount to be paid by A is not certain.
But, according to Section 5, para 3,
the
sum does not become indefinite merely because: (i) there is a promise to pay
the amount with interest, provided the rate of interest is stated; (ii)
the amount is to be paid at an indicated rate of exchange
or according to the course of exchange; or (iii) the amount is payable by instalments, even

with a provision that on default being made in payment
of an instalment, the balance unpaid shall become due. 8.
The amount payable must be in legal tender money of India.
A document containing a promise to pay a certain amount of foreign money or to deliver a certain quantity of goods is not a
promissory note. Similarly,
a promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.
Thus, an instrument signed by A, saying, "I
promise to pay B Rs 500
and to deliver to him my black horse on 1st January next 14
is not a valid promissory note. 9.
Other formalities. Though it is usual and proper to state in a note the place where it is made and the date on which it is made but their omission will not render the instrument invalid. Even where
the amount is made payable at a certain time after date,
omission of date does not invalidate the instrument and the date of execution can be independently ascertained
or proved.
The words "value received" are also not an essential part of the form of a pronote, because, as per Section 118, consideration is presumed until the contrary is proved. But a promissory note must be properly stamped 15 as required by the Indian Stamp Act and each stamp must also be duly cancelled. The maker's signature with the date across the stamp cancels the stamp effectively. Although an unstamped or inadequately stamped promissory note is invalid, but the amount of loan can be recovered if proved otherwise. 21.3
BILL OF EXCHANGE 21.3.1 Definition Section 5 of the Negotiable Instruments
Act defines
a
bill
of exchange
as
follows: "
A bill of exchange is an instrument in
writing containing an unconditional order, signed by the maker, directing a certain
person
to pay a certain sum
of money only to, or to the order of, a certain person or to the bearer of the
instrument." 13
Illus. (c) to Sec. 4. 14 Illus. (h) to Sec. 4. 15 It may be mentioned that the stamp duty on Promissory Note and Bill of Exchange has been halved vide Notification No. 130(E) dated 28-1-2004 issued by Dept. of Revenue, Ministry of Finance. For example, in case of Promissory Note Bill of Exchange payable not more than three months after date, the new rates of stamp duty are: (a) if the amount of note or bill does not exceed Rs 500 ..... 30 Paise, (b) if it exceeds Rs 500 but does not exceed Rs 1000 .....60 Paise, and (c) for easy additional Rs 1000 or part thereof in excess of Rs. 1000 ..... 60 Paise. For further details refer to the aforesaid Notification. The reduced rates ol stamp duty have come into effect from 1st March, 2004.
Negotiable Instruments Self-Instructional Material 257 NOTES At the very outset the following two facts must be noted: (i) Although a bill of exchange directing to pay 'only to a particular person' is valid if it satisfies the requirements of the definition but it shall not be a negotiable instrument within the meaning of the Negotiable Instruments Act as its transferability is restricted. (ii) Although a bill of exchange may be originally drawn 'payable to bearer' but in such a case it must be payable otherwise than on demand (say, three months after date). In other words, a bill cannot be drawn 'payable to bearer on demand." If it is 'payable on demand' then it must be made 'payable to order' (Sec. 31 of the Reserve Bank of India Act).
Parties to a
bill of exchange.
There are three parties to a bill of exchange
viz.,
drawer,
drawee and payee.
The person who
makes
the bill

is called
the ‘drawer.” The person
who is directed to pay
is called
the ‘drawee.’
The
person to whom the payment is
to be made
is called the ‘
payee.’
The
drawer,
or, if the bill is endorsed to the payee,
the endorsee, who is in possession of
the bill
is called the ‘holder. ‘
The holder
must present the bill
to the drawee for his acceptance. When the drawee accepts the bill,
by writing the words ‘accepted’ and then signing it, he is called the ‘acceptor.’
It is not necessary, however, that three separate persons should answer to the description of drawer, drawee and payee. One person may fill any two of these positions.
Thus, one may become ‘drawer and payee’ (
when the bill is drawn “Pay to me or my order”),
or ‘drawee and payee’ (when the bill is subsequently endorsed in favour of the drawee), or ‘drawer and drawee’ (when one draws a bill upon himself). In the last case, the holder may treat the instrument
as a bill of exchange or as a promissory note. What is
required is that the three parties drawer, drawee and payee must be pointed out in the bill with certainty. Drawee in case of need. Sometimes the name of another person may be mentioned in a bill of exchange as the person who will accept the bill, if the original drawee does not accept it. Since another person so named is
to be approached in case of need, he is known as “drawee in case of need.” (
Sec. 7)
Acceptor for honour.
When a bill of exchange
has
been noted
or protested for non-acceptance or for better security,
and
any person accepts it supra protest for honour of the drawer or of any one of the indorsers, such person is called an “acceptor for honour” (
Sec. 7). Thus
any person may voluntarily become a party to a bill as an “acceptor
for honour.” 21.3.2 Essentials of a Bill of Exchange To be a valid bill of exchange an instrument must comply with the requirements of the definition given in Section 5, which are as follows: 1.
It
must be in writing. 2. It must contain an order to pay.
A
mere request to pay on account will not amount to an order.
But an order may be expressed in polite language. 3.
The order to pay
must be unconditional. 4.
It must be signed by the drawer. 5. The drawer, drawee and payee must be certain.
A bill cannot be drawn on two or more drawees in the alternative
because of the rule of law that “where liability lies, no ambiguity must lie.” But a bill
may be made payable in the alternative to one of two or more payees (
Sec. 13). 6.

The sum payable must be certain. 7. The bill must contain an order to pay money only. 8. It must comply with the formalities as regards date, consideration, stamps, etc.
Negotiable Instruments 258 Self-Instructional Material NOTES It will be seen that the fundamental essentials of a bill enumerated above are more or less similar to that of a promissory note. As such the rules that apply to promissory notes in regard to those essentials are in general applicable to bills of exchange as well. (For details of these essentials see notes to promissory note.) 21.3.3 Special Benefits of Bill of Exchange The special benefits of using bills of exchange in the world of commerce are as follows: 1.
A bill of exchange is a double secured instrument. If the bill is dishonoured by the acceptor, the holder or the payee may look to the drawer
of
the bill for payment. 2. In case of immediate need of money a bill can be discounted with a bank
by the payee. 3. Two separate trade debts can be discharged by a bill of exchange. Hence, where A buys goods on credit from B for Rs 1,000 to be paid three months after date and B buys goods on credit from C on similar terms for similar amount, an order by B to A
to pay the sum of Rs 1,000 to C will discharge two separate trade debts. Specimen of a Bill of Exchange
Rs 1,000 New Delhi, 25 August, 2004
Three months after date pay to C or order the sum of rupees one thousand only, for value received. To
A Revenue 135 Sadar Bazar Stamp Delhi Sd/- B 21.3.4 Distinction Between a Pro-note and a Bill The points of distinction between a promissory note and a
bill of exchange
are as follows: 1.
Number of parties. In a promissory note there are two parties — the maker
of the note and the payee. In a bill of exchange
there are three parties—
the drawer, the drawee and the payee. 2. The maker of a note
cannot be the payee. In the
case of a promissory note the maker cannot be the payee
for the simple reason that the same person cannot be both the promisor and
the promisee. But in a bill of exchange
the drawer and the payee may be one and the same person
as where a bill is drawn “Pay to me or my order.” 3.
Promise and order. In a promissory note there is a promise to make the payment whereas in a bill of exchange there is an order for making the payment. 4. Acceptance. A promissory
note requires no acceptance as it is signed by the person who is liable to pay.
The drawer of a bill of exchange is generally the creditor of the drawee and therefore it
must be accepted by the drawee before it can be presented for payment. 5.
Nature of
liability.
The liability of the maker of a pro-
note is primary and absolute
but the liability of a drawer
of
a bill
of exchange is secondary and conditional.
It is only when the acceptor does not honour the bill
that
the liability of the drawer arises as a surety. (Secs. 30 and 32) 6. Maker’s position.
The maker of a promissory
note stands in immediate relation with the payee, while the
maker or drawer
of
an accepted
bill stands in immediate relation with the acceptor and not the payee (
Explanation to
Sec. 44). Accepted Sd/- A
Negotiable Instruments Self-Instructional Material 259 NOTES The position of the maker of a pro-note also differs from the position of the acceptor of a bill.

A promissory note must contain an unconditional promise to pay and therefore the maker, who himself is the originator of a note, cannot make it conditional. In the case of a bill of exchange although the drawer, who is the originator of a bill, has to make an unconditional order to pay but under Section 86 the acceptor may accept the bill conditionally. 7. Payable to bearer. A promissory note cannot be drawn 'payable to bearer,' while a bill of exchange can be so drawn provided it is not drawn 'payable to bearer on demand.' 8. Notice of dishonour. In case of dishonour of a bill of exchange, notice of dishonour must be given by the 'holder' to all prior parties who are liable to pay (including the drawer and endorsers), whereas in case of dishonour of a promissory note, no notice is necessary to the maker. 9. Applicability of certain provisions. The provisions relating to presentment for acceptance, acceptance, acceptance supra protest and drawing of bills in sets are applicable only to a bill of exchange, they are not applicable to a promissory note. 21.3.5 Bills in Sets When a bill is drawn in sets of three, it is known as drawing the 'bill in sets.' Bills in sets are usually drawn when they are to be sent from one country to another. The three parts of a bill in set are sent by different mail routes in order to ensure the safe transmission of at least one part to the drawee and its acceptance by him as early as possible. Sections 132 and 133 provide the following rules for a bill in sets: 1. Bills of exchange may be drawn in sets or parts. All the parts together make a set and the whole set constitutes only one bill. 2. Each part of a bill in set should be numbered and must contain a provision that it shall continue payable only so long as the other parts remain unpaid. 3. The drawer must sign each part of the bill and should deliver all the parts. But only one part is required to be stamped and only one part is to be accepted by the drawee. 4. If payment is made on one of the parts of the bill, the whole bill is extinguished. 5. Where a person accepts or indorses different parts of the bill in favour of different persons and they go into the hands of different holders in due course, he and the subsequent indorsers of each part are liable on such part as if it were a separate bill. 6. When two or more parts of a set are negotiated to different holders in due course, then as between holders in due course he who first acquired title to his part is entitled to the other parts and the money represented by the bill. 21.3.6 Specimen of a Bill in a Set First Part No. 1 New Delhi, 15 January, 1993 Rs 5,000 Three months after sight of this first of exchange (second and third of the same tenor and date being unpaid) pay to A. K. Basu or order the sum of five thousand rupees for value received. To Revenue Stamp C.G. Silcocks London. Sd/- B.B. Lal

Negotiable Instruments 260 Self-Instructional Material NOTES Similarly second and third parts of the bill are drawn. The second part contains a reference to the first and third parts, and the third part contains a reference to the first and second parts. 21.3.7 Accommodation Bill An accommodation bill is apparently quite similar to an ordinary trade bill of exchange. The special feature which distinguishes it from an ordinary bill is that such a bill is not supported by any consideration or a trading transaction. The drawer does not give any consideration to the drawee but instead it is drawn with an object of providing financial help either to the drawer or to both the drawer and the drawee. Thus the relationship between the drawer and the drawee is not that of a creditor and a debtor in the case of an accommodation bill. Actually it is a sort of mercantile credit where one person lends out his name on the bill so that the other person taking the bill can get the same discounted from the bank and get money for the same. Since such bills are drawn and accepted without any consideration with a view to accommodate or oblige friends, they are rightly termed as 'accommodation bills.' Illustration. P desires to have Rs 5,000 for three months and approaches Q for that purpose. Q has no funds in hand but has credit in the market. Q agrees to help P. It is arranged, therefore, that P will draw a bill on Q for Rs 5,000 payable after three months and Q will accept the bill. P can discount the bill with his bankers and get the money or can negotiate the bill in discharge of his debt. Before the maturity of the bill, P will provide Q with funds sufficient to meet it. Thus P is able to get the required funds for three months. Such a bill is called an accommodation bill. The party accommodating (i.e., Q) is called the 'accommodation party' and the party accommodated (i.e., P) is called the 'accommodated party.' Sometimes a party may be accommodated by endorsing an existing bill with consideration. Such an endorser is called the 'backer' and the operation is called 'backing the bill'. The Negotiable Instruments Act lays down the following rules regarding accommodation bill: 1. An accommodation bill creates no obligation of payment between the parties to the transaction. In other words, the accommodation party is not liable on the bill to the accommodated party on maturity date, if the bill is in the hands of the accommodated party because of subsequent indorsement in his favour, or if the bill has been paid by the accommodated party (i.e., the drawer) on its dishonour by the acceptor (i.e., the accommodation party), as the contract between them is not based on any consideration. (Sec. 43) 2. The accommodation party is liable on the bill to any subsequent 'holder for value.' even if such a holder knew at the time of taking the bill that it is an accommodation bill (Sec. 43). Of course the accommodation party is entitled to recover from the accommodated party whatever he pays on the bill. 3. An accommodation bill can be negotiated after maturity (i.e., when it becomes over due), with all benefits of a 'holder in due course' to the transferee (i.e., the transferee acquiring a better title than the transferor) (Sec. 59). (The transferee of an overdue ordinary bill of exchange gets no better title than his transferor as he cannot be a 'holder in due course.' Section 9 provides that a 'holder in due course' should acquire the instrument before maturity). 4. Non-presentation of an accommodation bill to the acceptor for payment does not discharge the drawer. [Section 76 (d) provides that presentation is not necessary when drawer could not suffer damage.] It is an exception to the general rule contained in Section 64 whereby a bill must be presented for payment to the acceptor by the holder otherwise other parties thereto are not liable thereon to such a holder.

Negotiable Instruments Self-Instructional Material 261 NOTES 5. When an accommodation bill is dishonoured, failure to give notice of dishonour does not discharge the liability of prior parties, as it does in the case of an ordinary bill [Sec. 98 (c)] 21.3.8 Fictitious Bill When in a bill of exchange the names of both the drawer and the payee are fictitious, the bill is said to be a fictitious bill. Such a bill is drawn in a fictitious name and is made payable to the drawer's order and as such the names of both the drawer and the payee are said to be of a fictitious person. A fictitious person is one who has no existence, i.e., who is imaginary. If a real existing person's name is forged as drawer and payee, then the bill is a 'forged bill', which is a nullity and confers no title even to a holder in due course. In a forged instrument there is complete absence of title as distinct from defect of title. A fictitious bill even if accepted by a genuine person is not a good bill and cannot be enforced at law. However, such a bill,

if accepted by a genuine person, becomes a good bill in the hands of
a holder in due course provided he can show that the
first indorsement on the bill and the signature of the supposed drawer (being the holder as well) are in the same handwriting,
and the acceptor is liable on the bill to him (Sec. 42). 21.3.9 Documentary
Bill When documents relating to the goods represented by the bill,
e.g., bill of lading or
railway receipt,
invoice, marine insurance policy, etc., are attached to a bill, the bill is called a documentary bill. Such documents are delivered to the buyer only on acceptance or payment of the bill.
Such bills are usually used in foreign trade.
In inland trade generally "clean bills" are used with which no other documents are attached. 21.4 CHEQUE 21.4.1
Definition Section 6,
as substituted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, 16 defines a cheque as follows: "
A
cheque is
a bill of exchange
drawn on a specified banker
and
not expressed to be payable otherwise than
on demand
and it includes
the
electronic image of a truncated cheque and a cheque in
the electronic form." "
Explanation 1: For the purposes of this Section,
the expression: (
a) "
a cheque in the
electronic form" means a cheque which contains the exact mirror image of
a paper cheque, and is generated, written and signed
in
a
secure system ensuring the minimum safety standards with the use of digital signature (
with or without biometrics signature) and asymmetric crypto system; (
b) "
a truncated cheque" means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or
by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.
Explanation II: For the purposes of this Section, the expression "
clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the
Reserve Bank of India."
Thus,
a cheque is
a
bill of exchange with two distinctive features, namely: (i) it is always drawn on a bank, and (ii) it is always payable on demand. 16
This Amendment Act
was brought into force from 6th February, 2003.
Negotiable Instruments 262 Self-Instructional Material NOTES Specimen of a
Cheque 21.4.2 Distinction between
a Cheque and a Bill of Exchange
Although a cheque, being, a species of a bill of exchange, must satisfy almost
all the essentials of a bill,

e.g.,
signed by the drawer,
containing an unconditional order,
to pay a certain sum of money, to the order of a person or the
bearer,
etc., yet there are few points of difference between the two, namely: 1.
A
cheque is always drawn on a banker, while
a bill may be drawn on any person, including a banker. 2.
A cheque
can only be drawn
payable on demand, whereas a bill may be drawn payable on demand or
on
the expiry of a certain period after date or sight. 3.
A
cheque
drawn 'payable to bearer on demand' is valid but a bill drawn 'payable to bearer on demand' is absolutely void and illegal (though a bill
can be made payable to the bearer after a certain time) (
Sec. 31, The Reserve Bank of India Act). 4. A cheque does not require any acceptance by the drawee before payment can be demanded. But a bill requires acceptance by the drawee before he can be made liable upon it. 5.
A cheque does not require any stamp, whereas a bill
of exchange must be properly stamped. 6. Three days of grace are allowed while calculating the maturity date in the case of 'time bills' (i.e., bills drawn payable
after the expiry of a certain period). Since
a cheque is always payable on demand,
there is no question of
allowing any days of grace. 7. Unlike cheques, a bill of exchange cannot be crossed. 8.
Unlike cheques,
the payment of a bill cannot be countermanded by the drawer. 9.
Unlike bills, there is no system of Noting or Protest
in the case of a cheque. 10. The drawer of a bill is discharged from liability, if it is not duly presented for
payment, but
the drawer of a cheque
will not be discharged by delay of the holder in presenting it for payment,
unless through the delay, the drawer has been injured, e.g., by the failure of the bank the drawer has lost the money which would have otherwise discharged the amount of the cheque. However, where the drawer is so discharged, the payee may rank as creditor of the bank for the amount of the cheque. (Sec. 84) 21.4.3 Bank Draft A bank draft is an order issued by one bank on another bank or on its own branch (usually drawn on its own branch)
instructing the latter
to pay a specified sum of money to a specified person or
his order.
It is a negotiable instrument 17 and is very much like a cheque, with the following distinctions: (a) It can be drawn only by a bank on another bank or on its another branch and not by an individual as in the case of a cheque. 17 State Bank of India vs Jyoti Ranjan Majumdar, A.I.R. (1970), Cal. 503. Check Your Progress 1. Define the term negotiable instruments. 2. What are the essential characteristics of negotiable instruments? 3. What do you understand by quasi-negotiable instruments? 4. What do you mean by promissory note?
Negotiable Instruments Self-Instructional Material 263 NOTES (b) It cannot so easily be countermanded as a cheque. (c) It cannot be made payable to bearer. 21.5 HUNDIS Hundis are negotiable instruments written in Hindustani language. Sometimes they are in the form of promissory notes but usually they are like bills of exchange in form and substance. The provisions of the Negotiable Instruments Act apply to Hundis unless there is
a local usage to the contrary.
They are quite popular among the Indian Merchants from the very old days. 21.5.1 Types of Hundis The more popular types of hundis are as follows: 1. Darshani hundi. It is one payable at sight like a 'demand bill.'
It must be presented for payment within a reasonable time

of its receipt by the holder (Gohra Mal vs Hari Singh 18). If loss is caused to the drawer by delay in presentment it falls on the holder. 2. Miadi or Muddati hundi. It is one payable after a specified period of time like a 'time bill.' 3. Shah jog hundi. This is a hundi made payable by the drawer only to a Shah. A Shah means a respectable person of worth and substance in the Bazar. It may be Darshani or Miadi. It may
be transferred from one person to another by mere delivery,
but it is payable only to a respectable person. If at the time of payment the hundi reaches the hands of a person of straw, the drawee would be within his right to refuse to honour the hundi. If the drawee makes payment of the
hundi to a person other than a Shah he will not be entitled to recover from the drawer the money he pays to the holder. Thus, the drawee
must make sure that he makes payment on a Shah jog hundi only to a Shah. 4.
Nam jog hundi. Where a hundi is made payable
to or to the order of specified person it is called
a nam jog hundi.
Such a hundi can be indorsed like a bill of exchange payable to order. 5. Jokhmi hundi. The term 'Jokhmi' means 'against risk.'
A jokhmi hundi therefore is a combination of bill of exchange and insurance policy.
Such a hundi
implies a condition that the money shall be payable by the drawee only in the event of the safe arrival of the goods against which the hundi is drawn.
The drawer of the hundi (i.e., the consignor) discounts the hundi with the insurer, and thereby gets the sale price, less charges of the insurer immediately. If the goods are lost in transit the insurer, cannot claim payment of the hundi from the drawee (i.e., the consignee). Thus, if the goods arrive safely such a hundi works like a bill of exchange and if the goods are lost in transit such a hundi works like an insurance policy and protects the interests of the consignor and the consignee. Certain general terms. There are certain terms which can be used in all types of hundis. Hundis payable to the order are known as 'Firman Jog' hundis and hundis payable to the bearer are known as 'Dhani jog' hundis. A hundi when paid and cancelled is called a 'Khokha. 'The duplicate of a hundi, when the original is lost, is called 'Peth. 'The duplicate of a duplicate hundi is called '
Perpeth.' 21.5.2
Inland and Foreign Instruments A promissory note, bill of exchange or cheque which is (i) drawn or made in India and also made payable in India, or (ii) drawn or made in India upon any person resident in India, although it may be made payable in a foreign country, is deemed to be an inland instrument. (Sec. 11) 18 5 .I.C. 745.
Negotiable Instruments 264 Self-Instructional Material NOTES Since a promissory note is not drawn on any person, an inland promissory note, therefore, is one which is both made and payable in India. Thus, the following are the examples of inland instruments: (a) A promissory note made in Chennai and payable in Delhi. (b) A bill of exchange drawn in Delhi and made payable in Mumbai (although the drawee may be residing outside India). (c) A bill of exchange drawn in Kanpur on a person resident in Kolkata (although it may be made payable in London).
An instrument, which is not an inland instrument, is deemed to be a foreign instrument (Sec. 12).
The following are the examples of foreign instruments: (i) A promissory note made in India but made payable in Germany. (ii) A bill of exchange
drawn in India, on a person residing outside India, and made payable outside India.' (
iii) A bill drawn outside India
and made payable in India. (iv)
A bill drawn outside India,
on a person residing in India. 21.5.3
Time and Demand Instruments An instrument payable after a fixed time (say, after three months) or on a specified date (say, on 25 August 2004) is termed as a 'time instrument.' An instrument payable after happening of an event which is certain to happen, e.g., death, though the time of its happening may be uncertain, is also called a time instrument. In the case of time instruments the period of limitation begins to run from maturity date. It may be noted that there can be a 'time bill' or a 'time note' but not a 'time cheque,' the reason being that a cheque
cannot be expressed to be payable otherwise than on demand.
An instrument payable on demand or at sight (i.e., on presentation in case of a cheque or a promissory note, and on acceptance in case of a bill of exchange) is termed as a 'demand instrument.' Again, a promissory note or a bill of exchange in which no time for payment is specified is also a demand instrument (Sec. 19). In case of demand instruments the period of limitation begins to run from the date of their execution except where they are made payable 'at sight' in which case the period of limitation commences from the date of presentation. 21.5.4
Ambiguous Instruments An instrument, which in form is such
that it may either be treated as a bill

of exchange or
as a promissory note, is an ambiguous instrument. In such a case, the holder may either
treat it as a bill of exchange or a promissory note,
but once he has made his choice the instrument shall henceforth be treated accordingly. (Sec. 17) The following are the examples of ambiguous instruments: (a) Where in a bill the drawer and the drawee are the same person. Thus, where a bill is drawn
by an agent, acting within the scope of his authority,
upon his principal, the holder may, at his option, treat it
as a note or a bill because the drawer and the drawee are the same person
in the eye of law. But where drawer and payee are the same, e.g.,
where a bill is drawn payable to the drawer's order,
it is not an ambiguous instrument and is a valid bill of exchange. (b)
Where in a bill the drawee is a fictitious person
or a person not having the capacity to contract. Thus, where P draws a bill on Q and negotiates it away, and Q is a fictitious or
a minor drawee, the holder may treat the bill as a note made by
P.
Negotiable Instruments Self-Instructional Material 265 NOTES 21.5.5 Inchoate Instruments An incomplete or blank negotiable instrument properly stamped and signed is termed as an 'inchoate instrument.' Section 20 deals with inchoate stamped instruments and provides that "
where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, either wholly blank or having written thereon an incomplete negotiable instrument,
he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and
not exceeding the amount covered by the stamp.
The person so signing
shall be
liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount. But a
person other than a holder in due course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder."
It is to be emphasised that delivery of a stamped paper to the holder is necessary for the application of this Section, otherwise the maker or acceptor will not be liable even to a subsequent holder in due course. Where, for example, a person signed a blank acceptance and kept it in his drawer, and some person stole it and filled it up for Rs 1,500 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument (Baxendale vs Bennett 19). It is also important to note that although the Section makes the person signing and delivering the inchoate instrument liable to a 'holder' as well as to a 'holder in due course,' but there is a difference in their respective rights. A 'holder' can recover only what the signer intended to be paid under the instrument, while a 'holder in due course' can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller. Illustration. P owes Q some money on account of credit purchases made by him. P gives a promissory note, after affixing one rupee revenue, stamp and signing, leaving the amount blank to Q authorising him to fill it up in accordance with the account. Q fills Rs 450 while actual amount due is Rs 300 only. Q cannot recover more than Rs 300. But if Q transfers it to R, a holder in due course, R can recover Rs 450, the full amount, from P. If, however, the amount filled in by Q is Rs 5,200, R cannot recover it, for the amount is not covered by the stamp. 21.5.6 Escrow When a negotiable instrument is endorsed and
delivered conditionally or for a special purpose only, e.g., as collateral security or for safe custody, and not for the purpose of transferring absolutely property therein, it is
called an 'escrow.'
In this case
the property in the instrument does not pass to the endorsee, and he is merely a bailee with limited
title and power of negotiating it.
This, however,
does
not affect the rights of a holder in due course. 21.5.7

Maturity of Negotiable Instruments 'Maturity' means the date on which the payment of an instrument falls due. An instrument payable on demand or at sight such as a cheque becomes payable immediately on the date of its execution and there is no question of its maturity. Its payment falls due at once on the date of its issue. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange which is
expressed to be payable otherwise than on demand.
Every promissory note or bill of exchange
expressed to be
payable on
a specified day, or at a certain period after date or after sight, or at a
certain period after the happening of
an event which is certain to happen
is at maturity on the third day after the day on which it is expressed to be payable (
Sec. 22). A time bill or note is as such entitled to three days of 19 (1878), 3 Q.B.D. 525.
Negotiable Instruments 266 Self-Instructional Material NOTES grace and matures or falls due on the last day of grace (and not on the date on which it is expressed to be payable). For example, a bill of exchange drawn on 1st January, if expressed payable three months after date, is at maturity on 4th April. Such a bill or note must be presented for payment only on the last day of grace, and if dishonoured, the suit can be filed on the next day after maturity. Any presentment for payment earlier to the third day of grace is invalid, even if the word 'punctually' is added to a fixed date. Rules for calculating maturity. Sections 23 to 25 lay down the following rules for calculating the maturity of a time bill or note: 1. If it is made payable a
stated number of months after date or after sight, or after a certain event,
it matures (or becomes payable) three days after the corresponding date of the month after the stated number of months. Illustration.
A negotiable instrument, dated 30th August, 1977,
is made payable three months after date. The instrument is at maturity on
the 3rd December, 1977. [
See Illustration (b) to Section 23.] 2.
If the month in which the period would terminate has no corresponding
date,
the period shall be
held to terminate on the last day of such month.
Illustrations. (a)
A negotiable instrument dated 30th January, 1977, is made payable
at one month after date. The
instrument is at maturity on the third day after the 28
th February 1977 (
i.e., 3rd March, 1977). [Sec Illustration (a) to Section 23.] (b)
A promissory note or bill of exchange,
dated 31st August, 1977, is made payable three months after date. The instrument is at maturity on
the 3rd December, 1977. [
Sec Illustration (c) to Section 23.] 3. If it is
made payable a certain number of days after date or after sight, or after a certain event,
the maturity is calculated by excluding
the day on which the instrument is drawn or presented for acceptance or sight or
on which the event happens.
Note that only one day is to be excluded. Illustrations. (a) A bill of exchange dated 1st March, is made payable 20 days after date. The period of 20 days will be counted from 2nd March, and the bill will be at maturity on 24th March. (b) A bill of exchange, dated 1st January, and payable 20 days after sight, is presented for acceptance on the 5th January. The bill shall mature on 28th January. 4. If
the date
on which a bill or note is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding
business day. The expression 'public holiday' includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.
Thus, if the maturity of an instrument falls on Sunday, it shall be deemed to be due on Saturday. If the maturity falls on an emergency
holiday, the instrument shall be deemed to be due on the next succeeding business day. 5.

If an instrument is payable by instalments, three days of grace are to be allowed on each instalment (Sec. 67). 21.5.8 Payment in Due Course The payment of the amount due under a negotiable instrument must amount to 'payment in due course' in order to operate as a valid discharge of the instrument against, the holder. Section 10 provides that in order to constitute a payment of a negotiable instrument as a 'payment in due course,' the following conditions must be fulfilled: 1.
The
payment must be in accordance with the apparent tenor of the instrument.
It should be made at or after maturity. A payment before maturity is not a payment in due course so as to discharge the instrument. Thus if a bill of exchange is paid before the last day of grace and is subsequently indorsed over, it is valid in the hands of a holder in due course and
the acceptor will be liable to pay again on the instrument. Similarly, if the banker makes payment of a post dated cheque before the date mentioned therein, he acts against the Check Your Progress 5. What do you understand by bill of exchange? 6. Differentiate promissory note and a bill. 7. Distinguish cheque and bill of exchange. 8. What do you understand by the term Hundis?
Negotiable Instruments Self-Instructional Material 267 NOTES apparent tenor of the instrument i.e., against the true intentions of the drawer and hence the payment will not be treated as payment in due course. 2. The payment must be made in good faith and without negligence. It must be honestly made in the bonafide belief that the person demanding payment is legally entitled to it. The payer must not be guilty of any negligence in making the payment. If there are suspicious circumstances and the payer fails to make necessary inquiry which may reveal the defects, the payment is not a payment in due course. Thus, if a specially endorsed bill of exchange is paid without inquiry as to the payee or if a cheque with forged signature of the drawer is paid, it, will amount to negligence on the part of the payer and the payment will not be treated as payment in due course. 3. The payment must be made
to a person in possession of the instrument under circumstances which do not
arouse suspicion about his title to possess the instrument and to receive payment of the amount therein mentioned.
A payment cannot be a payment in due course if it is
made without requiring production of the instrument and, therefore, the payer must insist on seeing the instrument before making the payment and must obtain the instrument on payment. 4. The payment must be made in money only, unless the holder agrees to accept payment in any other medium or by cheque or draft. To sum up, 'payment in due course' implies payment (i) according to the apparent tenor
of the instrument at or after maturity (ii) in good faith and without
negligence (iii) in money (or by cheque if acceptable to the holder) (iv) to a person who is legally entitled to the instrument and is in possession of the same. 21.5.9 Payment of Interest The Negotiable Instruments Act lays down the following provisions regarding the payment of interest: 1. When rate specified. When interest at a specified rate is expressly made payable on a
promissory note or bill of exchange,
interest shall be calculated at the rate specified, on the amount of
the
principal money due thereon, from the date of the instrument, until tender or realisation of such amount,
or until such date after the institution of a suit to recover such amount as the Court directs (Sec. 79). 2. When no rate specified.
When no rate of interest is specified in the instrument,
or when no mention is made of interest at all, 20 interest on the amount due thereon shall, notwithstanding any oral agreement relating to interest between any parties to the instrument, be calculated
at the rate of eighteen per cent 21 per annum, from the date
at which the same ought to have been paid by the party charged, until tender or realisation of the amount due thereon,
or until such date after the institution of a suit to recover such amount as the Court directs (
Sec. 80). 3. When the party charged is the indorser of an instrument dishonoured by non-payment, he
is liable to pay interest only from the time that he receives notice of
the dishonour (Explanation to Section 80). 21.6 TEST QUESTIONS 1.
Define the term 'negotiable instrument.' What are its essential characteristics? 2.
Distinguish between negotiable, non-negotiable and quasi-negotiable instruments, giving examples. What are the presumptions as to negotiable instruments? 20 Best vs Haji Mohammad, 23 Mad. 18. 21 Subs. for the words "six per cent" by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988, w.e.f. 1-4-1989.
Negotiable Instruments 268 Self-Instructional Material NOTES 3. Define a promissory note. What are its essential elements? 4. What is a bill of exchange?
What are its essential elements? How does it differ from a promissory note? 5. Define

a cheque.
How does it differ from a bill of exchange? 6.
Explain the distinguishing features of Promissory Notes, Bills of Exchange and Cheques. 7. What is a hundi? State the more popular types of hundis used in India. 8. Define the term 'maturity'. State the rules determining the maturity of negotiable instruments. 9. When is a payment on a negotiable instrument said to be a "payment is due course"? What are the rules relating to payment of interest on negotiable instruments? 10. Explain the following: (a) Bill in sets, (b) Accommodation bill, (c) Fictitious bill, (d) Ambiguous instruments, (c) Inchoate instruments, (f) Bank draft, and (g) Inland instruments. 21.7 PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1.
A
bill is drawn payable at F-10, DDA Flats, Janakpuri, but does not contain the name of the drawee. W, who resides at the said flat,
accepts the bill. Is it a valid bill? [Hint. Yes,
it is a valid bill and W is liable thereon. The drawee may be named or otherwise indicated in the bill with reasonable certainty. In the instant case the description of the place of residence indicates the name of the drawee, and W, by his acceptance, acknowledges
that he is the person to whom the bill is directed (
Gray vs Milner, 1819, 2 Taunt 739).] 2.
X draws a bill
on Y and negotiates it to Z. Y is a fictitious person. Can Z treat it as a promissory note made by
A? [Hint. Yes, Z can treat the instrument
as a promissory note. Where in a bill the drawee is a fictitious person, it is an ambiguous instrument and the holder is entitled to treat the bill as note.] 3. P signs his name on a blank but stamped instrument and
gives the paper to Q with authority
to fill it up as a promissory note for Rs 400 only.
But Q fraudulently fills the paper for Rs 1,000,
the stamp
put upon it being sufficient to cover this amount. He then hands it to R for
Rs 1,000 who takes it in good faith for value. Can R recover the whole amount? [Hint. Yes, R can recover Rs 1,000 from P. Section 20 lays down that in the case of an inchoate instrument a holder in due course can recover the whole amount made payable by the instrument provided it is covered by the stamp, even though the amount authorised was smaller.] 4. A bill of exchange is payable to Hari Mohan or order. At maturity another person of the same name wrongfully gets possession of the bill and presents it to the acceptor for payment. After
making due inquiries and
being satisfied that the presenter is Hari Mohan, the acceptor makes payment on it. Is the acceptor discharged? [Hint. Yes, the acceptor is discharged. When the presenter is in possession of the instrument and the acceptor pays it to him in good faith after due inquiry as to his identity, it is a payment in due course and the acceptor is discharged.]
Parties to Negotiable Instruments Self-Instructional Material 269 NOTES UNIT 22 PARTIES TO NEGOTIABLE INSTRUMENTS Structure 22.0 Introduction 22.1 Unit Objectives 22.2 Holder 22.3 Capacity of Parties 22.4 Test Questions 22.5 Practical Problems 22.0 INTRODUCTION A holder refers to an individual who is in possession of an instrument that is either payable to him or her as the payee, endorsed to him or her, or payable to the bearer.If a note or draft is negotiated to a person who acquires the instrument in good faith for value without notice of any defenses to payment, the transferee is a holder in due course and can enforce the instrument without being subject to defenses which the maker of the instrument would be able to assert against the original payee, except for certain real defenses which are rarely applicable. 22.1 UNIT OBJECTIVES ? Know the privileges enjoyed by a 'holder in due course' under the Negotiable Instrument Act ? Understand the different cases of incapacity to incure liability as a party to negotiable instrument ? Comprehend the provisions of law regarding the liability of parties to negotiable instruments 22.2
HOLDER The '
holder' of a negotiable instrument means any person
entitled to the possession of the instrument
in his own name and to receive
or recover the amount
due thereon from the parties
liable
thereto (
Sec. 8). Thus,
in order to be called a 'holder' a person must satisfy
the following two conditions: 1. He

must be
entitled to the possession of the instrument in his own name.
Actual
possession of the instrument is not essential. What is required is a right to possession under some legal or valid title. He should be a 'de jure holder' and not necessarily
a 'de
facto holder.' It means that
the person must be named in the instrument as the payee or the indorsee, or
he must be the bearer thereof,
if it is a bearer instrument. However, the heir of a deceased holder or any other person becoming entitled by operation of law is a holder although he is not the payee or indorsee or bearer thereof. If a person is in possession of a negotiable instrument without having a right to possess the same he cannot be called the holder. Thus, a thief, or a finder on the road, or an indorsee under a forged indorsement, although may be having the possession of the instrument, cannot be called its holder because he does not acquire legal title thereto and hence is not entitled in his own name to the possession thereof.
Similarly, a beneficial owner claiming through a 'benamidar' in whose favour the instrument had been made or drawn is not a
Parties to Negotiable Instruments 270 Self-Instructional Material NOTES holder because he is not entitled to the possession in his own name and cannot by himself maintain an action on the instrument (Subba Narayana vs Ramaswami 1). 2.
He must be entitled
to
receive or recover the amount due thereon from the parties
liable thereto.
In
order to be called a holder, besides being
entitled to the possession of the instrument
in his own name,
the
person must also have the right to receive or recover the amount
of the instrument and give a valid discharge to the payer. Thus, one may be the bearer or the payee or indorsee of an instrument but he may not be called a holder if he is prohibited by a Court order from receiving the amount due on the instrument.
It may, thus, be concluded that both the above conditions must be satisfied by a person to be called a holder. For instance, where an instrument payable to order is, without endorsement, entrusted by the payee to his agent, the agent does not become the holder of it, although he may receive its payment, because he has no
right to sue on the instrument in his own name. The holder of a negotiable instrument
is a very important party to the instrument as such. It is he alone who can sue upon a negotiable instrument, can negotiate it (with certain exceptions)
and can give a valid discharge for it. 22.2.1
Holder in Due Course
The '
holder in due course' means any person who for consideration became the possessor
of
a negotiable instrument if payable to bearer, or the payee or indorsee thereof
if payable to order,
before
the amount mentioned in it became payable,
and
without
sufficient cause to believe that
any defect existed in the title of
the
person from whom he
derived his title (
Sec. 9).
Thus,

in order to be called
a 'holder in due course' a person must possess the following qualifications: 1. He must be
a 'holder,'
i.e.,
he must be
entitled to the possession of the instrument in his own name
under a legal title and to recover the amount thereof from the parties liable thereto. 2. He must be a holder for valuable consideration, i.e., there must be some consideration to which law attaches value. The consideration, however, need not be adequate. A donee, who acquires
title to the instrument by way of gift, is not a holder in due
course
for want of consideration, although he is a holder. The consideration must also be lawful. Thus, a debt incurred in gambling is not valid or lawful consideration, and a person who acquires a bill or note in consideration of such a debt is not a holder in due course. 3.
He must have become the holder of the negotiable instrument
before its maturity.
The holder who acquires a negotiable instrument after maturity cannot be a holder in due course. But an accommodation bill can be negotiated after maturity with all benefits of a holder in due course to the transferee (Sec. 59). In case of instruments payable on demand, e.g., a cheque, he must have taken the instrument within a reasonable time of its issue. After the lapse of reasonable length of time the cheque becomes over due and any one who takes an over due cheque cannot be
a holder in due course. 4. He must take the negotiable instrument
complete and regular on the face of it.
It is the duty of every person who takes a negotiable instrument to examine its form
and contents thoroughly, for if it contains any material alteration which has not been confirmed by the drawer through his signature, or if it is incomplete, say, drawer's name is not there or it is not properly stamped, he will not become a holder in due course. 5.
He must have become holder in good faith
without having
sufficient cause to believe that any defect existed in the
title of
the
transferor. This is the most important condition to be satisfied. He must exercise great care and take all necessary precautions in finding out if the 1 (1907), 30
Mad. 88 (F.B.).
Parties to Negotiable Instruments Self-Instructional Material 271 NOTES transferor's title was defective. Moreover, he must take the instrument without any negligence on his part. If there is something to arouse a suspicion and he takes the negotiable instrument without making proper inquiries he cannot be said to be acting in good faith and cannot be called a holder in due course. For example, when he takes a bill which has been torn and the pieces pasted together, at least if the tears appear to show an intention to cancel it, without inquiry, he is not
a
holder in due course. 22.2.2
Privileges of
a
Holder in Due Course A
holder in due course
enjoys
the
following privileges under the Negotiable Instruments Act: 1. He gets a better title than that of the transferor. One who is a 'holder' only
gets no better title than that of his transferor but a holder in due course
is in
a privileged position
in that
he gets a better title than that of the transferor
and the
defences on the part of a person liable

that the
instrument
has been lost,
or has been
obtained by means of an offence
or fraud or
for an unlawful consideration
cannot be pleaded against a
holder in due course (Sec. 58).
For example, if P obtains an instrument payable to bearer by theft or fraud, or for an unlawful consideration, he cannot sue on it. But if P transfers the instrument (being a bearer one) to R under circumstances (for value in good faith) which make R a holder in due course, R can sue on the instrument.
The party liable to pay can take, as against P, the defence of theft or fraud, but as against R he will not be allowed to take such a defence. Further, not only the holder in due course himself gets a good title free from all defects
but also serves as a channel to protect all subsequent holders.
Once an
instrument
passes through the hands of a holder in due course it is
purged of all defects.
Section 53 states that "
a
holder of a negotiable instrument
who derives title from
a holder in due course has the rights thereon of that holder in due course."
Thus, anybody who takes a negotiable instrument from
a holder in due course
can recover the amount from all prior parties, although
he had knowledge of the prior defects, e.g., no consideration was paid by some of the prior parties or some one of them was a thief. It is important to note that a forged instrument,
even if it
passes through the hands of a holder in due course,
cannot be cured of
its
defect because there is no defect of title but there is complete absence of title. 2. Privilege in case of inchoate stamped instruments (Sec. 20). In the case of inchoate stamped instrument, if the holder or original payee fills more amount than that was authorised,
he cannot enforce the instrument for the whole amount (only actual authorised amount can be recovered). If such an instrument is transferred
to a holder in due course, he can claim
the whole of the amount so entered provided that the amount is covered by the stamp affixed thereon. Thus,
the defence that the amount filled by the holder was in excess of the authority given cannot be taken against a holder is due course. 3. Liability of prior parties. All prior parties to a negotiable instrument (i.
e., its
maker or drawer, acceptor and intervening
indorsers) continue to remain
liable to
a holder in due course
both jointly and severally (i.e., he can hold any or all prior parties liable) until the instrument is duly satisfied (
Sec. 36). Whereas, only preceding party is liable to a succeeding party, if the succeeding party is only a holder. 4. Privilege in case of fictitious bills (Sec. 42). When a bill
of exchange is drawn in a fictitious name and is made payable to the drawer's order (i.e.,
where both drawer and payee
of a bill are fictitious persons), the
bill is said to be a fictitious bill. Such a bill is not a good bill and cannot be enforced at law. But
the acceptor of such a bill
is liable to a holder in due course provided the latter can show
that the first indorsement on the bill and the

signature of the supposed drawer are in the same handwriting. 5. Privilege when an instrument delivered conditionally is negotiated. When a negotiable instrument is endorsed or delivered conditionally or for a special purpose only, e.g., as collateral security or for safe custody, and not with the idea of transferring absolutely

 property therein, the property in the instrument does not pass to the indorsee, and he is merely a bailee with limited title and power of negotiating it. This, however, does not affect the rights of a holder in due course, i.e., if such an instrument is negotiated to a holder in due course, the parties liable on the instrument cannot escape liability (Sections 46 and 47). For example, if I give a cheque to a shopkeeper with the condition that he should not encash the cheque till he supplies me the goods, anybody encashing the cheque prior to fulfilling the condition is liable to return the money except the holder in due course. 6. Estoppel against denying original validity of instrument (Sec. 120).

The plea of original invalidity of the instrument, e.g., that no consideration actually passed between the maker and the payee of a promissory note; cannot be put forth against the holder in due course by the drawer of a bill of exchange or cheque or by the maker of a promissory note or by an acceptor of a bill for the honour of the drawer. However, the aforestated parties are not precluded from challenging the validity of the instrument on the ground that at the time of making the instrument he was a minor or his signature had been forged or the instrument is otherwise void ab-initio, e.g., where a promissory note is made 'payable to bearer' it is void and illegal as per the Reserve Bank of India Act. 7. Estoppel against denying capacity of payee to indorse. "

No maker of a note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or the bill to indorse the same" (Sec. 121).

Thus, a holder in due course can claim payment in his own name despite the payee's incapacity to indorse the instrument. As per Section 51, only a 'holder' or a person in lawful possession of the instrument is competent to indorse. Accordingly, a person who got the instrument for a gambling debt or for unlawful consideration cannot negotiate the same. However, the holder in due course enjoys a privilege in this regard and he gets a good title even if he holds a negotiable instrument endorsed by a person who got the instrument for unlawful consideration because Section 121 provides that as against a holder in due course, no maker of a note and no acceptor of a bill payable to order shall be permitted to deny the payee's capacity to indorse the

same. 22.3 CAPACITY OF PARTIES "
Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, indorsement, delivery and negotiation of a promissory note, bill
of exchange or cheque" (
Sec. 26). This Section thus declares that capacity to incur liability on negotiable instruments is coextensive with the capacity to contract. If a party is not competent to contract (say, if he is a minor), the agreement
is absolutely void and inoperative as against him but he can derive benefit under it.
Thus, a person incompetent to contract cannot make himself liable as a party to negotiable instrument, but he may make the other parties competent to contract liable, because he can be a promisee or payee as per the Indian Contract Act. It follows, therefore, that if some of the parties to negotiable instrument are not capable of contracting, the instrument is void only as against such parties and the other competent parties remain bound under it. If, however, all the parties are incapable to contract, then the negotiable instrument is a nullity and does not have any legal value whatsoever. The different cases of incapacity to incur liability as a party to negotiable instrument are discussed below:
Minor. Section 26 declares that
a minor may draw, indorse, deliver and negotiate a negotiable instrument so as to bind all parties except himself. Accordingly,
a minor can be a party to negotiable instrument but he
does not incur any liability himself although other adult parties to the instrument remain liable thereon. Thus, though the minor cannot Check Your Progress 1. What do you mean by holder of a negotiable instrument? 2. Describe the various privileges, of a 'holder in due course' under the Negotiable Instrument Act.
Parties to Negotiable Instruments Self-Instructional Material 273 NOTES originate title or liability he can well serve as a channel or conduit pipe to pass it on to others. When an instrument is signed by a minor and adult jointly, the minor is not liable but the adult is. As in the case of every other contract, so in the case of a negotiable instrument, the minor is in a privileged position. For, although he cannot incur liability under a negotiable instrument, he can acquire rights under it. He can be a promisee and therefore an instrument can be drawn or made in his favour as payee. He can also become an indorsee by subsequent transfer of the instrument in his name. He can thus be a holder 'entitled to sue', through his guardian, all parties liable under the instrument. Insolvent. An insolvent is not competent to draw, make, accept or indorse a negotiable instrument so as to bind his estate which now stands vested in the Official Receiver. But if he indorses
an instrument of which he is the payee or indorsee to a holder in due course, the
indorsement is valid as against all prior parties liable except himself (i.e., the insolvent). Joint stock company. A company being an artificial person is competent of doing only such acts as are expressly or impliedy allowed by its Memorandum of Association. Hence if a company executes (i.e., draws, accepts or negotiates) a negotiable instrument without being authorised to do so by its Memorandum of Association, the instrument is void and
even a holder in due course cannot enforce the same against the company. A trading company has an implied power to execute negotiable instruments, but a non-trading company
has no such power unless expressly authorised by its Memorandum of Association. Although a company cannot incur liability under a negotiable instrument unless expressly or impliedly (as being incidental or ancillary to the attainment of its main objects) permitted by its Memorandum of Association, but it can always acquire rights under it. It can be a payee, or indorsee or holder and can enforce payment of the amount of the instrument. The position of the company as regards rights under a negotiable instrument is similar to the case of a minor. Agent. Every person who has the capacity to incur liability as a party to negotiable instrument (i.e., who can himself make, draw, accept or negotiate an instrument) may draw, make, accept or negotiate so as to
become a party to a negotiable instrument
through a
duly authorised agent acting in his name.
But
a general authority to transact business and to receive and discharge debts does not
confer upon an agent the power of accepting
or indorsing bills of exchange so as to bind his principal. Further, an
authority to draw bills of exchange does not
of itself import an authority to indorse. (Sec. 27)
Thus,
an agent can execute negotiable instruments so as to bind his principal
in that capacity (i.e., as a drawer, maker, acceptor or indorser) only for which he is expressly authorised by the principal in very clear terms. Further, while signing an instrument, the agent
must make it clear that he is signing as an agent

by using words like 'for and on behalf of' or 'per pro,'
otherwise he will be personally liable,
except
to those who induced him
to sign upon the belief that the principal only would be held liable. (
Sec. 28)
Legal representative. A legal representative of a
deceased person who signs his name to a
negotiable instrument (either as a maker or drawer or acceptor
or indorser)
is liable personally thereon unless he expressly limits his liability to the extent of the assets inherited by him
from the said deceased (Sec. 29). Thus, in order to avoid personal liability a legal representative must, while signing an instrument, use words to indicate that he is not personally liable, e.g., he may add words like 'without recourse to me personally' or 'with recourse against the estate of the deceased only.' 22.3.1 Liability of Parties to Negotiable Instruments
The provisions of law regarding the liability of parties to negotiable instruments are as follows:
Parties to Negotiable Instruments 274 Self-Instructional Material NOTES
Liability of drawer. "
The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor
thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer
as hereinafter provided" 2 (
Section 30). Thus,
the drawer of a bill
or cheque is liable to the holder
only
if (i) the instrument has been dishonoured, and (ii) due notice of dishonour has been given to him.
In the case of an 'accommodation bill,' however, no notice of dishonour to the drawer is required (Sec. 98).
It is to be noted that
the liability of a drawer of a bill of exchange is
secondary
like a surety (i.e., he is liable to pay only if the acceptor fails to pay and on dishonour the holder can sue the acceptor or approach the drawer for payment), except in a case where the bill has been dishonoured by non-acceptance by the drawee, in which case he is primarily liable like a principal debtor to the holder. The liability of a drawer of a cheque, though arises only when the drawee bank fails or refuses to pay, is not secondary like the drawer of a bill because on dishonour while the holder of a cheque cannot sue the banker, the holder of a bill can sue the acceptor. Once the banker dishonours a cheque, its holder's remedy is only against the drawer. In this sense it may be said that
the liability of the drawer of a cheque is primary (
Punjab National Bank vs Bank of Baroda 3). Liability of drawee of cheque (Sec. 31). The drawee of a cheque (i.e., paying banker) must pay the cheque when duly presented for payment provided
he has
sufficient funds of the drawer applicable to
the payment of such cheque.
If the drawee banker wrongfully dishonours the cheque he can be made liable
to pay exemplary damages to the drawer.
Notice that when the banker makes a default he is liable
not towards the payee or the holder but towards the drawer.
This is so because
there is no privity of contract between the holder and the banker. The holder
has a remedy against the drawer and not against
the banker.
Liability of 'maker' of note and 'acceptor' of bill (Sec. 32).
The maker of a
promissory note and the acceptor of a bill
of exchange
are
the
principal debtors and hence they are primarily liable for the amount due on
the instrument according to its apparent tenor, in the absence of a contract to the contrary.

There may be a contract to the contrary, for instance, in the case of an 'accommodation bill' the acceptor may be exempt from liability as per contract. Remember that
the maker of a note or the acceptor of a bill
must make the payment thereof according to the apparent tenor of the note or bill respectively at or after maturity to the holder. For, if he makes payment of a premature bill or note, as the case may be, and the same is subsequently endorsed over, it is valid
in the hands of a holder in due course and
the acceptor or maker will be liable to pay again on the instrument. Liability of Endorser (Sec. 35). When an indorser indorses and delivers a negotiable instrument before maturity he impliedly undertakes to be liable to every subsequent holder for the loss caused to him if the instrument is dishonoured by the party primarily liable thereon. Thus the indorser stands in the position of a "drawer" to all the subsequent holders. Like a drawer, the indorsee's liability is secondary and conditional. He is liable to every subsequent holder only if the following conditions are fulfilled: (i) the instrument must have been dishonoured by the party primarily liable to pay the instrument on its maturity, i.e., by the drawee, acceptor or maker, (ii)
due notice of dishonour must have been given to or received by such
indorser, (iii) he must not have excluded his own liability by "sans recourse" indorsement, and (iv) the holder must not have destroyed his remedy against prior parties, e.g., cancellation of prior indorsements without his consent. 4 2 For rules regarding notice of dishonour, see Unit 25. 3 A.I.R, (1944), P.C. 58. 4 Condition no. iv is based on Section 40. Check Your Progress 3. Differentiate 'holder' and 'holder in due course'. 4. Discuss the different cases of incapacity to incur liability as a party to negotiable instrument.
Parties to Negotiable Instruments Self-Instructional Material 275 NOTES Nature of liability of various prior parties. Every prior party, namely, the maker or drawer, the acceptor, and all the intervening indorsers;
to a negotiable instrument is liable thereon
to a holder in due course
until the instrument is duly satisfied
by payment or otherwise gets discharged 5 (Sec. 36). Accordingly, the
liability of prior parties to a holder in due course
is joint and several. He may hold any or all the prior parties liable for the amount of the dishonoured instrument. Illustration. A bill drawn by P on Q in favour of R is made payable three months after date. It is indorsed by R in favour of X, by X in favour of Y, and by Y in favour of Z. The bill has been accepted by Q, and Z presents it on maturity for payment to Q who duly pays the amount and indorses the fact of payment of the bill. On payment by Q the bill is duly satisfied. But if payment had not been made, Z could sue P, Q, R, X, Y—all or any of them; Y could sue P, Q, R, X; X could sue P, Q, R and so on. Liability Inter se. Though various parties to a negotiable instrument could be liable thereon but the nature of liability of each one of them is not similar. Some of them are primarily liable like a principal debtor while the others are secondarily liable like a surety. Section 37 provides in this connection that
the maker of a promissory note or cheque, the drawer of a bill
of exchange until acceptance and the acceptor are,
in the
absence of a contract to the contrary, respectively liable thereon as principal
debtors. The parties
other than those stated above (i.e., the drawer of a bill after acceptance and the indorser on instrument being indorsed) are liable as sureties for those who are liable as principal debtors, that is, they are liable only in case the principal debtors fail to perform their contracts. Section 38 deals with the nature of the liability between successive parties. It provides that
"
as between the parties so
liable as sureties, each prior party is, in the absence of a contract to the contrary,
also liable thereon as
a principal debtor in respect of each subsequent party."
As such each prior party is
liable as a principal debtor to succeeding party and hence can claim payment from his preceding party only. Illustration. A, draws a bill payable to his own order on B, who accepts.
A,
afterwards indorses the bill to C, C to D, and D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety. 6

Thus if the acceptor B does not pay on maturity, the holder in due course E can claim payment from any prior party and if he claims it from C, D is the principal debtor and D is C's surety. C can now claim the amount from B or A and not from D. If B and A are insolvent, C will suffer the loss. In case the holder of a negotiable instrument agrees to grant release to the party primarily liable thereon from his liability or to grant him extension of time, all the intervening parties shall be discharged from liability, except when the holder has expressely, by a special contract, reserved his right against them (Sec. 39). Further, if the holder,
without the consent of the indorser, destroys or impairs the indorser's remedy against prior party,
e.g., by cancellation of a prior indorsement or by destruction or release of securities held by him,
the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. (Sec. 40) 22.4
TEST QUESTIONS 1. Explain the terms (a) holder and (b) holder in due course. 5 In certain circumstances an instrument gets discharged by operation of law and as a result the holder cannot make any prior party, liable thereon. For instance, when the primary party liable becomes insolvent, the instrument is discharged and the payee holder cannot make any prior party liable thereon because here the acceptor or maker is unable to pay. It is only on refusal to pay that prior parties are liable. An instrument is also discharged when it becomes time barred against all the parties thereto or contains some material alteration. 6 Illustration to Section 38.
Parties to Negotiable Instruments 276 Self-Instructional Material NOTES 2.
Distinguish between a 'holder' and
a 'holder in due course.'
Explain fully the
privileges granted to
a 'holder in due course' under the Negotiable Instruments
Act. 3. '
A holder in due course gets a
title free from equities' Explain the statement and discuss the various privileges of a holder in due course. 4. "
The capacity to incur liability on negotiable instruments is coextensive with the capacity to contract.' Explain the statement and discuss the different cases of incapacity to incur liability as a party to negotiable instrument. 5. Discuss the liability of various parties to negotiable instruments. 6.
Discuss
the liability of prior parties on a negotiable instrument to a subsequent holder and among themselves, in case of its dishonour. 22.5
PRACTICAL PROBLEMS Attempt the following problems, giving reasons: 1. A
draws
a cheque in favour of B, a minor. B indorses it in favour of C, who in turn indorses it in favour of D. The cheque is dishonoured by the bank. Discuss the rights of C and
D. [Hint. C and D cannot claim from B, who being a minor does not incur any liability on the cheque (Sec. 26). C can claim payment from A, the drawer, only and D can claim against C, the indorser and A, the drawer.] 2.
A bill is payable to 'M or order'. It is stolen from M and the thief
forges M's signature and indorses it to B who takes it as a holder
in due course.
Discuss the rights of
B on the bill. [Hint. B acquires no title to the bill and cannot recover on it. The bill in question bears a forged indorsement. A forged indorsement being a nullity can convey no title and therefore B cannot claim to be holder in due course.] 3.
A is the holder of a bill of exchange made payable to the order of B, which contains the following indorsements in blank: First
indorsement
by 'B'. Second indorsement by 'Peter Williams.' Third indorsement by 'Wright & Co.' Fourth indorsement by 'John Rozario.' On this bill A puts in a
suit against John Rozario and strikes out, without John Rozario's consent, the indorsements by Wright & Co.,
and Peter Williams. Will A Succeed? [Hint. No, A will not succeed. By striking out indorsements by Wright & Co., and Peter Williams. A has impaired the remedy of John Rozario against them and so John Rozario is discharged from liability on the bill. (See Illustration to Section 40).]
Presentment of Negotiable Instruments Self-Instructional Material 277 NOTES UNIT 23 PRESENTMENT OF NEGOTIABLE INSTRUMENTS Structure 23.0 Introduction 23.1 Unit Objective 23.2 Presentment for Acceptance 23.3 Presentment for Sight 23.4 Presentment for Payment 23.5 Test Questions 23.6 Practical Problems 23.0 INTRODUCTION Exhibiting, presenting or placing of

a negotiable instrument for acceptance, sight or payment before the acceptor, maker, drawee or other party liable thereon by or on behalf of the holder
is called 'presentment.' Thus presentment may be made
for any of the following three purposes: I. Presentment for acceptance. II. Presentment for sight. III. Presentment for payment. 23.1 UNIT OBJECTIVE Be familiar with the legal provisions regarding 'presentment for acceptance' and 'presentment for payment' of negotiable instruments. 23.2 PRESENTMENT FOR ACCEPTANCE 'Presentment for acceptance' is necessary in case of bills of exchange only. But it is not every bill which has to be presented for acceptance. A bill of exchange 'payable on demand', or 'payable on the expiry of certain period after date' (say, payable three months after date), or 'payable on the date of happening of an event which is certain to happen' (say, on the death of Mr X) need not be presented for acceptance and it becomes due for payment even otherwise.
The following bills, however, must be presented for acceptance in order to charge the parties
with liability: (a) A bill payable at a specified period after sight.
Such a bill must be presented to the drawee for sight or acceptance
in order to fix the maturity of the bill. (Sec. 61) (b)
A bill in which there is an express stipulation that it shall be presented for acceptance
before it is presented for payment.
Even where presentation is optional, it is
advisable to present the bill to the drawee for his acceptance
in order to get (i) the
additional security of the acceptor's name on the bill, or (ii) an immediate right of recourse against the drawer and the indorsers, if any, in case the bill is dishonoured by non-acceptance.
From the drawer's point of view also presentment for acceptance is desirable, for if acceptance is refused, he may, on receiving early notice of dishonour, be able to get his effects out of the hands of the drawee.
Presentment of Negotiable Instruments 278 Self-Instructional Material NOTES 23.2.1 Acceptance When the drawee of the bill signifies his consent in writing to the drawer's order in the bill, by signing
across the face of the bill with or without the word 'accepted' and delivers back the
bill to the holder or gives notice of acceptance to the holder, the bill is said to have been accepted. The drawee is not liable on a bill
until he gives his acceptance and thereby becomes the acceptor thereof. A
bill may be accepted even before the drawer has signed it or after notice of the drawer's death.
Types of acceptance. An acceptance on the bill may be either (i) general acceptance,
or (ii) qualified acceptance. (i) General acceptance. If
the drawee accepts the order of the drawer to pay the sum specified in the bill in full, without any condition or qualification,
the acceptance is said to be general, absolute or unqualified. The acceptor may mention the bank where payment shall be made and this does not amount to putting a condition. As a rule, in order to be valid, an acceptance must be 'general' or unconditional. (ii) Qualified acceptance. (Sec. 86). When the drawee accepts the bill subject to some condition or qualification, thereby varying the terms as expressed in the bill, it is said to be a qualified acceptance. For example, acceptance for an amount less than that mentioned in the bill or for a period longer than that specified in the bill or acceptance dependent upon the happening of an event or acceptance
to pay only at a specified place and not elsewhere or to pay at a place different from the place mentioned in the bill is a qualified acceptance. When the bill is drawn on two or more drawees, not being partners, and only one or some of them accept, it is also a qualified acceptance. In case of partners, acceptance by one of the partners is a general acceptance.
The holder may refuse to take a qualified acceptance and regard the bill dishonoured by non-acceptance.

The holder may, at his option, accept qualified acceptance. If he accepts such qualified acceptance, without the consent of the prior parties, the latter are discharged from their liability. A qualified acceptance makes the bill an invalid negotiable instrument and thereafter the bill will be treated as an ordinary contract of acknowledging debt. 23.2.2 Presentment by Whom? Only a 'holder' of the bill or his agent can present a bill for acceptance. It means that the drawer himself or the indorsee, if the bill has been negotiated before acceptance, or his agent can present the bill for acceptance. 23.2.3 Presentment to Whom? A bill can be presented for acceptance to any one of the following: 1. The drawee of the bill or his duly authorised agent (Secs. 61 and 27). 2. All the drawees where there are several drawees. But if some of the drawees have the authority from others to accept, as in case of partnership firm, presentment to a person having such an authority or to a partner is enough. A bill accepted by some of the several drawees, who are not partners, binds only those who accept it and not the others who do not accept it and the acceptance is a qualified acceptance (Sec. 34) 3. The legal representative in case the drawee is dead (Sec. 75). The legal representative would be personally liable by such an acceptance unless accepted 'sans recourse' (Sec. 29). 4. The Official Receiver in case the drawee has become insolvent (Sec. 75). 5. The drawee in case of need, i.e., the person whose name is mentioned in the bill as one to whom the bill is to be presented in case of its dishonour by the original drawee (Secs. 33 and 115).
Presentment of Negotiable Instruments Self-Instructional Material 279 NOTES 6. An acceptor for honour. In certain circumstances a stranger
to
the bill may also accept it for the honour of any party—
drawer or indorser liable on the bill.
This is known as 'acceptance for honour' or 'acceptance supraprotest.' Section 108 lays down that "
when a bill of exchange
has
been noted or
protested for non-acceptance or for better security,
any person not being a party already liable thereon may with the consent of the holder, by writing on the bill,
accept the same for the honour of any party thereto."
Thus, for a valid acceptance for honour it must be made: (i) after the bill has been noted or protested; (ii) by a stranger to the bill; (iii) in writing on the bill; (iv) with the consent of the holder. The acceptor for honour must by writing on the bill declare
that he accepts under protest the protested bill for the honour of the drawer or of a particular indorser whom he names, or generally for honour (
Sec. 109).
Where the acceptance does not express for whose honour it is made, it
shall be deemed to be made for the honour of the drawer (Sec. 110). Rights and liabilities of acceptor for honour.
On acceptance the acceptor for honour takes exactly the same position as the party for whose honour he accepts. His rights and liabilities are the same with the only difference that his liability is conditional and arises only after: (i) the bill has been again presented to the original drawee for payment at its maturity and has been dishonoured by him, and (ii) noting and protesting has been done for such dishonour by non-payment. If the acceptor for honour makes payment without the fulfilment of the above conditions, none will be viable to him, not even the original drawer. (Secs. 111 and 112)
Payment for honour. The essentials of a valid payment for honour are: (a)
The bill must have been noted and protested for non-payment. (
b) The acceptor for honour making payment must declare before a notary public the party for whose honour he is paying which must be duly recorded by the Notary Public. (Sec. 113) An acceptor for honour, on making a valid payment of the bill, is entitled to recover from the party for whose honour he has paid and from all parties prior to such party, all sums paid by him with interest thereon and with all expenses properly incurred in making such payment. All parties subsequent to the party for whose honour the payment has been made are discharged from liability. (Sec. 114) It will be seen that this Section, by allowing an acceptor
for honour to recover the amount paid by him from the party for whose honour he has
paid or from other parties prior to such party, makes an exception to the general rule of law that 'no person by voluntarily paying the debt of another, can make himself his creditor.' 23.2.4 Time for Presentment The rules with regard to time of presentment for acceptance are as follows: 1. The presentation for acceptance must be made on a business day within business hours, whether the parties are traders or non-traders (Sec. 61). 2. Where presentation for acceptance is obligatory, i.e., where the bill is expressed payable at a specified period after sight, the bill must,
if no time is specified therein for presentation,
be-presented within a reasonable time after it is drawn (

Sec. 61). 3. Where period of presentment is specified in the bill, it must be presented within that period. 23.2.5 Place of Presentment If a particular place has been specified in the bill for presentment for acceptance, it must be presented at that place. If at such a place the drawee cannot be found on the due date for
Presentment of Negotiable Instruments 280 Self-Instructional Material NOTES presentment, after reasonable search, the bill is dishonoured. (Sec. 61) If no place is mentioned in the bill, it may be presented at the usual place of business of the drawee or his residence. 23.2.6 Proof of Presentment There must be a definite proof of presentment for acceptance and the drawee's refusal for the same. In order to declare 'dishonour by non-acceptance' the holder must prove before the Notary Public with the help of witnesses that the bill was in fact presented to the drawee for his acceptance or that the drawee could not be found after reasonable search, and such proof must be duly recorded by the Notary Public.
Where
authorised by agreement or usage, a
presentment through the post office by means of a registered letter is
sufficient (
Sec. 61). 23.2.7
Drawee's Time
for Deliberation The
holder must, if so
required by
the drawee of a bill of exchange presented to him for acceptance,
allow
the drawee
forty-eight hours (exclusive of public holidays) to consider whether he will accept
it (
Sec. 63). Thus if the drawee wants time for deliberation before taking up liability, the holder is bound to allow him forty-eight hours time at the most.
If the holder
allows the drawee more than forty-eight
hours, exclusive of public holidays, for deliberation, all previous parties not consenting to such
extension of time are thereby discharged from liability to such holder (
Sec. 83). If the drawee does not return the accepted bill within forty-eight hours the holder should treat the bill as dishonoured. If the drawee gives acceptance, it has retrospective effect and dates back to the date of the presentation. 23.2.8 Presentment for Acceptance When Excused? In the following cases
presentment for acceptance is excused and the bill is deemed to be dishonoured
for non-acceptance even without presentment for acceptance: 1.
When the drawee is incompetent to contract or he is a fictitious person (Sec. 91). 2. When the drawee, even after a reasonable search, cannot be found (
Sec. 61). 23.2.9 Effect of Non-presentment Where presentation for acceptance is obligatory, i.e., where the bill is payable at a specified period after sight, and the holder fails to present the bill for acceptance, all parties thereto, i.e., the drawer and the indorsers, if any, are discharged from their liability to such a holder (Sec. 61). 23.3 PRESENTMENT FOR SIGHT
"Presentment for sight" is necessary only in the
case of
a promissory note which is made payable at a certain period after sight,
so that the maturity of the note may be ascertained.
According to
Section 62, "
a promissory
note, payable at a certain period after sight, must be presented to the maker
thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and in
business hours on a business day.
In default of such
presentment, no party thereto is liable thereon to the person making such default." 23.4
PRESENTMENT
FOR PAYMENT Promissory
note, bill of exchange and cheques must be presented
for payment on the

due dates. On default of such presentment the parties thereto, other than the maker, acceptor or drawee, are not liable thereon to the holder of the instrument. [Sec. 64(1)] Check Your Progress 1. Define the term 'present- ment for acceptance'. 2. Presentment for acceptance is necessary in case of bills of exchange only. Elucidate. 3. What are the rules governing presentment for payment of different types of negotiable instruments?
Presentment of Negotiable Instruments Self-Instructional Material 281 NOTES Presentment by whom? The presentment for payment is to be made by the person who can give valid discharge to the debtor, i.e., either by the holder or by his authorised agent, or in case of his death or insolvency, by his legal representative or Official Assignee, as the case may be.
Where authorised by agreement or trade
usage, a
presentment through the post office by means of a registered letter is
sufficient. [
Sec. 64(1)]
Presentment to whom? The presentment for payment of
promissory notes, bills of exchange and cheques must be made to the maker, acceptor or drawee thereof respectively [
Sec. 64(1)]. It may also
be made to the duly authorised agent of
the maker, acceptor or drawee,
as the case may be,
or, where the maker, acceptor
or drawee
has died, to his legal representative, or, where he has been declared
an insolvent, to his
Official Assignee (
Sec. 75).
Where an electronic image of a truncated
cheque is presented for payment,
the drawee bank
is entitled to demand any further information regarding the truncated cheque from the
bank holding the
truncated cheque in case of
any reasonable suspicion about the genuineness
of the
apparent tenor of instrument,
and if the suspicion is that of any
fraud, forgery, tampering or destruction
of
the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification
and retain the truncated cheque so demanded if the payment is made accordingly [
Sub-section (2) inserted in Section 64 by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 (w.e.f. 6-2-2003)]. 23.4.1 Time of Presentment for Payment The rules with regard to time of presentment for payment as laid down in the Act are as follows: 1.
Presentment for payment must be made during the usual hours of business and
if
payable at
a
bank, during the usual banking hours (Sec. 65). 2. A negotiable instrument payable otherwise than on demand, i.e., payable
at a specified period after date or sight thereof, must be presented for payment at maturity (
Sec. 66).
Earlier presentment is premature and ineffective, and even a day's delay would discharge the parties thereto except one which is primarily liable. 3.
A negotiable instrument payable on demand
must be presented for payment within a reasonable time after
it is received by the holder,

otherwise the parties thereto except one which is primarily liable will be disharged from their liability (Secs. 74 and 73). 4. A cheque, which is always payable on-demand, should be presented for payment not only within a reasonable time after delivery thereof but also
before the relation between the drawer and his banker has been altered to the prejudice of
the drawer (
i.e., before the bank has failed), otherwise even the party primarily liable, namely, the drawer will also be discharged from his liability to the extent of loss suffered by him on account of the delay (Secs. 72 and 84). When delay in presentment is excused (Sec. 75
A).
Delay in presentment (for acceptance or payment) is excused if the same
is caused by circumstances beyond the control of
the
holder, and not imputable to his default, misconduct or negligence.
Thus, delay on account of impracticability of transmitting the instrument to the place of payment because of postal strike is excusable. But
when the cause of delay ceases to operate, presentment must be made within
a reasonable time.
Reasonable time (Sec. 105). In determining what is a reasonable time for presentment for acceptance or payment regard shall
be had to the nature of the instrument
and the
usual course of dealing with respect to similar
instruments; and, in calculating such time, public holidays
shall be excluded.
Presentment of Negotiable Instruments 282 Self-Instructional Material NOTES 23.4.2 Place of Presentment for Payment The Act lays down the following rules regarding the place of presentment for payment: 1. Where in an instrument the precise address of the place of payment has been indicated by the maker, drawer or acceptor, it must be presented at that place for payment (Secs. 68 and 69). For example, if a bill has been accepted 'payable at his bankers', the bill must be presented at the acceptor's bank and a presentment to the acceptor personally will be insufficient. However, if alternative places of payment have been mentioned then the instrument may be presented for payment at either of the places. 2. Where no place of payment has been indicated, the note or the
bill
must
be presented
at the place of business (if any), or at
the usual
residence of the maker, drawee or acceptor, as the case may be (
Sec. 70). 3.
If the maker, drawee
or
acceptor
of a negotiable instrument
has no known place of business or fixed residence, and no place is specified in the instrument
for presentment for
acceptance or payment such presentment
may
be made to him in person wherever he can be found (
Sec. 71). If there is a default in making the presentment in accordance with the above rules, the parties to the instrument, other than
the maker, acceptor or drawee thereof, are not liable thereon to the holder. Non-presentment for payment
discharges only the drawer and the indorsers in the case of a bill of exchange, and the indorsers, if any, in the case of a promissory note (Sections 68-69 read with Section 64). 23.4.3 When Presentment for Payment Unnecessary (Sec. 76) No presentment for payment is necessary, and the instrument may be taken to be
dishonoured on
the due date for presentment, in any of the following cases: 1.

When presentment is intentionally prevented. Where the maker, acceptor or drawee intentionally does something which prevents the holder from presenting the instrument, e.g., where a promissory note is lost and the maker refuses to give a duplicate. 2. Place of business closed.
If the instrument is payable at the payer's place
of business and he closes such place on a business day during
the usual business hours. 3.
Payer absents from place of
payment. If the instrument is payable at some other specified place, neither the payer nor any person authorised to make payment attends at such place during the usual
business hours. 4. When the payer cannot be found. If
the instrument is not payable at any specified place
and the payer cannot after due search be found. 5.
Waiver of presentment. If the person entitled to the presentment, namely, the payer waives the presentment and promises to pay even though no presentment is made. Such waiver may be made either expressly or impliedly. An express waiver may be made before maturity by expressly adding in the instrument such words as 'presentment waived'.
An implied waiver will be inferred from the conduct of the maker, acceptor or drawee, when after maturity
he
makes a part payment on account of the amount due on the instrument or promises to pay the amount due
thereon
in whole or in part. 6.
Where drawer could not suffer damage. Where the drawer is not likely to suffer damage by non-presentment for payment, e.g., where drawee is a fictitious person or one incompetent to contract or where the drawer and the drawee are the same person, the presentment is excused as against the drawer and a holder can make the drawer liable without presentation. Check Your Progress 4. What are the essentials of a valid payment for honour? 5. What are essentials of a valid acceptance for honour?
Presentment of Negotiable Instruments Self-Instructional Material 283 NOTES 23.5 TEST QUESTIONS 1. Discuss the rules regarding 'presentment for acceptance' of a negotiable instrument. State the circumstances under which such presentment is excused. 2. Define 'acceptor for honour'. Explain his rights and liabilities. 3. What are the rules governing presentment for payment of promissory notes, bills of exchange and cheques? When is such presentment unnecessary?
23.6
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A,
draws a bill of exchange payable after 60 days on B. B accepts it payable after three months. Is it a valid acceptance? [Hint. No, it is not a valid acceptance. It is a qualified acceptance and the holder may, at his option, accept it or regard the bill as dishonoured by non-acceptance.] 2. X
draws a bill of exchange on Y. Z writes an acceptance on it. Is it a valid acceptance? [
Hint. No, it is not a valid acceptance. A stranger to the bill cannot accept it unless it is done for the honour of a party liable on the bill after the bill has been noted or protested for non-acceptance. As in the instant case the bill has not been noted and protested, Z cannot be termed as an 'acceptor for honour' and hence he cannot be held liable on the basis of his acceptance.] 3.
A promissory note is presented for payment five days after its maturity. Are
the (i) maker and (ii) indorser discharged by such delay? [Hint. The indorser is discharged by the delay but the maker continues to be liable.
Delay in presentment for payment discharges parties to the instrument other than the party which is primarily liable.]
Negotiation of Negotiable Instruments Self-Instructional Material 285 NOTES UNIT 24 NEGOTIATION OF NEGOTIABLE INSTRUMENTS Structure 24.0 Introduction 24.1 Unit Objectives 24.2 Negotiable Instruments 24.3 Negotiation by Unauthorised Parties 24.4 Test Questions 24.5 Practical Problems 24.0 INTRODUCTION Easy transferability being one of the essential features of negotiable instruments, they are frequently transferred from one person to another for making payment and discharging business obligations. Generally
the person who is entitled to receive the payment of
a
negotiable instrument (i.e., the holder) does not retain it till maturity but transfers it to one of his creditors in payment of his debt, who in turn again transfers it to his creditor and so on the ownership of a negotiable instrument continues to be transferred from one to another. This process of transferring the title or ownership of negotiable instruments is called 'negotiation.' 24.1 UNIT OBJECTIVES ? Know the meaning of negotiation and the difference between negotiation and assignment ? Be familiar about the different kinds of indorsements ? Know the rules regarding negotiation of a lost instrument and an instrument obtained by fraud 24.2 NEGOTIABLE
INSTRUMENTS Definition.

According to Section 14, "
when a
promissory note, bill of exchange
or cheque is transferred to any person,
so as
to
constitute
that person
the
holder thereof, the instrument is said to be negotiated."
Thus
negotiation implies a transfer of negotiable instrument so as to constitute the transferee a holder thereof, who should be
entitled in his own name to sue on the instrument and recover the amount due thereon.
Handing over a bearer instrument to a servant for safe keeping is not negotiation; there must be a transfer with intention to pass title
and in the manner prescribed by the Act. Who can negotiate? Every maker, drawer, payee or indorsee, and if there are several makers, drawers, payees or indorsees, all of them jointly can negotiate an instrument, provided
the negotiability of such instrument has not been restricted or excluded
by any express words used in
the instrument. But the maker, drawer, payee or indorsee cannot negotiate an instrument, unless he is in lawful possession or is holder
thereof (Sec. 51). The case when a maker or drawer has to indorse an instrument arises where the instrument is made or drawn payable to his own order, e.g., "pay to myself or order". Duration of negotiability. A negotiable instrument may be negotiated until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after Negotiation of Negotiable Instruments 286 Self-Instructional Material NOTES such payment or satisfaction (Sec. 60). Thus, negotiability of an instrument stops only when the party ultimately liable thereon pays it at or after maturity. It can be negotiated even at or after maturity if it has not been paid or satisfied. A payment before maturity does not stop negotiability. The acceptor or maker who receives the instrument after payment but before maturity may reissue it. 24.2.1 Negotiation and Assignment Distinguished The Negotiable Instruments Act does not prohibit transfer of negotiable instruments otherwise than by negotiation. The equitable title to the instrument may also be transferred by 'assignment' by a separate deed in writing in accordance with the Transfer of Property Act.
The various points of distinction between negotiation and assignment are stated below: 1.
Formalities.
Negotiation requires mere 'delivery' of a 'bearer' instrument and 'indorsement and delivery' of an 'order' instrument to effectuate a transfer.
Assignment requires a written document signed by the transferor
irrespective of whether the instrument is a 'bearer' or 'order' one. 2.
Notice of transfer. In the case of assignment a
notice of transfer of debt is required to be given by the assignee to the debtor
in order to complete his title. No such notice is
required to be given in the case of negotiation. 3. Title. In the case of negotiation if the transferee takes the negotiable instrument for value and in good faith, i.e, as holder in due course, he takes it free from all defects in the title of the previous transferors. But in the case of assignment,
the assignee takes the instrument subject to the defects in the title of
his assignor, even though he took the assignment for value and in good faith. 4. Consideration.
Consideration is always presumed in the case of transfer by negotiation,
whereas there is no such presumption in the case of transfer by assignment, where the burden of proof of consideration lies upon the assignee. From the foregoing differences it will be seen that the rights which the transferee of a negotiable instrument by negotiation acquires are substantially superior to those of an assignee under assignment, and it is for this reason that the method of transfer by assignment is very rarely used while transferring negotiable instruments. 24.2.2 Modes of Negotiation There are two ways of negotiating or transferring a negotiable instrument: 1.
Negotiation by mere delivery. A negotiable
instrument payable to bearer
is negotiable by delivery thereof (Sec. 47). Thus, a

bearer instrument may be negotiated by delivery only. It does not require signature of the transferor (i.e., indorsement) and the transferee becomes the holder thereof by mere possession. The transferor of a bearer instrument is not liable on its dishonour because by not signing as indorser he has not added his credit to the instrument. 2. Negotiation by indorsement and delivery. A negotiable
instrument
payable to order is negotiable by the holder by indorsement and delivery thereof (
Sec. 48). Thus the negotiation of an
order instrument requires two formalities, namely, first the holder should indorse it and then deliver to his indorsee. Importance of delivery in negotiation. It may be noted that in both the modes of negotiation stated above, delivery made voluntarily with the intention of transferring the ownership of the instrument to the transferee is essential. Mere delivery without the intention of passing the property is not sufficient to constitute a complete negotiation. If a person delivers a negotiable instrument to his servant for safe custody or to his solicitor for filing a suit, the delivery does not amount to negotiation and the servant or the solicitor acquires no title to
Negotiation of Negotiable Instruments Self-Instructional Material 287 NOTES the instrument. Similarly, if the holder of a negotiable instrument payable to order makes the indorsement but dies before delivering the same to the indorsee, the negotiation is not complete and his legal representative cannot negotiate the same by mere delivery thereof (Sec. 57). It is so because there is no valid delivery since the instrument has not been voluntarily delivered by the deceased himself. Thus, delivery with the
intention of passing
the property in the instrument to the person to whom it is delivered
is an
essential formality
to complete any contract on a negotiable instrument whether it be
a contract of making, indorsement or acceptance (Sec. 46). Delivery of a negotiable instrument may be (a) actual, (b) constructive, or (c) conditional. Delivery is actual when the instrument is physically handed over by the transferor to the transferee or to someone on his behalf.
Constructive delivery is effected without any change of actual possession.
It implies a delivery in the eyes of law. Illustrations. (a)
A, the holder of a negotiable instrument payable to bearer,
which is in the hands of A's banker, who is at the time the banker of B also, directs the banker to transfer the instrument to B's credit in the Banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it. [
Illustration (b) to Section 47] (b) A, indorses a promissory note in favour of B and holds it, on B's request, as B's agent. There is constructive delivery by A to B. Where the instrument is delivered with some condition attached, it is called a conditional delivery. In such a case the negotiation is not valid, i.e.,
the property in the instrument
does not pass to the
transferee, till the condition is fulfilled. However, if it is subsequently
negotiated to a holder in due course,
he will get
a good title to it and all prior parties shall be liable to him in spite of initial conditional delivery. Illustration. P delivers a bearer cheque to Q on the condition that Q will not encash or negotiate the cheque unless he supplies him with the goods. There is a conditional delivery by P to Q and the property in the cheque will pass to Q only on supplying the goods. If the indorsee i.e., Q, encashes the cheque before supplying the goods, P can recover the money so paid to him. But if Q negotiates the cheque to R,
who takes the same in good faith and for value, he becomes the holder in due course
and can rightfully encash the cheque. 24.2.3 Indorsement Section 15
defines indorsement as follows: "
When the maker or holder of a negotiable instrument signs the same, otherwise than as
such maker,
for the purpose of negotiation,
on the back or face thereof
or on a slip of paper annexed thereto,
or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to indorse the same, and is called the
indorser." Thus, an indorsement consists of the signature of the holder usually made on the back of the negotiable instrument with the object of transferring the instrument. 1 If no space is left on

the back of the instrument for the purpose of indorsement, further indorsements are signed on a slip of paper attached to the instrument.
Such a slip is called 'allonge' and becomes part of
the instrument.
The person making the indorsement
is called an endorser' and
the person to whom the instrument is indorsed is called
an 'indorsee.'
In order to be a valid indorsement it should be made in ink. An indorsement in pencil or by
a rubber stamp is invalid. The indorser (i.e.,
the payee) must sign his name in the exact spellings as appearing on the face of negotiable instrument or the preceding indorsement. If the payee is an illiterate person, he may indorse the instrument by affixing his
left hand 1 Signing at the back of the instrument before surrendering the same to the payer (i.e., banker, acceptor or maker) for payment, merely acts as a receipt for money and not as indorsement because the payer does not occupy the position of a 'holder.'
Negotiation of Negotiable Instruments 288 Self-Instructional Material NOTES
thumb impression thereon, but the same should be duly witnessed or attested by somebody who should give his full address thereon.
Indorsements shall be
presumed to have been made in the order in which they appear
on the instrument unless proved to the contrary. 24.2.4
Kinds of Indorsements Indorsements may be of the following kinds: 1. Blank or general indorsement. If the indorser signs his name only
and does not specify the name of the indorsee, the indorsement is said to be in blank [Sec. 16(1)]. The effect of a blank indorsement is to convert the order instrument into bearer instrument (Sec. 54), which may be transferred merely by delivery. 2. Indorsement in full or special indorsement. If the indorser, in addition to his signature, also
adds a direction to pay the amount mentioned in
the instrument to, or to the order of, a specified person
the indorsement is
said to be in full [
Sec. 16(1)].
If, for example, A, the holder of a bill of exchange, wants to make an indorsement in full to B, he would write thus: "Pay to B or order, Sd/A.' After such an indorsement it is only the indorsee, i.e., B, who is entitled to receive the payment of the instrument and to further negotiate the instrument by his indorsement. A blank indorsement can easily be converted into an indorsement in full. According to Section 49, the holder of
a negotiable instrument indorsed in blank may, without signing his own name,
by writing above the indorser's signature a direction to pay to
any other person as indorsee,
convert the indorsement in blank into an indorsement in full; and since such holder does not
sign himself on the instrument he does not thereby incur the responsibility of an indorser. 3. Partial Indorsement. Section 56 provides that a negotiable instrument cannot be indorsed for
a part of the amount appearing to be due on the instrument.
In other words, a partial indorsement which transfers the rights to receive only a part payment of the amount due on the instrument is invalid. Such an indorsement has been declared invalid because it would subject the prior parties to plurality of actions (one action by holder for part value and another action by indorsee for part value) and will thus cause inconvenience to them. Moreover, it would also interfere with the free circulation of negotiable instruments. It may be noted that an indorsement which purports to transfer the instrument to two or more indorsees separately and not jointly is also treated as partial indorsement and hence would be invalid. Thus, where A holds a bill for Rs 2,000 and indorses it in favour of B for Rs 1,000 and in favour of C for the remaining Rs 1,000, the indorsement is partial and invalid. Section 56, however, further provides that where an instrument has been paid in part,
a note to that effect
may be indorsed on the instrument
and it may then be negotiated for the
balance.
Thus, if in the above illustration the acceptor has already paid Rs 1,000 to A, the holder of the bill, A can then make an indorsement saying "Pay B or order Rs 1,000 being the unpaid residue of the bill." Such an indorsement would be valid. 4. Restrictive indorsement. Stating the effect of indorsement Section 50 provides that "

the indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation."
However, Section 50 permits restrictive indorsement. An indorsement which, by express words, prohibits the indorsee from further negotiating the instrument or restricts the indorsee to deal with the instrument as directed by the indorser is called 'restrictive' indorsement. The indorsee under a restrictive indorsement gets all the rights of an indorser except the right of further negotiation. In other words, such an indorsement entitles the indorsee to receive the payment on due date and sue the parties for it but he cannot further negotiate the instrument.
Negotiation of Negotiable Instruments Self-Instructional Material 289 NOTES Illustrations. (a) B, the holder of the bill, makes an indorsement on the bill saying "Pay C only." It is a restrictive indorsement as C cannot negotiate the bill further. 2 (b) B, the holder of the bill, makes an indorsement on the bill, saying "Pay C for my use" or "Pay C or order for the account of B." In either case there is a restrictive indorsement as the right of further negotiation by C has been excluded thereby. 3 The person liable on the bill must pay by drawing a cheque in the name of the holder (or the indorser) B. If he makes the payment to C on C's own account, he will still be liable to B, the indorser. Hence C cannot indorse the bill further in his own name. 5. Conditional indorsement. If
the indorser of a negotiable instrument, by express words in the indorsement, makes his liability,
dependent on
the happening of a specified event, although such event may never happen,
such indorsement is called a 'conditional' indorsement (Sec. 52). The law permits a conditional indorsement and therefore it does not in any way affect the negotiability of the instrument. Thus, indorsements can validly be made in the following terms: (i) "Pay B or order on his marriage;" (ii) "Pay B 4 on the arrival of Pearless ship at Mumbai." In the case of a conditional indorsement
the liability of the indorser would arise only upon the happening of the event specified.
But the indorsee can sue other prior parties, e.g., the maker, acceptor, etc., if the instrument is not duly met at maturity, even though the specified event did not happen. 6. Sans recourse indorsement (Sec. 52). When the indorser expressly excludes his own liability on the negotiable instrument
to the indorsee or any subsequent holder in case of dishonour of the instrument,
the indorsement is known as 'sans recourse' indorsement. Such an indorsement is generally made by adding the words 'sans recourse' or 'without recourse.' Thus, "Pay X or order sans recourse" or "
Pay X without recourse to me" or "Pay X or order
at his own risk" are examples of this type of indorsement. 7. Facultative indorsement. When the indorser expressly gives up some of his rights under the negotiable instrument, the indorsement
is called a '
facultative' indorsement. Thus, "Pay X or order, notice of dishonour waived" is
a facultative indorsement.
As a result of such an indorsement the indorsee is relieved of his duty to give notice of dishonour to the indorser and the latter remains liable to the indorsee for the non-payment of the instrument, even though no notice of dishonour has been given to him. 24.2.5 Negotiation Back During the course of negotiation if a negotiable instrument is reindorsed by the last indorsee to the original holder or a previous indorser it is called as 'negotiation back.' The person who becomes the holder by reason of negotiation back cannot make any of the intermediate indorsers liable on the instrument because to make them liable would involve a circuity of action; he having ultimately to sue himself as being a prior party he is liable to all of them. But where an indorser excludes his liability by the use of the words 'sans recourse' or 'without recourse to me,' and afterwards becomes the holder of the instrument in his own right, all intermediate indorsers are liable to him and in case of dishonour
he can recover the amount from all or any one of them [
Sec. 52, Para 2]. 24.3 NEGOTIATION BY UNAUTHORISED PARTIES We shall now discuss about the negotiation of lost instruments and instruments obtained by unlawful means (e.g., by theft or fraud) or for unlawful consideration. 2 See Illustration (a) to Section 50. 3 See Illustrations (b) and (c) to Section 50. 4 The negotiability is not restricted by the omission of the word "or order" (Sec. 51). Check Your Progress 1. Differentiate negotiation and assignment. 2. What are the various kinds of indorsements? 3. What do you understand by forged indorsement?
Negotiation of Negotiable Instruments 290 Self-Instructional Material NOTES 24.3.1 Lost Instruments The following rules are applicable in the case
of lost negotiable instruments: 1. Where a bill of exchange has been lost before it is overdue, the person who was its holder may apply to the drawer to give him another bill of the same tenor. The drawer
may require the holder to give security to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again.
If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so

by means of a suit (Sec. 45A). The right to obtain a duplicate of lost instrument is given to the holder of a promissory note or a cheque also. 2. To avoid the risks involved in case of loss of a negotiable instrument, its holder should inform all parties liable on it and should also give public notice by advertisement in some local newspaper. 3. If the holder could not obtain a duplicate copy, he should on maturity make an application to the person liable to pay on the lost instrument for payment of the amount due thereon. Although the payer is entitled to refuse payment till the instrument is delivered to him, he may make the payment after getting a written undertaking from the payee to indemnify him against any further claim thereon. In case the payer insists on delivery of the instrument and rufuses to pay otherwise, then payment can be obtained through court on similar undertaking to indemnify. (See Sec. 81) 4. The Finder of the lost instrument gets no title to it and cannot sue the party liable thereon for its payment. The rightful holder (or the true owner) is entitled to get back the instrument from him. But if the finder obtains payment of the instrument in his possession, it being a bearer document, the payer (i.e., the maker, acceptor or drawee) will be discharged from his liability if he makes a payment in due course. The true owner, however, will be entitled to recover the amount from the finder. (See Secs. 58 and 82) 5. Although the finder of the lost instrument, in the absence of title to it, cannot lawfully transfer it, but if he negotiates it, being a bearer instrument or one indorsed in blank, to a holder in due course, such holder gets a good title to it and can obtain payment from the party concerned. (Sec. 58) The true owner cannot take possession of the same from such a holder in due course, of course he can claim damages from the finder, if traceable. 6. In case the finder transfers an order instrument by making a forged indorsement, even a bonaflde transferee for value gets no legal title to it, and therefore he is not entitled to sue on the instrument. Forgery can confer no title and thus indorsee is not a holder in due course. If the party liable to pay on the instrument makes the payment to the indorsee who holds it under a forged indorsement, he shall continue to be liable to the true owner. (Protection has, however, been given by law to a paying banker in such a case). 24.3.2 Stolen Instruments The position in case of a stolen negotiable instrument is almost the same as in the case of a lost instrument, with the difference that on being traced the thief is open to criminal prosecution while a finder is not. Here also, the thief does not acquire any title to the instrument and the true owner can sue him for the recovery of the instrument or the money if he has received it from the maker, acceptor or drawee. But if the thief transfers a bearer instrument to a holder in due course, such a holder gets a good title to it (Sec. 58). 24.3.3 Instruments Obtained by Fraud If a person obtains a negotiable instrument by fraud, undue influence or coercion, he is not entitled to enforce its payment as his title is defective. But if such an instrument (bearer or
Negotiation of Negotiable Instruments Self-Instructional Material 291 NOTES order) is transferred to a holder in due course, such a holder will acquire good title to it and the plea of fraud will not be of use against him. It may be noted that in the case of instruments obtained by fraud etc., even an order instrument can be negotiated so as to make the indorsee a holder in due course because it is not a case of the absence of title (as in the case of lost or stolen instruments) but only a case of defective title and hence the indorsement shall not be a forged one. The indorsement in this case will be genuine, though by a person having a defective title,
but
once the
instrument
passes into the hands of a holder in due course,
it is
purged of
all
its defects (
Sec. 58). 24.3.4 Instruments Obtained for an Unlawful Consideration The general rule of law of contracts
that
every agreement of which the object or consideration is unlawful
or immoral or against the public policy is void and inoperative applies to negotiable instruments for unlawful consideration as well. Thus, a bill of exchange or a promissory note given in consideration of future illicit cohabitation or for reimbursing someone for committing a crime
is void and creates no obligation between the parties thereto.
But
if such
an instrument passes into the hands of a holder in due course,
such a holder and
any holder deriving title from such
a holder in due course gets a good title to the instrument (

Sec. 58). 24.3.5 Forged Instruments If the signature of maker, drawer or acceptor is forged on a negotiable instrument, it is termed a forged instrument. A forged signature is in law wholly inoperative and therefore a forged instrument is deemed incomplete on the face of it. It has no existence in the eye of law. It is totally ineffective and a nullity. It cannot confer any right or create any liability. Hence the holder of a forged instrument cannot enforce it and if he obtains payment on such instrument, the person making the payment can recover the amount paid by him as payment under a mistake. Even if, in the course of negotiation,
a forged
instrument passes through the hands of a holder in due course it
cannot be cured of
its
defect because there is no defect of title which can be cured but there is a complete absence of title. Forged indorsement. If the signature of indorser is forged on a negotiable instrument it is called a forged indorsement. A forged indorsement is regarded in law as no indorsement at all. As a result the indorsee of an order instrument bearing a forged indorsement gets no title thereto, even if he is a bonafide holder for value, because in law he has taken an instrument which was incomplete on the face of it. The indorsee of an order instrument obtains title only through the indorsement made by the indorser and the same being forged one cannot confer any title on the indorsee. The title of the indorser whose indorsement has been forged remains unaffected. If the party liable to pay on the instrument makes the payment to the indorsee who holds it under a forged indorsement, he shall continue to be liable to the true owner. Protection has, however, been granted to a paying banker who pays in due course its customer's cheque payable to order and bearing a forged indorsement (Sec. 85). In the case of a bearer instrument or the one which has been indorsed in blank, a forged indorsement is immaterial and does not affect the title of the indorsee. For, in case of such instruments the indorsee or holder derives title by delivery and not through the indorsement. It is relevant to state that where a person accepts a bill of exchange already carrying forged indorsement with full knowledge of forgery, he
is not relieved from liability by reason that such indorsement is forged (
Sec. 41). 24.3.6 Negotiation of Dishonoured and Overdue Instruments Dishonoured and overdue instruments may be negotiated but the transferee of such an instrument will not be termed as
a
holder in due course. Section 59 provides that
the holder of a negotiable
instrument,
who has acquired it after dishonour whether by non-acceptance
Negotiation of Negotiable Instruments 292 Self-Instructional Material NOTES or non-payment, with notice, thereof, or after maturity, is not a holder in due course and his title will not be better than that of his transferor. Such a holder can recover only from his immediate preceding party in case of dishonour and not from any prior party like a holder in due course. The case of an accommodation bill or note is, however, different. The proviso to Section 59 lays down that any person who, in good faith and for consideration, becomes the holder, after maturity, of an accommodation bill of exchange or an accommodation promissory note, is a holder in due course in the same way as a holder before maturity and can recover the amount of the bill or note from any prior party. 24.3.7 Instruments Without Consideration Unlike ordinary contracts, in the case of negotiable instruments there is a presumption of consideration. Until contrary is proved there shall be a presumption that every negotiable instrument was drawn, made, accepted, indorsed, negotiated or transferred for consideration [Sec. 118 (a)]. The presumption is rebuttable by a person who wants to avoid his liability on the ground of absence of consideration. The rights of the parties to negotiable instruments without consideration or with partial consideration are discussed below: Total absence or failure of
consideration. According to
Section 43, "
a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails,
creates no obligation of payment between the parties to the transaction.
But if any such party has transferred the instrument (with or without indorsement)
to a holder for consideration such holder, and
every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto."
Partial consideration. According to Sections 44 and 45, when there is a partial failure of consideration, either originally or subsequently,
the parties standing in immediate relation to each other cannot recover more than
the
actual consideration. But this rule does not apply to a holder in due course

who can recover the full amount due on such instrument. Thus, the absence of consideration, either total or partial, in case of a negotiable instrument can be taken as a defence to avoid the liability only towards parties to the transaction, i.e., those parties who have immediate relation with one another. Want of consideration cannot be a valid defence to a suit brought by a subsequent holder in due course or any other person deriving title therefrom and such a holder in due course may recover the amount due from any prior party. Accordingly, a person who might have accommodated the drawer of the bill, shall be liable on the bill to any subsequent 'holder for value', even if the holder knew such party to be an accommodation party. According to the Explanation added to Section 44,
the drawer of a bill of exchange
stands in immediate relation with the acceptor.
The maker of a promissory note,
bill of exchange or cheque stands in immediate relation with the payee,
and the
indorser with his
indorsee. Illustrations. (a) A makes a promissory note in favour of B and delivers the same to B without consideration. B indorses the same
to C without consideration C indorses it to D for consideration and D indorses it to E without consideration.
B cannot recover anything from A, as there was no consideration between them. Similarly, C also got it without consideration from B and thus cannot claim the amount of the note from B. D is the transferee for consideration and therefore D can claim the amount from C, as also from B and A, because a person who takes a negotiable instrument for consideration
can claim the amount
from the transferor for consideration or any prior party thereto.
Not only D can have rights against A, B and C but any person who derives title from D, i.e., E in the instant case, can claim payment from A, B and C. E, however, cannot bring any action against D, because as between E and D, who stand in immediate relation with each other there was no consideration. (
b) A is the holder of a bill for consideration. A indorses it away to B without consideration. The property in the bill passes to B. The bill is dishonoured at maturity. B cannot sue A on the bill as
there was no consideration between them. Check Your Progress 4. Describe the rules that are applicable in the case of negotiation of overdue. 5. Discuss the rights of the parties to negotiable instruments without consideration.
Negotiation of Negotiable Instruments Self-Instructional Material 293 NOTES (c)
A draws a bill on B for Rs 500 payable to the order of A. B accepts the bill, but subsequently dishonours it by non-payment. A sues B on the bill. B proves that it was accepted for value as to
Rs 400,
and as an accommodation to the plaintiff
as to the residue, A can only recover
Rs 400. [Illustration to Section 44] 24.4 TEST QUESTIONS 1. Explain clearly what is meant by negotiation. State the differences between negotiation and assignment. 2. What is an indorsement? Explain and illustrate the different kinds of indorsements. 3. "
A partial indorsement does not operate as a negotiation of the instrument."
Comment. Describe the different kinds of indorsements. 4. What are the requisites of a valid indorsement? Explain the different kinds of indorsements with suitable examples. 5. Discuss the rules regarding negotiation of a lost instrument, a forged indorsement, an instrument obtained by fraud and for an unlawful consideration. 6. (a) Can an overdue instrument be negotiated? (b) "The absence of consideration for a negotiable instrument is material only between immediate parties to the instrument." Comment. 24.5
PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1.
A
bill is payable to 'B or order'. It is stolen by C who forges B's indorsement and indorses it to D who takes
it
for value and in good faith.
Does D acquire good title to it? [Hint. No, D does not acquire good title to the bill because a forged indorsement is no indorsement in the eye of law and as such cannot confer any title on the indorsee.] 2.
A cheque is drawn payable to 'B or order.' It is stolen and B's indorsement is forged. The banker pays in due course. Is the banker discharged from liability? [
Hint. Yes, the banker is discharged from liability as per Section 85.] 3.
A draws a bill on B who accepts it without consideration,
A
indorses the bill to C for valuable consideration. On due date C presents the bill to B for payment

but B contends absence of consideration and refuses to pay. Is B's contention justified? [Hint. No, B's contention is not justified against C who is a holder of the bill for value, even if C knew that B is an accommodation party, B is liable on the bill to C. Absence of consideration can be taken as a defence to avoid liability only towards parties who stand in immediate relation with each other.] 4. X,
the holder of a bill, transfers it to Y without consideration, Y transfers
the bill to Z without consideration but Z transfers to M for consideration, M transfers it to N without consideration. Can N hold M, Z, Y or X liable for payment? [Hint. N can hold X, Y or Z liable on the bill, for he derives title from M who has taken the bill for consideration. N, however, cannot make M liable because of absence of consideration between them.] 5. M obtains P'
s
acceptance to a bill by fraud, M indorses it
to Q who takes it as
a holder in due
course,
Q indorses the bill to
R who knows of the fraud. Can R recover from P? [Hint. Yes, R can recover
from P, because he takes the bill from
a holder in due course and
once an
instrument
passes through the hands of a holder in due course it is
purged of all defects.]
MODULE - 7
Dishonour and Discharge of Negotiable Instruments Self-Instructional Material 297 NOTES UNIT 25 DISHONOUR AND DISCHARGE OF NEGOTIABLE INSTRUMENTS Structure 25.0 Introduction 25.1 Unit Objectives 25.2 Dishonour of Negotiable Instruments 25.3 Dischange of the Instrument and the Parties 25.4 Test Questions 25.5 Practical Problems 25.0 INTRODUCTION Law relating to promissory notes, bills of exchange, cheques and other negotiable instruments is categorized in India under the Negotiable Instruments Act, 1881. It lays down the definition for promissory note, bill of exchange, cheque, foreign instrument and negotiable instrument. According to the provisions of this Act, in India, every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by making, drawing, accepting, endorsing, delivering and negotiating of a promissory note, bill of exchange or cheque and every person capable of binding himself or of being bound, may so
bind himself or be bound by a duly authorized agent acting in his name.
In this unit, you will learn about dishonour of negotiable instruments and dishonour of the instrument and the parties.
25.1 UNIT OBJECTIVES ? Understand the cases in which
a bill of exchange is said to be dishonored by non acceptance ?
Know the
effect of dishonour ? Understand the legal provisions regarding the notice of dishonour ? Note the meaning of the terms 'noting' and 'protest' ? Be familiar with
the various ways in which one or more parties to a negotiable instrument is are discharged
from liability 25.2
DISHONOUR OF NEGOTIABLE INSTRUMENTS A negotiable instrument may be dishonoured by (i) non-acceptance or (ii) non-payment. As presentment for acceptance is required only in case of bills of exchange, it is only the bills of exchange which may be dishonoured by non-acceptance. Of course any type of negotiable instrument —
promissory note, bill of exchange or cheque —
may be dishonoured
by non- payment. 25.2.1
Dishonour by Non-acceptance A bill of exchange
is said to be dishonoured by non-
acceptance
in the
following
cases: 1 1 Section 91
Dishonour and Discharge of Negotiable Instruments 298 Self-Instructional Material NOTES 1.
When
the drawee or one of several drawees (not being partners)
makes default in acceptance upon being duly required to accept the bill.

It may be recalled that the drawee may require 48 hours time (exclusive of public holidays) to consider whether he will accept or not (Sec. 63). 2. Where the presentment for acceptance is excused and the bill is not accepted, i.e., remains unaccepted. 3. Where the drawee is incompetent to contract. 4. Where the drawee makes the acceptance qualified. 5. If the drawee is a fictitious person or after reasonable search cannot be found (Sec. 61).

It is important to note that where a 'drawee in case of need' is named in a bill of exchange, the bill is not dishonoured until it has been dishonoured by such drawee (Sec. 115). 25.2.2 Dishonour by Non-payment

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same (Sec. 92).

Also, a promissory note or bill of exchange is dishonoured by non-payment when presentment for payment is excused expressly by the maker of the note or acceptor of the bill and the note or bill remains unpaid at or after maturity (Sec. 76). 25.2.3 Effect of Dishonour As soon as a negotiable instrument is dishonoured (either by non-acceptance or by non- payment) the holder becomes entitled to sue the parties liable to pay thereon. The drawer of cheque, maker of note, acceptor and drawer of bill and all the indorsers are liable severally, and jointly to a holder in due course. 2

The holder must, however, give 'notice of dishonour' to all parties against whom he intends to proceed. He may (at his option) also have the instrument 'noted and protested' before a notary public. 25.2.4 Notice of Dishonour Notice of dishonour means formal communication of the fact of dishonour.

It is given to the party sought to be made liable and, therefore, it serves as a warning to the person to whom the notice is given that he could now be made liable. Such a notice also serves the purpose of enabling the person so notified to protect himself against his prior parties.

Notice by whom? Notice of dishonour must be given by the holder or by some party to the instrument who remains liable thereon (Sec. 93). Further, any party receiving notice of dishonour must also transmit the same

within a reasonable time to all prior parties in order to render them liable to himself.
He cannot sue any prior party to whom he has not transmitted the notice
unless that party has received due notice from the holder or some other party to the instrument (
Sec. 95). It may be noted that where a number of persons are required to give notice to certain persons it is not necessary that all of them must give the notice. If some of them have given notice of dishonour, the other persons can take advantage of the same. Notice of dishonour can also be given by the duly authorised agent of the person who is bound to give notice.
When an instrument is deposited with an agent for presentment and is dishonoured
the agent can himself give notice to prior parties on behalf of the holder.
But it is not obligatory on him to do so. He may give notice to his principal within the same time 2 For further details about the liability of parties to a negotiable instrument refer to Unit on negotiable instrument.
Dishonour and Discharge of Negotiable Instruments Self-Instructional Material 299 NOTES as if he were the holder and the principal may then give notice to parties to whom he wants to hold liable.
The principal is also entitled to a further like period to give notice of dishonour (
Sec. 96).
Notice to whom? Notice
of dishonour must be given to all
parties (
other than
the maker
of
a note, acceptor of a bill or drawee of a cheque)
to whom the holder seeks to make liable or to
their duly authorised agents. Where there are two or more persons jointly liable as drawers or indorsers, notice to any one of them is
sufficient. No notice
need be given
to the maker of a note, or acceptor of a bill or
drawee of a cheque
who are the
principal debtors and have themselves dishonoured the instrument (Sec. 93).
In case of death of a person, notice must
be given
to his legal representative,
or, where he has been declared
an insolvent,
it must
be given to his Official
Assignee (Sec. 94).
When the party to whom notice of dishonour is despatched is dead, but the party despatching the notice is ignorant of his death, the notice is sufficient
to bind the estate of the deceased (Sec. 97). Thus if the fact of death is known to the holder a notice addressed to the dead person is a nullity. In such a case notice must be addressed to his legal representative. Mode of giving notice.
According to Section 94
the notice of dishonour may be oral or written. If it is written it may be
sent by post.
A notice duly addressed and posted is good even though it may be miscarried. The notice may be in any form but
the language used
must indicate
that the instrument has been dishonoured
and in what way
dishonoured, and that the recipient
will be held liable
thereon.
It should
be given within a
reasonable time

after dishonour,
at
the place of business or (in case such party has no
place of business) at the residence of the party
for whom it is intended.
What is
reasonable time? In determining what is a
reasonable time for giving notice of dishonour,
regard shall be had to the
nature of the instrument, the
usual course of dealing with respect to similar
instruments
and the distance between the parties, and,
in calculating such time, public holidays shall be excluded (Sec. 105).
Section 106
further provides that
if
the holder and the party to whom notice of dishonour is given
carry on business or live (
as the case may be) in different places,
such notice shall be
deemed to be given within a
reasonable time if it is
despatched
by the next post or on the day next after the day of dishonour. If the
said parties carry on business or live in the same place,
such notice
is within reasonable time if it is
despatched
in time
to reach
its destination
on the day next after the day of dishonour.
If a party
who receives the notice of dishonour
is
to transmit the same to his own prior parties, the transmission is
within reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder (Sec. 107). When notice of dishonour is unnecessary.
Notice of dishonour is
not necessary, i.e., the parties are liable without any notice of dishonour in the following cases mentioned in Section 98: 1. When it is dispensed with by the party entitled to the notice. For example, where the indorser while signing in that capacity adds the words 'notice of dishonour waived,' no notice of dishonour is required. 2. When the drawer of a cheque has countermanded payment, no notice of dishonour is required
to charge the drawer. 3.
When the party charged could not suffer damage for want of notice.
For example, when the cheque is dishonoured because the drawer had closed his account with the banker, 3 or in case of accommodation bills, no notice of dishonour to the drawer is required. 4.
When
the party entitled to notice cannot, after due search, be found;
or the party bound to give notice is,
because of some justifiable reason (e.g., death, accident or serious illness), unable to give it. 3 Punjab National Bank vs lqbal Singh, (1962), Punjab, 158.
Dishonour and Discharge of Negotiable Instruments 300 Self-Instructional Material NOTES 5. When the drawer also happens to be the acceptor. 6.
In the case of a promissory note which is not negotiable.

Since such a note is not negotiable, the payee ought not to indorse it, and if it is indorsed, the indorsee cannot have any claim against the maker of the note or the indorser. Therefore no one is prejudiced for want of notice. 7.
When the party entitled to notice promises to pay unconditionally the amount due on the instrument
after dishonour
and with full knowledge of facts. Consequences of not giving notice of dishonour. Any party to a negotiable instrument (other than
the maker of a note, acceptor of a bill or drawee of a cheque)
to whom notice of dishonour
is not sent by the holder is discharged from his obligation under the instru- ment and cannot be sued by the holder, unless the circumstances are such that no notice of dishonour is required to be sent. The drawer or indorser who has not received notice is
discharged not only on the bill or note but also in respect of the original consideration (
Mohd. Raffi vs Qazi Mahzar 4). 25.2.5 Noting 'Noting' is the authentic and official proof of presentment and dishonour of a negotiable instrument. The question of noting does not arise in the case of dishonour of a cheque because in such a case
the bank, while refusing payment, returns back the cheque giving reasons in writing for the dishonour of the same, and that itself acts as an authentic evidence of the fact of dishonour.
Even in the case of inland bills or notes noting is not compulsory (Sec. 104). According to Section 99,
when a promissory note or a
bill of exchange has been
dishonoured by non-acceptance
or
non-payment, the holder may cause such dishonour to be noted by a Notary Public 5
upon the instrument,
or upon a paper attached thereto, or partly upon
each.
For this the holder takes the bill or note to the notary public who makes a demand for acceptance or payment upon the drawee or acceptor or maker formally and on his refusal to do so notes the same on the bill or note. Thus 'noting' means recording the fact of dishonour on the dishonoured instrument or on a paper attached thereto for the purpose.
Noting must be made within a reasonable time after dishonour and must specify: (i)
the date of dishonour; (
ii) the reason assigned for such dishonour; and (iii) the notary's charges. 25.2.6
Protest 'Protest' is
a formal certificate of dishonour issued by the notary public to the holder of
the bill or note, on his demand (noting is merely a record of dishonour on the instrument itself) (Sec. 100). Protest for better security. Such protest can be made in the case of bills only.
When the acceptor of a bill of
exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a Notary Public
to demand better security of the acceptor, and on its being refused,
may within a reasonable time cause such facts to be noted and certified as aforesaid. Such certificate is called
a protest
for better security (
Sec. 100, Para 2). It may be noted that in spite of such a protest the holder shall have to wait till the date of maturity to take any action against the acceptor, drawer or indorsers. The only advantage of protest for better security is that it enables the bill to be accepted for honour, for Section 108 provides that
when a bill of exchange
has
been noted or protested for non-acceptance or for better security,
the
same can thereafter be accepted for honour. 4 I.L.R. (1936), Lah. 796. 5 "Notary Public" is an officer appointed by Government for the purpose of 'noting and protesting' as laid down in Negotiable Instruments Act. Check Your Progress
1. What do you understand by 'dishonour by non- acceptance'. 2. What do you understand by 'dishonour by non-payment'? 3. Notice of dishonour is not necessary in certain cases. Elucidate.
Dishonour and Discharge of Negotiable Instruments Self-Instructional Material 301 NOTES Noting and protest of inland bills or notes
is not compulsory, but

foreign bills must be protested for dishonour if so
required by the law of the place where they are drawn (
Sec. 104). Contents of protest (Sec. 101). The
protest must contain the following particulars: 1.
The instrument itself or a literal transcript of the instrument
and of
everything written or printed thereupon. 2.
The name of the person for whom and against whom the instrument has been protested. 3.
The fact and
the
reasons for dishonour,
i.e.,
a statement that payment or acceptance, or better security, as the case may be, was demanded by the notary public
from the
person concerned and he refused to give it or did not
answer, or that he could not be found. 4.
The place and time of
dishonour. 5. The
signature
of the Notary Public. 6. In the case of acceptance for honour
or payment for honour, the
names of the persons by whom and for whom
it is accepted or paid. 25.3
DISCHARGE OF THE INSTRUMENT AND
THE PARTIES The term ‘
discharge” in relation to negotiable instruments has two connotations, viz., (1)
discharge of the instrument, and (2) discharge of one or more parties from liability
on the instrument. 25.3.1 Discharge of the Instrument A negotiable instrument is
said to be discharged when
it becomes completely useless, i.e., no action on that will lie, and it cannot be negotiated further. After a negotiable
instrument is discharged
the rights against all the parties thereto comes to an end, and no party, even
a holder in due course, can claim the amount of the instrument from
any party thereto.
Discharge
of the
party primarily and ultimately liable on the instrument
results in the discharge of the instrument itself. For example, in the following cases the instrument is deemed to be
discharged: 1. When the party primarily liable on the instrument (i.e.,
the maker of the note, acceptor of the bill or drawee
bank) makes the payment in due course to the holder at or after maturity (
Sec. 78).
A payment by a party who is secondarily liable does not discharge the instrument
because in that case the payer holds it to enforce it against prior indorsers and the principal debtor. 2. When
a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right,
the instrument is discharged (Sec. 90). 3. When the party primarily liable becomes insolvent, the instrument is discharged
and the holder cannot make any other prior party liable thereon. Notice that in the case of insolvency, the acceptor or
maker is unable to pay and it is only on refusal to pay that the instrument is deemed to be dishonoured and prior parties
can be made liable thereon. Similarly, an instrument stands discharged when the primary party liable is discharged by
material alteration in the instrument (Sec. 87), or by lapse of time making the debt time barred under the Limitation Act.
Dishonour and Discharge of Negotiable Instruments 302 Self-Instructional Material NOTES 4. When the holder cancels
the instrument with an intention to release the party primarily liable thereon from the liability, the instrument is
discharged and ceases to be negotiable (Sec. 82). 25.3.2
Discharge of One or More Parties A party
is said to be discharged
from his liability when his liability on the instrument comes to an end. When only
some of the parties

to a negotiable instrument
are discharged, the instrument continues to be negotiable and the undischarged parties
remain liable on it.
Thus, the discharge of one or more parties to an instrument does not discharge the instrument
and the rights under it can still be enforced against those parties who continue to be liable thereon.
One or more
parties to a negotiable instrument is/are discharged
from liability
in the following ways: 1. By
cancellation [Sec. 82(a)]. When
the holder of a negotiable instrument deliberately cancels the name of
any of the
party (by drawing a line through the name) liable on the instrument with an intent to discharge him from liability thereon,
such party
and all indorsers subsequent to him,
who have a right of action against the party
whose name is
so cancelled, are discharged from liability. Thus, if the maker's or acceptor's name has been cancelled the liability of all other parties to the instrument, who must have obviously become parties thereto subsequent to the maker or acceptor and as such must be in the position of sureties to him, comes to an end, which in effect discharges or cancels the instrument itself. But if the name of an indorser has been cancelled then all the indorsers subsequent to him will be discharged but those prior to him will remain liable. Section 40 contains a similar provision, according to which if the holder,
without the consent of the indorser, destroys or impairs the indorser's remedy against
a prior party, the indorser is discharged from liability.
It is important to note that where the cancellation is done under a mistake, or without the authority of the holder it would be inoperative and will not discharge any party. 2. By release [Sec. 82 (b)]. If
the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation
of names (i.e., by a separate agreement of
waiver, release, or remission), the party so released and all parties
subsequent to him,
who have a right of action against the party so released, are discharged from liability. 3.
By payment [Sec. S2(c) and 78].
When
the party primarily liable on the instrument makes the payment
in due course
to the holder at or after maturity, all the parties to the instrument stand discharged, because
the instrument as such is discharged by such payment. 4.
By allowing drawee more than 48 hours to accept (Sec. 83).
If
the holder of a bill of exchange allows the drawee more than
forty eight
hours 6 , exclusive of
public holidays,
to consider whether he will
accept the same, all previous parties not consenting to such allowance are
thereby discharged from liability
to such holder. 5.
By
taking qualified acceptance (Sec. 86).
If the
holder of a
bill agrees to
a qualified acceptance
all prior parties whose consent is not obtained to such an acceptance are discharged
from liability. 6.

By not giving notice of dishonour. Any party to a negotiable instrument (other than the party primarily liable) to whom notice of dishonour is not sent by the holder is discharged from liability as against the holder, unless the circumstances are such that no notice of dishonour is required to be sent. 6 According to Section 63 the drawee is entitled to be allowed a period of 48 hours at the most (exclusive of public holidays) to consider whether he will accept the bill or not.

Dishonour and Discharge of Negotiable Instruments Self-Instructional Material 303 NOTES 7. By non-presentment for acceptance of a bill (Sec. 61). When a bill of exchange is payable certain period after sight, its holder must present it for acceptance to the drawee within a reasonable time after it is drawn. If he makes a default in making such presentment the drawer and all indorsers who were liable towards such a holder are discharged from their liability towards him. 8. By delay in presenting cheque (Sec. 84). It is the duty of the holder of a cheque to present it for payment within reasonable time of its issue. 7 If he fails to do so and in the meanwhile the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him. 9. By material alteration.

Any material alteration of a negotiable instrument renders the same void, i.e., discharges the instrument itself, and all parties thereto at the time of making such alteration and not consenting to the change are discharged from liability thereon (Sec. 87). But persons who become parties to the instrument after the alteration are liable under the instrument as altered. In other words, those who take an altered instrument cannot complain (Sec. 88). It is worth noting that the material alteration of the instrument discharges all the parties liable thereon at the time of making such alteration, and it makes no difference whether the alteration is for the benefit or detriment to any party to the instrument 8 or whether it is made by the holder of the instrument or by a stranger while the instrument was in the custody of the holder, because the party in custody of the instrument is bound to preserve it in its integrity (Davidson vs Cooper 9)

But alteration made by a stranger without any negligence on the part of the holder does not affect the liability of the parties there to (Guorochandra vs Krushna Charana 10). What constitutes a material alteration? It is not every alteration that necessarily would affect the validity of an instrument or the rights of parties thereto. Only when the alteration is 'material,' the validity of the instrument or the rights of parties would come in for question. The Negotiable Instruments Act is silent on the question — what constitutes a material alteration? Courts in India have, therefore, followed the English Common Law and held that anything which has the effect of altering the legal relations between the parties or the character of the instrument or the sum payable amounts to a material alteration. 11

The following are the examples of material alteration: (i) Any alteration of the date, the sum payable, the time of payment and the place of pslyment. 12 (ii) Alteration by the addition of a new party to the instrument (Gardener vs Walsh 13). (iii) Alteration of the rate of interest (Verco Pvt. Ltd. vs Newandram 14). (iv) Tearing off the material part of the instrument. Alterations not vitiating the instrument. There is no material alteration so as to vitiate the instrument in the following cases, as they do not prejudice the rights and liabilities of the parties thereto: (i) Alteration made for the purpose of correcting a mistake or a clerical error. (ii) Alteration made to carry out the common intention of the original parties (Sec. 87). 7 See Sections 64, 72 and 73. 8 Rampadarath vs Hari Narain, A.I.R. (1965), Pat. 224. 9 (1844),,, 13 M. & W. 343. 10 A.I.R. (1941), Madras 383. 11 Banking Laws Committee Report on Negotiable Instruments Law, 1975, p. 48. 12 Sec. 64(2) of the (English) Bills of Exchange Act, 1882. 13 (1885), 5

E.&B. 83. 14 A.I.R. (1974), Madras 4. Check Your Progress 4. Enumerate the cases in which a negotiable instru- ment is deemed to be discharged. 5. Explain the terms 'noting' and 'protest' as per used in the context of dishonour of a bill of exchange.
Dishonour and Discharge of Negotiable Instruments 304 Self-Instructional Material NOTES (iii) Alteration made before the instrument is issued. (iv)
Alteration made with the consent of the parties liable on the instrument. (
v) Conversion of bearer cheque into an order cheque. (vi) Filling blanks in the case of inchoate or incomplete instruments (Sec. 20). Thus, putting a date on the undated cheque by the payee does not amount to material alteration rendering the instrument void (Bhaskaran Chandrasekharan vs Radhakrishnan 15). (vii) Conversion of blank indorsement into an indorsement in full (Sec. 49). (viii) Making qualified acceptance (Sec. 86). (ix) Crossing of an uncrossed cheque (Sec. 125). (x) Alteration which is the result of an accident, e.g., mutilation by washing, ravages by white ants or rats, document torn by a child, document burnt in part by the hot end of a cigarette (Hongkong and Shanghai Banking Corpn. vs Lo Lee Shi 16).
Payment of instrument on which alteration is not apparent. Sometimes, a negotiable instrument is
materially
altered but does not appear to have been so altered,
for example, a cheque is drawn for Rs. 500 with space left before the amount in both words and figures and the payee fraudulently alters the amount of Rs. 3,500 which is not apparent. In such cases, if the
person or banker liable to pay makes the payment according to the apparent tenor and otherwise is due course,
then he will be discharged
from liability and such payment cannot be
questioned by reasons of the instrument having been altered [
Sec. 89(1)].
Where the cheque
is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and
it
shall be
the duty of the bank or the clearing house,
as the case may be,
to
ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image [
Sec. 89(2). 17
Any bank or a clearing house which receives a transmitted electronic image
of a
truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is
exactly the same [Sec. 89(3)]. 18 10. By negotiation back
of a bill. When a bill of exchange
comes back to the acceptor by process of negotiation and he becomes its holder, it is called as "
negotiation back."
If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all
rights
of action thereon are extinguished (
Sec. 90). 25.4
TEST QUESTIONS 1.
In what different ways may a negotiable instrument be dishonoured? What
are the duties of a holder of a dishonoured bill? 2. How and when should a notice be served on a bill being dishonoured by either non-acceptance or non-payment? Under what circumstances is notice of dishonour unnecessary? 3. When are bills of exchange, promissory notes or cheques said to be dishonoured? Who should give notice of dishonour and to whom? 15 (1998) 30 CLA (Snr.) 58 (Ker.). 16 (1928), A.C. 181 (P.C.). 17
Inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002,
w.e.f. 6-2-2003. 18 Ibid.
Dishonour and Discharge of Negotiable Instruments Self-Instructional Material 305 NOTES 4. What is the difference between
discharge of a negotiable instrument and discharge of a party

to a negotiable instrument? When is a negotiable instrument said to be discharged? Give examples. 5. What are various ways in which one or more parties to a negotiable instrument is/are discharged from liability? Discuss. 6. In what manner is the liability of a drawer, acceptor and indorser of a negotiable instrument discharged? 7. Explain the meaning of material alteration in a negotiable instrument. What is effect of such alteration? 25.5 PRACTICAL PROBLEMS Attempt the following problems, giving reasons: 1. P draws a bill on Q payable three months after sight. It passes through several hands before R becomes its holder. On presentation by R, Q refuses to accept. Discuss the duties and rights of R on the bill. [Hint. On dishonour of the bill by non-acceptance, it is the duty of R, the holder, to give notice of dishonour to all prior parties. He may also have the instrument noted and protested. Thereafter R is entitled to make P, the drawer of the bill, liable as principal debtor and the intervening indorsers liable as sureties.] 2. A drew a cheque for Rs 5,000 in favour of B on 1st January, 2004, and gave it to him on the same day. The cheque was presented for payment on the 5th June, 2004. In the meantime the bank had failed in May 2004. Discuss the legal position of B's recourse against A and the Bank for recovering the amount. [Hint. As B presented the cheque for payment after more than five months, which cannot be considered as reasonable period, and the drawer suffered loss due to this long delay, the drawer is discharged from his liability to the extent of the actual damage suffered by him. B, however, can claim as a creditor in the insolvency of the bank for the balance.] 3. A bill payable three months after date is altered to a bill payable three months after sight by the holder. The acceptor refuses to make payment. Can the holder enforce its payment against the acceptor or the drawer? [Hint. No, the holder cannot enforce the payment of the bill against any party thereto as the bill has been materially altered. Material alteration renders the instrument void.]

Banker and Customer Self-Instructional Material 307 NOTES UNIT 26 BANKER AND CUSTOMER Structure 26.0 Introduction 26.1 Unit Objective 26.2 Crossing of Cheques 26.3 Types of Crossing 26.4 Liability of Banker 26.5 Rights of Holder against Banker 26.6 Bouncing of Cheques 26.7 Test Questions 26.8 Practical Problems 26.0 INTRODUCTION

A banker is one who does banking business. The Banking Regulation Act, 1949, defines a 'banking company' as a company which transacts the business of banking in India. The term 'banking' is defined as " accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or, otherwise, and withdrawable by cheque, draft, order or otherwise" [Sec. 5(b), The Banking Regulation Act, 1949]. It may be emphasised that the primary function of a banking company consists of accepting of deposits for the purpose of lending or investing the same. If the purpose of accepting of deposits is not to lend or invest, e.g., where a trader accepts deposits of money from the public merely for the purpose of financing his business, the business will not be called the banking business. Another special feature of banking business is that the deposited money should be repaid to the depositor on demand or according to the agreement. The demand should be made through an order, cheque, draft or otherwise and not merely by verbal order. The term 'customer' of a bank is not defined by law. Ordinarily, a person who has an account in a bank is considered

to be a customer of the bank. But to constitute a customer of the bank in the technical sense, besides opening of an account with the bank it is also essential that the dealings with the banker must relate to the business of banking, e.g., depositing and withdrawing money or taking loans. Merely availing of services rendered by the banker, i.e., encashing a cheque, remitting money through a bank draft or depositing valuables in the safe deposit vaults in the bank, do not create the relationship of banker and customer. 26.1 UNIT OBJECTIVES ? Understand the concept of "crossing of cheque" ? Be aware of the various types of crossing ? Know the cases in which a banker must refuse and 'may refuse' payment of his customer's cheques ? Understand the law relating to bouncing of cheques for insufficiency of funds in the account 26.2 CROSSING OF CHEQUES Cheques may be of two types—(i) Open or uncrossed cheques and (ii) crossed cheques. An open
cheque is payable at the counter of the drawee bank on the presentation of the
Banker and Customer 308 Self-Instructional Material NOTES cheque. Such a cheque runs great risk in the course of circulation because once a wrong person takes away the payment of an open cheque it is difficult to trace him.
A crossed cheque is payable only through a collecting banker and not directly at the counter of the bank.
Thus, crossing affords security and protection to the holder of the cheque because when payment of a cheque has been drawn through a banker it may easily be detected to whose use the money has been received. The collecting banker credits the proceeds to the account of the payee of the
cheque. A cheque is said to be crossed
when
two parallel transverse lines, with or without any words,
are drawn on the left hand top corner of the
cheque.
It is
relevant to state that such lines are essential for 'general crossing' are may not be drawn in case of 'special crossing.'
Crossing of a cheque does not affect its negotiability. A crossed cheque can be negotiated in the same way as uncrossed one, i.e., it can be negotiated by mere delivery in case
it
is payable to bearer and by indorsement and delivery if it is payable to order.
Where the holder
of a crossed cheque has no account in any bank the either he may open an account with some banker and pay the cheque in that account to enable the banker to collect its payment on his behalf and credit the same into his account, or he may obtain payment by indorsing the cheque in favour of some person who has got an account in any bank. 26.3 TYPES
OF CROSSING
There are two types of crossing: (1) General or (2) Special. 1. General crossing.
Where a cheque bears across its face (
usually on the left hand top corner) two parallel transverse lines without any words or with words 'and company' (or & Co.) or/and 'not negotiable' written in between these two parallel lines, it is called general crossing (Sec. 123). Thus, general crossing may take any of the following forms: and Company & Co Not Negotiable and Co. Not Negotiable 1 2 3 4 5
Where a cheque is crossed generally, the banker on whom it is drawn shall
not pay it otherwise than to a banker (
Sec. 126). In the case of general crossing, therefore, the holder may get the cheque collected through some bank. Collecting bank may be any bank of the choice of the holder. 2. Special crossing. Where a cheque bears across its face (transverse lines are not compulsory)
an addition of
the
name of a banker,
either with or without the words 'not negotiable,'
that addition shall be deemed
a crossing,
and
the cheque shall be deemed to be crossed specially, and to be crossed to that
banker (
Sec. 124). Thus, special crossing
may take any of the following forms: Not Negotiable The Bank of India The Bank of India The Bank of India 1 2 3
Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to
the banker to whom it is crossed, or his agent for collection (

Sec. 126).
Banker
and Customer Self-Instructional Material 309 NOTES Thus, in the
case of special crossing the paying banker is to honour the cheque only when it is presented through
the banker
mentioned in the crossing, or an agent of such bank (i.e., another banker acting as agent
for collection of that bank). According to Section 127,
where a cheque is crossed specially to more than one banker, except when
that bank to whom it has been specially crossed makes another special crossing in the name of another bank
for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.
A
special crossing makes the cheque more safer than a general crossing because
now a thief will have to search an account-holder of that particular bank only whose name appears in the crossing which may create more difficulty. 26.3.1 Account Payee or Restrictive Crossing To give still more protection to the payee of a cheque the practice of restrictive crossing is also prevalent in the business community. Such crossing can be made in both the cases of 'general' as well as 'special' crossing by adding the words 'Account Payee' (A/c Payee), 'Account Payee only' (A/c Payee only) or 'Account Alok Kuchhal only.' Thus, restrictive crossing may take any of the forms shown below. Account Payee Not Negotiable Account Payee only 1 2 3 A/c Payee only State Bank of India The effect of 'Account Payee'
crossing is that the collecting banker is supposed to
credit the amount of the cheque
to the Account of the payee
only and nobody else. This should not be taken to mean that an 'Account Payee' crossed cheque cannot be negotiated further. Such a cheque remains transferable 1 , but the liability of the collecting banker is enhanced in case he credits the proceeds of a cheque so crossed to any person other than the payee and the indorsement in favour of last payee is proved forged. The banker will be held guilty of negligence in such a case and will not be entitled to the protection given under Section 131 (where a banker acting bonafide will not be liable to the true owner, if he receives payment of a crossed cheque for a customer whose title is defective). 2 Thus, the collecting banker must act like a blood hound and make proper enquiries as to the title of the last indorsee (whether indorsement in his favour is genuine or not) from the original payee named in the cheque before collecting an 'Account Payee' crossed cheque in his (i.e., the last indorsee) account. 26.3.2 'Not Negotiable' Crossing As stated earlier, the words 'Not Negotiable' may also be written in both types of crossing— 'general' and 'special' (Sees. 123 and 124), and
a crossing with these words is said to be 'Not Negotiable' crossing.
Section 130 states the effect of such a crossing in the following words: "
A person taking a cheque crossed generally or specially, bearing in either case
the words 'not negotiable,' shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it
had.". 1 National Bank vs Silke. (1891), I Q.B. 415. 2 For details see "Protection to Collecting Banker" discussed later in this Unit.
Banker and Customer 310 Self-Instructional Material NOTES Thus, the effect of such a crossing is that it takes away one of the essential characteristics of a negotiable instrument, in the sense, that
the transferee of such a crossed cheque cannot get a better title than that of the transferor (
i.e., cannot become the holder in due course) and cannot convey a better title to his own transferee, though the instrument remains transferable.
The object of 'not negotiable' crossing is to afford protection to the holder or drawer of
a cheque,
because even if such a cheque
goes to wrong hands and from there it is
transferred to holder in due course, the true owner will not lose his claim against such an indorsee. Thus an indorsee of such a crossed cheque must not accept the cheque unless he knows the
indorser very well and is convinced about his having a good title thereto. 26.3.3 Who May Cross a Cheque? Crossing of an uncrossed cheque does not amount to a material alteration so as to affect the validity of the instrument. Obviously the drawer of a cheque may cross it generally or specially at the time of issue. Section 125 permits the crossing being made even
after issue of a cheque in the following ways: (i) Where a
cheque is uncrossed, the holder may cross it generally or specially. (
ii) Where

a
cheque is crossed generally, the holder may cross it specially. (
iii) Where a
cheque is crossed generally or specially, the holder
may add the words 'not negotiable'. (iv)
Where a cheque is crossed specially,
the banker to whom it is
crossed
may again cross it specially to another banker
as his agent for collection.
Crossing once made becomes a material part of the cheque and only the drawer of the cheque is entitled to cancel or open the crossing by writing the words 'Pay Cash' and cancelling the crossing along with his full signature. Similarly, any alteration in the crossing, except in the ways stated above, must be authenticated by the signature of the drawer, otherwise the same will be treated as material alteration so as to discharge the instrument itself. Thus where a cheque is crossed 'Account Payee' and the holder alters it into a general crossing by striking out the words 'Account Payee,' the alteration is irregular and discharges the instrument. 26.4 LIABILITY OF
BANKER The relationship between banker and customer primarily is that of a debtor and
a creditor and therefore it is the prime duty of a banker to honour his customers' cheques unless there are valid reasons for refusing payment of the same. In case he dishonours a cheque without justification he is liable to compensate the customer (i.e.,
the drawer) for any loss or any damage caused by such default (
Sec. 31). It must be noted that the liability of the banker for wrongful refusal to pay a cheque is only towards the drawer and not towards the payee of the cheque. The payee has no right of action against the banker for refusing to honour the cheque for the simple reason that there is no privity of contract between him and the banker. He can, however, hold the drawer liable in damages for breach of contract. The rule of awarding damages. In case of wrongful dishonour of cheque, a non-trader customer is entitled only to general damages for such monetary loss which he might have actually suffered. But a trader or businessman customer is entitled to claim not only the general damages, but special damages also for loss of credit or reputation in the market and even without proving the actual loss suffered by him. "In cases where a cheque issued by a trader customer is wrongfully dishonoured even special damages could be awarded without proof of special loss or damage. The fact that such dishonouring took place due to a mistake of the bank is no excuse nor can the offer of the bank to write and apologize to the
Banker and Customer Self-Instructional Material 311 NOTES payees of such dishonoured cheques affect the liability of the bank to pay damages for their wrongful act." (New Central Hall vs United Commercial Bank Ltd. 3). In the case of a trader customer claiming damages,
the rule of awarding damages is, 'the smaller the amount of the cheque wrongfully dishonoured the larger the amount of damages.' 26.4.1

When banker 'Must Refuse' Payment of his customer's Cheques There are some cases when a banker must refuse payment of his customer's cheques without incurring any liability. In these cases the payment made is not good against the drawer and the banker will have to bear the loss himself or may recover it from the wrong payee, if traceable, in some cases only. The cases in which a banker is bound to dishonour his customer's cheques are as follows: 1. When customer countermands payment. When a customer countermands the payment, that is, issues instructions to the bank not to honour a particular cheque issued by him, the banker is bound to comply with such instruction. The countermand order must, however, be given in sufficient time before the banker actually makes the payment of the cheque. Oral countermand is sufficient. Any payment made by mistake after a due notice of countermanding the payment is not good against the drawer, nor is the banker entitled to a refund from the payee (because the payee gets payments of an otherwise valid cheque), and the banker will have to bear the loss caused by such payment. 2. Garnishee order. On receipt of the 'garnishee order,' i.e., a prohibitory order by any court attaching money in customer's account, the banker is bound to dishonour the customer's cheques. If by mistake the banker makes payment of any cheque after the receipt of such an order, he will have to bear the loss himself. He cannot recover from the payee who gets payment of an otherwise valid cheque. 3. Death, Insolvency or Insanity of the customer. When the banker receives a notice that his customer has died, or has been adjudged insolvent, or has become insane, his authority to pay cheques drawn by the customer stands revoked and therefore he must not pay the cheques. Any payment made after a due notice is not good against the drawer, nor is the banker entitled to a refund from the payee, who gets payment of an otherwise valid cheque. 4. Notice of assignment. When the banker receives a notice of assignment of his credit balance from a customer, he must refuse payment of the cheques drawn by the customer. The banker would be liable if he makes the payment of any cheque after the receipt of such a notice. 5. Defective title of the Party. When the banker becomes aware of the defective title of the person presenting the cheque, e.g., he is a thief, the banker must refuse to honour the cheque. 6. Loss of cheque. When the customer has informed the banker about the loss of the cheque, he must not pay it. In case the payment of such a cheque is made by mistake it is not good against the drawer but the banker can recover from the wrong payee, if traceable, as he is not entitled to possession and payment of the cheque. 7. When the cheque is irregular. When there is material alteration in the cheque or the signature of the drawer does not tally with the specimen signature kept in the bank, the banker must dishonour the customer's cheque. In case of payment by mistake the banker can recover from the wrong payee, if traceable, otherwise will have to bear the loss himself. 8. Closing of account. On receipt of the 'notice for closing the account' from the customer, the banker must not pay the customer's cheques. If the banker makes payment of any cheque after the receipt of such a notice, he will have to bear the loss himself. 3 A.I.R. (1959), Mad. 153.

Banker and Customer 312 Self-Instructional Material NOTES 26.4.2 When banker 'May Refuse' payment of his customer's Cheques There are some cases when a banker may refuse payment of his customer's cheques. In these cases, if payment is refused, the banker shall not be liable for damages, and if payment is actually made, the court will decide as to whether the payment made is good against the drawer (i.e., the customer) or not, taking into account the various facts of the case. The cases in which a banker may dishonour his customer's cheques are as follows: 1. Where the cheque is postdated and is presented before the ostensible date. A customer's order to pay a cheque is deemed to be made on the date it bears and therefore if the cheque is presented before that date the banker is justified in refusing the payment of the same. But if a banker pays a postdated cheque, the payment is good against the drawer provided the cheque is not countermanded until the stated date. The banker honouring a post dated cheque, thus takes a great risk. Such a banker may also be made liable for damages to the customer if he is not able to meet the customer's other cheques presented within the intervening period. 2. When the balance to the credit of the customer's account is insufficient to meet the cheque and there is no overdraft arrangement. 3. When the funds of the customer in the hands of the banker are not properly applicable to the payment of such cheque. Thus, if the funds in his hands are earmarked for some specific purpose by the customer, or he is entitled to a set-off in respect of them, the said funds are not available for honouring the cheque and the banker may refuse the payment. 4. When the cheque is not properly presented, for example, it is presented at a branch where the customer has no account, or where the cheque is presented after banking hours, the banker is justified in dishonouring the cheque. But for personal reasons he may make the payment. 5. Where the cheque is not presented within a reasonable time of its issue.

Ordinarily a period of six months is considered sufficient within which the cheque must be presented for payment. On the expiry of this period the cheque is treated as 'stale' and the banker may dishonour the same. He may, after getting the stale cheque confirmed by the drawer, honour it. 6. When the cheque is of doubtful validity, i.e., it is drawn on a paper different from what has been issued by the bank, the bank may refuse payment. But if he so likes he may make the payment because legally a cheque can be totally handwritten and may be drawn on any paper. It is relevant to state that where payment is refused, a holder can sue the drawer within three years from the date of issue of the cheque because a cheque becomes time-barred after three years from its date of issue. 26.4.3 Protection to the Paying Banker The Negotiable Instruments Act provides special protection to a banker who honours his customer's cheques. The rationale of the protection may be explained as follows. While the paying banker knows the state of, and takes the responsibility for the authenticity of the signature of, the drawer, he cannot be presumed to have any special knowledge about the payee or other holders of the instrument. As such a paying banker acting in good faith and in the ordinary course of business should not be saddled with responsibility if the payee's title is subsequently found defective or wanting. Moreover, cheques have to be honoured or rejected promptly and the banker does not have time, nor necessary experience, to enable him to enquire or investigate about the identity of the person who presents the cheque for payment. Protection in case of order cheques. Section 85(1) provides protection to the paying banker in case of order cheques as follows: "
Where a cheque
payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by 'payment in due Banker and Customer Self-Instructional Material 313 NOTES course'." 4 Accordingly, the paying banker shall be discharged from liability if he makes payment of an order cheque to the payee or the apparent indorsee thereof in good faith and without negligence even though subsequently it may turn out that such an indorsement was forged. Thus, where P draws a cheque payable to Q or order and forwards the same
to his agent R with instructions to hand it over to Q and R forges Q's indorsement and collects payment
of the cheque, the banker making payment in due course is discharged from liability and he can validly debit P's account with the amount of this cheque. This protection to a paying banker is an exception to the general rule that 'a forged indorsement is no indorsement in law.' In practice the banker usually gets the identity of the holder of an order cheque verified by some responsible man of the bank or by an account- holder, but this simply means that in case the indorsement of the payee subsequently comes out to be a forged one, the verifier will be liable to the original payee and not the banker. The banker is also protected against forged indorsements in case of 'bank drafts' (Sec. 85A) and crossed cheques (Sec. 128), if he makes payment in due course. Protection in case of bearer cheques. Section 85(2) provides protection to the paying banker in respect of bearer cheques as follows: "
Where a cheque is originally expressed to be payable to bearer,
the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation."
Accordingly, where a cheque is originally issued as a bearer cheque,
the banker may ignore any indorsements on the cheque. He shall be discharged by payment in due course
to the bearer of the cheque. Thus, for the purpose of discharge of the paying banker from liability, once a bearer cheque always remains bearer cheque. No protection when the drawer's signature is forged. A banker is not protected even by a payment in due course if the drawer's signature is forged, and as such if he makes payment on forged signature, he cannot debit the customer's account with such payment and will have to bear himself the loss so caused (Allahabad Bank vs Kul Bhushans 5). There is, however, one exception to this rule. Where the customer has been negligent and his negligence was the proximate cause of the wrong payment, for example, where the customer did not inform the banker immediately on becoming aware of
the forgery, the banker can debit the customer's account with the amount so paid. 26.4.4
Protection to the Collecting Banker A collecting banker is one who receives the payment of a crossed cheque on behalf of his customer. Section 131 grants protection to the collecting banker and states that "
a banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment."
Accordingly, if the collecting banker has collected a cheque on behalf of a person whose title to the cheque was defective, he would be protected and would not be held liable in 'conversion' to the true owner, provided he proves that: (i) he acted in good faith and without negligence; (ii) the cheque was already crossed before it reached his hands; and (iii) he received the payment on behalf of a 'customer' and not on his own account, i.e., he acted as an agent for collection and not in the capacity of holder for value. 4 "
Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence

to
any person in possession thereof
under circumstances which do not afford a reasonable ground for
believing that he is
not entitled to receive payment of the amount
therein mentioned (
Sec. 10). 5
A.I.R. (1961), Punj. 471. Check Your Progress 1. What is meant by the term crossing of cheques. 2. Distinguish between 'general crossing' and 'special crossing' 3. What do you understand by 'not negotiable crossing'?
Banker and Customer 314 Self-Instructional Material NOTES It may be noted that if a
banker credits his customer's account with the amount of the cheque before receiving payment thereof,
he does not become a holder for value and the protection of this Section shall be available to such a collecting banker as well (
Explanation I to Sec. 131).
It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care (Explanation
II
to Sec. 131). 6 This protection, however, is not available where the banker allows the proceeds of an "Account payee crossed cheque" to be credited to any account other than the payee and the indorsement in favour of the last payee is proved forged. The protection afforded by Section 131 to the collecting banker is very valuable in view of the fact that when one person deals with the goods of another without his permission, he is liable to an action for 'conversion', and in the absence of this protection the position of the banker would not be different from that of any other person. 26.5 RIGHTS OF HOLDER AGAINST BANKER As observed earlier, the liability of a banker for wrongful refusal to pay a cheque is only towards the customer (i.e., the drawer) and not towards the holder or payee of the cheque. The holder has no light of action against the banker for refusing to pay
the cheque because there is no privity of contract between him and the banker. But the holder
is entitled to enforce payment from the banker in the following two cases: 1. Where the holder does not present the cheque within a reasonable time of its issue and on account of the delay the drawer suffers actual damage by
the failure of the bank and is therefore discharged to the extent of such damage,
then the holder can prove his debt to the extent of such discharge against the banker in insolvency proceedings. The holder in such case
shall
be a creditor, in place of such drawer, of such banker to the extent of such discharge and can recover the amount from him. (
Sec. 84). Illustration. (appended to Section 84). A draws a cheque
of
Rs 1,000,
and, when the cheque
ought to be presented, has funds at the bank to meet it. The bank fails before the
cheque is presented. The drawer is discharged, but the
holder can prove against the bank for the amount of the cheque. 2. Where a banker pays a cheque
crossed generally over the counter
or a cheque crossed specially otherwise than to the
banker to whom the same is crossed, he is liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid (Sec. 129).
Of course the banker can recover from the wrong payee, if traceable. 26.6 BOUNCING
OF CHEQUES A cheque is said to be bounced or
dishonoured
by non-payment when the
drawee of the cheque makes default in payment
upon being duly required to pay the same.
With a view to enhancing the acceptability of cheques in settlement of liabilities, it is necessary that the cheques drawn are honoured and not bounced. To ensure better discipline in the matter of circulation and payment of cheques, the Negotiable Instruments Act, 1881 has been amended
by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988,

which came into force on April 1, 1989. Apart from few minor amendments, the major amendment pertains to insertion of a new Chapter (Chapter XVII) in the Negotiable Instruments Act, whose heading is "
Penalties in case of Dishonour of certain Cheques for Insufficiency of Funds
in the Accounts".
This Chapter contained five Sections — Sections 138 to 142. 6
Inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 (
w.e.f. 6-2-2003).
Banker and Customer Self-Instructional Material 315 NOTES To further amend 'the law of dishonour of a cheque', the Negotiable Instruments Act, 1881 has been amended again by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, which has been made effective from February 6, 2003. The Amendment Act, 2002, inter alia, has amended Sections 138, 141 and 142 and also inserted five new Sections — Sections-143 10147—in the aforestated Chapter XVII, which will give the much needed relief to the harassed litigants. The salient features of the provisions of Sections 138 to 147 are discussed below.
A drawer of a dishonoured cheque shall be deemed to have committed an offence
and shall, without prejudice to any other provision
of the Negotiable Instruments Act,
be punishable with imprisonment for a term which may extend to two years, or with
a
fine which may extend to
twice the amount of the cheque, or with both.
However, before the penal provisions can be invoked against the drawer of a cheque which has bounced, the following requirements should be satisfied: 1. The cheque should have been dishonoured due to insufficiency
of funds standing to the credit of the account on which the cheque was drawn or for the reason that the amount of cheque drawn on the account exceeds the sanctioned limit of overdraft. 2. The cheque should have been issued by the drawer
in favour of another person
for the discharge of legally enforceable debt or other liability, in whole or in part.
Therefore, when any cheque issued for meeting social obligations, such as charity, marriage presents, birthday gifts, etc., is dishonoured for want of funds, the drawer would not be deemed to have committed an offence. However, the court shall presume that the holder of a cheque
received the cheque in the discharge of a liability, unless the contrary is proved
by the accused
drawer. 3.
The cheque should have
been presented to the bank
within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier.
In the
case of dishonour of a post-dated cheque, the aforesaid period of six months
has to
be counted from the date mentioned in the cheque, because such a cheque becomes a cheque only when it becomes payable on demand (Anil Kumar Sawhney vs Gulshan Rai 7). 4.
The payee or the holder in due course of the cheque should
have
made a demand for the payment of the said amount of money by giving a notice in writing to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid/bounced. 5.
The drawer of such cheque should have failed to make the payment of the said amount of money to
the payee or the holder in due course
of the
cheque
within 15 days of the receipt of the said notice
of demand. If the drawer does not pay till the expiry of the 15 days time, the
cause of action arises on the 16th day. 6.
The payee or the holder in due course of the cheque
dishonoured should have
made a written complaint of the offence to a Court not inferior to that of a metropolitan magistrate or a first class judicial magistrate,

within one month of the date on which the cause of action
arose under the said provisions, i.e., within one month of the date of expiry of said period of 15 days within which the drawer was asked to pay
the amount of the dishonoured cheque. However,
if the complainant satisfies the court that he had sufficient cause for not
making a complaint within
the prescribed period of one month, the court is empowered to condone the delay. Recent Amendments. The provisions of Sections 143-147, which were
inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002
for speedy trial of offences relating to bouncing of cheques, are highlighted below: 1. The Court can try the cases summarily notwithstanding anything contained in the Code of Criminal Procedure 1973 (Cr. PC)
and the provisions of Sections 262 to 265 of Cr. PC shall, as far as may be, apply to such trials: 7 (1994) 79
Comp. Cas. 150 (SC).
Banker and Customer 316 Self-Instructional Material NOTES
Provided that in the case of any conviction in a summary trial, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding
five thousand rupees: Provided further that when at the commencement of, or in the course of, summary trial, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall, after hearing the parties, record an order to that effect. After making such an order, the Magistrate can recall any witnesses and proceed to hear or rehear the case in accordance with the provisions of the Cr. PC. 2. This trial of a case shall be continued from day-to-day until its conclusion. However, if
the court finds the adjournment of the trial/case beyond the following day to be necessary,
it can adjourn the case by making a written order citing the reasons for such an adjournment. 3. Every trial shall be concluded within six months from the date of filing the complaint. However, this provision is not mandatory but only directory. 4.
A Magistrate issuing summons to an accused or a witness may direct a copy of summons to be served
through speed post or private courier. 5. Where an acknowledgement purporting to be signed by the accused or the witness has been received, the court may declare that the summons has been duly served. If the summons are returned back with the postal or the courier services remark that the addressee has refused to take delivery of summons, the court may consider that the service has been duly effected. In other words, the law allows for 'constructive service' of summons. 6.
The evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions, be read in evidence in any enquiry, trial or other proceeding under the
Cr. PC. If the accused wants to contradict the statements made by the complainant in his affidavit, he can require the presence of the complainant for the purposes of cross- examination. 7.
In respect of every proceeding for cheque bounce offences, on production of bank's slip or memo having thereon the official mark that the cheque has been dishonoured, the
court shall presume that the cheque was returned for the reason of insufficient funds, unless and until such fact is disproved by the accused drawer. 8. Every offence of cheque bouncing shall be compoundable, i.e., the accused can pay agreed amount of money to the complainant and the case can be compromised bringing an end to the litigation. It is hoped that the above mentioned amendments will go a long way in removing the bottlenecks in the speedy disposal of cases relating to the bouncing of cheques. Offences by companies. If the person committing an offence under the aforestated provisions is a company, the company itself as well as every person like the Managing Director, Executive Director or Finance Director of the company who was incharge
of, and was
responsible
to the company for the conduct of the business of the
company, shall be deemed to
be guilty of offence
and
shall be liable to be proceeded against and punished accordingly.
Again,
if
it is proved that the offence was committed with
the consent or connivance of, or was attributable to
the

neglect on the part of, any director, manager, secretary or other officer of the company, such person would also be deemed to be guilty of that offence
and shall be liable to be proceeded against and punished accordingly.
But
a person will not be liable in a case where
he proves that the offence was committed
without his knowledge, or that he had exercised all due diligence to prevent
that commission of
such offence. It may be noted that any person who is nominated as a director of the
company
by virtue of his holding any office or employment in the
Central Government or
Check Your Progress 4. Describe the cases in which a banker is bound to dishonor his customer's cheques. 5. Discuss briefly the law relating to bouncing of cheques for insufficiency of funds in the account.
Banker and Customer Self-Instructional Material 317 NOTES
State Government or a Financial Corporation owned or controlled by the Central or State Government
shall not be liable for prosecution under the above provisions. When a company commits an offence of cheque bouncing, its liability is joint and not several. Without impleading its directors or officers who are responsible for the conduct of business, a company alone cannot be prosecuted. On the contrary, the director can be prosecuted without making a company party to the prosecution. A complaint against the officer who has issued the dishonoured cheque on behalf of the company is maintainable and it cannot be contended that the complaint should have been filed against the company also (Bhaskar vs Muthusamy 8). When a person is not a director at the time of issue of cheque but is a director at the time of dishonour, he is liable for the offence (K. Shunmugam vs Purushottamlal 9). When persons who were directors on the date of issue of the cheque but resigned the office of directorship before notice of dishonour was issued by the payee, they were held liable to be proceeded against (Ashwin C. Muthiah vs Multipack 10). Striking Case Law. In an appeal in the case of Sadanandan Bhadran vs Madhavan Sunil Kumar 11 the Supreme Court held that the payee of a cheque cannot initiate prosecution for an offence under Section 138 of the Negotiable Instruments Act, 1881 for bouncing of the cheque for the second time, if he had not initiated such a prosecution on the earlier cause of action which arose in his favour as a result of his earlier notice in writing duly given to the drawer for the first dishonour of the cheque. The judges observed that there could not be more than one cause of action in respect of a single cheque. In this connection it is worth noting that the Act does not put any embargo upon the payee to successively present a dishonoured cheque during the period of its validity. In course of business transactions it is not uncommon for a cheque being returned due to insufficient funds and being presented again by the payee after sometime, on his own volition or at the request of the drawer, in expectation that it would be encashed. Needless to say, the primary interest of the payee is to get his money and not prosecution of the drawer. But once the payee gives a notice of demand in accordance with the aforementioned provisions, he forfeits such right, for in case of failure of the drawer to pay the money within 15 days of the receipt of the said notice of demand, the drawer would be liable for the offence and the 'cause of action' of filing the complaint will arise. There cannot be successive causes of action because for dishonour of one cheque there can be only one offence. In a landmark judgment that could considerably reduce the misuse of penal provisions relating to the growing phenomenon of dishonoured cheques, the Supreme Court has held that a person who gives a "stop payment instruction" to his bank immediately after issuing a cheque against a debt or liability cannot escape prosecution (Modi Cements Ltd. vs Shri Kochi Kumar Nandi 12) It may be noted that the remedy available to the payee or the holder of a dishonoured cheque under the above provisions is an additional remedy. He does not lose his right under the civil law to claim the amount due to him in case the cheque accepted by him in payment of such dues is dishonoured. He can either base his claim on the original debt or he can sue the drawer of the cheque for the amount of the cheque. 26.7 TEST QUESTIONS 1.
What is meant by the term "crossing a cheque?" What are the various types of
crossing? 2. What is the effect of
crossing a cheque? Who can cross a cheque? What is the difference between general and special crossing? 8 (2001) 106 Comp. Cas. 198 (Mad.). 9 (2002) 109 Comp.Cas. 289 (Mad.). 10 (2002) 108 Comp. Cas. 563 (Mad.). 11 (1998) 94 Comp. Cas. 812 (SC). 12 1998 (2) S.C.C.
Banker and Customer 318 Self-Instructional Material NOTES 3. Discuss the law relating to crossed cheques and the protection granted to the collecting banker in respect thereof. Does a paying banker even incur liability in the case of crossed cheques? 4. Indicate
the cases in which a banker (i) must, (ii) may, refuse to honour a customer's

cheques. 5. Discuss the law relating to the protection granted to a paying banker with special reference to order and bearer cheques. 6. (a) Explain the effect of "Not Negotiable" crossing. (b) Has the holder of a cheque any rights against the banker? If so, under what circumstances? 7. Discuss the law relating to bouncing of cheques for insufficiency of funds
in the account. 26.8 PRACTICAL PROBLEMS Attempt the following problems, giving reasons: 1. A
cheque payable to bearer is crossed generally and is marked 'not negotiable.' The cheque
is lost and comes into the possession of
B, who takes it in good faith and for value. B
deposits the cheque into his own account and his banker collects the
same. (a) Discuss the liability of collecting banker and paying banker. (b) Can B be compelled to refund the money to the true owner of the cheque? [Hint. (a) Neither the collecting banker nor the paying banker incur any liability to anyone because of special protection granted to the bankers under the Act. (b) Yes, the true owner can compel B to refund the money because the cheque bears 'not negotiable' crossing as a result
of which
the transferee cannot
get a better title than that of the transferor.] 2.
A'
s wife forged his signature on 40 cheques drawn on M bank and cashed them. Upon
his
discovery of the forgeries, A did not at once inform the bank, but some months later when his wife informed him that she wanted more money for the purpose for which the previous cheques had been drawn and cashed by her, he stated his intention of notifying the bank, with the result that the same night his wife committed suicide. A brought an action against the bank, claiming to be credited with the amounts of the forged cheques. Will he succeed? [Hint. No, A will not succeed as he
did not inform the banker at once after coming to know about the forgeries. He is guilty of gross negligence. His continued silence operated to prevent the bank from taking its remedies against the wife.] 3.
A cheque is drawn payable to 'B or order.' It is stolen and B's indorsement is forged. The banker pays the cheque in due course. Is the banker discharged from liability? Would it make any difference if the drawer's signatures were forged? [Hint. Yes, the
paying banker is discharged from liability, despite the forged indorsement in favour of the payee, because of special protection granted by Section 85(1). Of course, where the drawer's signature is forged, a banker remains liable to the drawer even by a payment in due course and cannot debit the drawer's account.] 4. A banker pays a cheque crossed generally over the counter. Is he liable to the drawer or to the payee of the cheque? [Hint. The banker is liable to the payee of the cheque and not to the drawer (Sec. 129).] 5. A draws a cheque payable to 'Self or order'. Before he could encash the cheque, one of his creditors, B approaches him for payment. A endorses the same cheque in B's favour. The banker refuses payment to B on account of insufficiency of funds in the
Banker and Customer Self-Instructional Material 319 NOTES account. Can A be made liable to penalties for dishonour of cheque due to insufficiency of funds in the account under Section 138 ? [Hint. No, A cannot be made liable to penalties for dishonour of cheque due to insufficiency of funds in the account since the cheque was not originally drawn payable to another person. A cheque drawn payable to self and later endorsed in favour of another person does not seem to fall within the purview of the provisions of Section 138 which lays down that the cheque should have been drawn for payment to another person.]
Consumer Protection Act, 1986 Self-Instructional Material 321 NOTES UNIT 27 CONSUMER PROTECTION UNIT 33 ACT, 1986 Structure 27.0 Introduction 27.1 Unit Objectives 27.2

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Definition of Consumer 27.3 Who can File a Complaint 27.4 Grounds on which a Complaint can be Made 27.5 Unfair Trade Practice 27.6 Restrictive Trade Practice 27.7 Consumer Protection Councils 27.8 Consumer Disputes Redressal Agencies 27.9 District Forum 27.10 State Commission 27.11 National Commission 27.12 Powers of the Consumer Forums 27.13

Test Questions 27.0 INTRODUCTION The law relating to 'consumer protection' is contained in Consumer Protection Act, 1986. 1 The Consumer Protection Act, 1986 was enacted to meet the long felt necessity of protecting the consumers from getting cheated by unscrupulous suppliers of goods and services for which the remedy under various existing laws like
the Sale of Goods Act, the Prevention of Food Adultration Act, the Standards of Weights and Measures Act, the

Dangerous Drugs Act, etc., has become illusory. These laws require the aggrieved consumer to initiate action by way of a civil suit involving expensive and time consuming legal process. It is a known fact that in Civil Courts judgement in a suit takes years. The Consumer Protection Act, 1986 attempts to provide an inexpensive, simpler and quicker access to redressal of consumer grievances. The
Act has provided a machinery whereby consumers can file their complaints
against defective goods or deficient services with Consumer Forums, namely,
the District Forum at the District level, State Commission at the State level and National Commission at the National level. The Act
provides for an alternative system of consumer justice by summary trial. There is no need to engage a lawyer to present the case and there is a time limit for disposal of a case. The Consumer Protection Act, 1986 is one of the benevolent pieces of legislation intended to protect a large body of consumers from exploitation. It aims to protect the interests of consumers by recognising them in the form of rights. The various rights of consumers recognised under the Act which are to be promoted and protected by the Consumer Protection Councils
are as follows: (i)
Right to safety.
To be protected against the sale of goods and services which are
spurious or hazardous to life and property. (ii) Right to information. To be informed about the quality, quantity, weight and the price of goods or services being paid for, so that they are not cheated by unfair trade practices. 1 References to Sections in this Unit, unless otherwise indicated, are references to Sections of the Consumer Protection Act, 1986 as amended upto date. The word 'Act' wherever used in this Unit means the Consumer Protection Act.
Consumer Protection Act, 1986 322 Self-Instructional Material NOTES (iii)
Right to choose.
To be assured, wherever possible, access to a variety of goods and services at
a competitive price. (iv) Right to be heard.
To be heard and to be assured that their interest will receive due consideration at appropriate forums. (v) Right to seek redressal against
exploitation.
To seek legal redressal against unfair or restrictive trade practices or exploitation. (vi) Right to consumer education.
To have access to consumer education. Unless the consumers are aware of their rights and remedies, protection of their interest shall remain a myth. The Consumer Protection Act, 1986 was amended in 1991, 1993 and 2002 to make it more effective and purposeful. The Consumer Protection (Amendment) Act, 2002 appears to be a milestone. It has strengthened the procedures and has conferred more powers on the consumer disputes redressal agencies. The Amendment Act, 2002 is expected to greatly facilitate the working of the redressal agencies and help in achieving speedy settlement of disputes. The main provisions of the Consumer Protection Act, 1986 as amended upto date are discussed in the following pages. Scope and Applicability.
The Consumer Protection
Act, 1986
extends to the
whole of India except the State of Jammu and
Kashmir.
The
Act
applies to all goods and services
except those
notified by the Central Government (Sec. 1).
The provisions of the Act are
in addition to and not in derogation of the provisions of any other law (
Sec. 3). As such the provisions of the Act grant additional remedy to the consumers. Thus, an arbitration clause in an insurance policy is no bar to a proceeding under the Consumer Protection Act. 27.1 UNIT OBJECTIVES ? Know the objectives of Consumer Protection Act, 1986. ? Understand the grounds on which a complaint can be made under the consumer Protection Act. ? Be clear about the distinction between 'unfair trade practices' and 'restrictive trade practices'. ? Know the objects of consumer protection councils. ? Know about consumer disputes redressal agencies. ? Know the provisions relating to the powers of the consumer forums. 27.2 DEFINITION OF CONSUMER [SEC. 2(1) (D)] A " Consumer" means: (i)
any person who buys any goods for a
consideration which has been paid or promised or partly paid
and partly promised,

or under any system of deferred payment,
and includes any
person who uses such goods
with the approval of the buyer. It
does not include a person who buys goods for
resale or for any commercial purpose; or (
ii)
any person who
hires or avails any services for a
consideration which has been paid or promised or partly paid
and partly promised,
or under any system of deferred payment, and includes any
person who is a beneficiary of
such services with the approval of the hirer. It does not include a person who avails of such services for any commercial purpose.
Consumer Protection Act, 1986 Self-Instructional Material 323 NOTES
Explanation: For the purposes of this clause, "
commercial purpose" does not include use by a person
of goods bought and used by him
and services availed
by him exclusively for the
purpose of earning his livelihood, by means of self-employment. The
term 'person' includes a firm, Hindu undivided family, company, cooperative
society, and
every other association of persons whether registered under the Societies Registration Act, 1860
or not.
It may be observed that the aforestated definition of the term 'consumer' is in two parts: I. Consumer of goods. II. Consumer of services. Consumer of Goods The important features of the definition of 'consumer of goods' may be stated as follows: 1. Buying goods for consideration. There must be a contract of sale of goods between a seller and a buyer. The seller should be a 'business seller', i.e., a trader or manufacturer, and the buyer should be 'consumer buyer', i.e., who buys goods for consumption or private use. The buying of goods must be for consideration, which may be paid imme- diately or promised to be paid later–even in instalments. Thus, it includes credit sale and hire purchase transactions also. Consideration may be in terms of money or other goods and services. The meaning of the term 'goods' is to be construed according to
the
Sale of
Goods Act. According to
Section 2(7)
of
the
Sale of Goods Act, "
goods
means
every kind of movable property other than actionable claims
and money;
and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale."
Thus,
goodwill, trade marks, copyrights, patents-right, are all regarded as goods. 2. User of goods with the approval of the buyer. The term 'consumer' also includes any
person who uses the goods with the permission of the buyer
though he is himself not a buyer. When a person buys goods, they may
be used by his family members, relatives and friends. The actual user of the

goods may come across the defects in goods. Thus, the law treats rightful user of the goods as consumer. Illustration. A purchases a scooter. One of his family members B was using it from the date of purchase. B had a complaint regarding the scooter. B sued the seller. The seller pleaded that since B did not buy the scooter, he was not a consumer under the Act. The Delhi State Consumer Disputes Redressal Commission held that B, the complainant was using it with the approval of A, the buyer, and therefore he was a consumer under the Act (Dinesh Bhagat vs Bajaj Auto Ltd. 2). 3. Goods should not be purchased for resale or for any commercial purpose. The term 'consumer'
does not include a person who buys goods for 'resale' or for any 'commercial purpose'.
The expression 'commercial purpose' implies that the goods are bought to commercially exploit them with the object to earn profits. Thus, where a company purchases a computer system to facilitate its work, the said purchase is a purchase for 'commercial purpose' and the company is not a 'consumer' under the Act. Illustration. A charitable trust was running a diagnostic centre, where patients taking advantage of X-ray, CT scan etc., were ordinarily required to pay for the same and only 10% of them being provided free service. It was held that the machines purchased by the 'Trust' for use in the diagnostic centre were meant for 'commercial purpose'. Therefore the 'Trust' was not a consumer [Kalpavraksha Charitable Trust vs Toshniwal Brothers (Bombay) (P) Ltd. 3]. 4. Person buying goods for self-employment is a consumer. When the goods are bought and used by the buyer himself, exclusively for the purpose of earning his livelihood, by 2 (1992), III CPJ 272. 3 (2000), 1 S.C.C. 512.
Consumer Protection Act, 1986 324 Self-Instructional Material NOTES means of self-employment, then such buyer/user is also recognised as a consumer under the Act. Thus a person who purchases a taxi, or a sewing machine or a photostat machine
exclusively for the purpose of earning his livelihood by means of self-employment,
will be a consumer. Illustration. P, an eye surgeon, purchased a machine from R for his private nursing home. The machine was found to be defective one. P sued R for damages. R contended that P was not a consumer under the Act as the machine was bought for commercial purposes. The National Commission rejected this contention and held that P is a medical practitioner, a professional working by way of self-employment by using his knowledge to earn his livelihood and therefore he is a 'consumer' (Rampion Pharmaceuticals vs Dr. Preetam Shah 4). Consumer of Services The second category of 'consumer' is that of 'consumer of services'. A person is a 'consumer of service' if he satisfies the following criteria: 1. Hiring of services for consideration. There must be a transaction of hiring or availing of service for consideration. However, the payment of consideration need not necessarily by immediate. It may be paid later. If the service is provided without charging any thing in return, the person availing the service is not a 'consumer'. Illustrations. (a) A goes to a Doctor to get himself treated for fever. The Doctor charged Rs. 200 for the treatment. Here A is hiring the services of the Doctor. Thus he is a 'consumer'. (b) X goes to a Doctor to get himself treated for a fracture. The Doctor, being his friend, charged him nothing for the treatment. X is not a 'consumer' under the Act. (c) Where services are rendered at a Government Hospital on payment of charges and also free of charge, the free service also comes under "service" as defined in Section 2(1) (O) of the Act and the person availing such service is a 'consumer' within the meaning of the Act, entitled to file complaint thereunder (Sukhwarsha Ravi vs General Hospital 5). (d) A hires an advocate to file a suit for recovery of money from his employer. He promises to pay the fee to the advocate after settlement of the suit. A is a 'consumer' under the Act. (e) A customer of a bank is a 'consumer' entitled to seek compensation under the Act, and the bank is liable for deficiency of service (Vimal Chandra Grover vs Bank of India 6). (f) A landlord neglected and refused to provide the agreed amenities to his tenant. The tenant filed a complaint against the landlord under the Consumer Protection Act. The National Commission dismissed the complaint saying that it was a case of lease of immovable property and not of hiring of services of the landlord (Laxmiben Laxmichand Shah vs Sakerben Kanji Chandan 7). 2. Beneficiary of service is also a 'consumer'. A beneficiary of service, though not the hirer himself, is also regarded as a 'consumer' provided the beneficial use is made with the approval of the person who hired the service. Thus, a nominee under an insurance policy 8 and an actual user of the subscriber's telephone 9 have been held to be 'consumers'. Illustration. R takes his wife S to a Doctor to get his wife treated for a fracture. The Doctor charged Rs. 1200 for the treatment. Here R is a hirer of services of the Doctor and S is beneficiary of the service. For the purpose of the Act, both R and S are 'consumers'. 3. Service should not be availed for any commercial purpose. The term 'consumer of service' does not include a person who avails service for any 'commercial purpose'. Thus, where a person hires the services of a goods carrier and starts plying it on hire as public carrier with the object to earn profits, the said hiring of services of a goods carrier is for 'commercial purpose' and the person is not a 'consumer' under the Act. 4 (1997), I CPJ 23 (NCDRC). 5 (2000), 1 CPR 337 (Chd-UTCDRC). 6 (2002), 110 Comp. Cas. 499 (SC). 7 (1992), 1 Comp. LJ 177 (NCDRC). 8 Divisional Manager L.I.C. vs Uma Devi, (1991), II CPJ, 516 (NC). 9 Mahanagar Telephone Nigam Ltd. vs Vinod V. Karkare, (1991), II CPJ, 655.
Consumer Protection Act, 1986 Self-Instructional Material 325 NOTES "Service" defined. Section 2(1) (O) defines the term 'service' as follows: "
Service"
means

service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information. However, it does not include the rendering of any service free of charge or under a contract of personal service. The expression 'contract of personal service' means contract to render service in a private capacity to an individual. For example, where a servant enters into a contract with a master for employment, it is a contract of personal service. The rationale for excluding a 'contract of personal service' from the definition of "service" is that the master can discontinue the service at any time according to his will, he need not approach Consumer Forum to complain about deficiency in service. Complaint. Literally the word 'complaint' means a formal allegation against a party. In the present context, 'complaint' is an allegation made in writing to the National Commission, the State Commission or the District Forum, by a person competent to file it, with a view to obtaining relief provided under the Act. 27.3 WHO CAN FILE A COMPLAINT [SEC. 2(1) (B) AND SEC. 12(1)] A complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided, may be filed, with a Consumer Forum, by— (a) A consumer; or (b) any recognised consumer association, namely, any voluntary consumer association registered under the Companies Act or under any other law for the time being in force, whether the consumer is a member of such association or not; or (c) one or more consumers, where there are numerous consumers having the same interest, with the permission of the Consumer Forum, on behalf of, or for the benefit of, all consumers so interested; or (d) the Central Government or the State Government, as the case may be, either in its individual capacity or as a representative of interests of the consumers in general; or (e) in case of death of a consumer, his legal heir or representative. Further, the following are also considered as a consumer and hence they may file a complaint: (i) User of goods and beneficiary of services. It may be recalled that the definition of 'consumer' itself includes user of goods and beneficiary of services. (ii) Husband of the consumer. A husband can file a complaint on behalf of his wife (Punjab National Bank, Bombay vs K.B. Shetty 10). (iii) Insurance company. Where Insurance Company pays and settles the claim of the insured, it can file a complaint for the loss caused to the insured goods by negligence of goods/service providers. For example, when loss is caused to such goods because of negligence of transport company, the insurance company can file a claim against the transport company (New India Assurance Company Ltd. vs Green Transport Co. 11). 10 (1991), (2) CPR 633. 11 (1991), CPJ (1) Delhi.

GROUNDS ON WHICH A COMPLAINT CAN BE MADE [SEC. 2(1)(C)]

The Consumer Protection
Act has provided certain grounds on which complaint can be made.
A complaint must contain any of the following allegations: (i)
An 'unfair trade practice' or a 'restrictive trade practice' has
been adopted by any trader
or
service provider;
Illustration.
A sold a second-hand computer to B representing it to be a new one. Here B can make a complaint against A for adopting an unfair trade practice. (
ii)
The goods bought by him or agreed to be
bought by him suffer from one or more
defects;
Illustration. A bought a computer from B. It was not working properly since day one. A can make a complaint against B for supplying him a defective computer. (
iii)
The services hired or availed of or agreed to be hired or availed
of by him suffer from deficiency in any respect;
Illustration. A
booked a taxi at a Taxi Stand which should reach at his residence at 5.30 A.M. The taxi did not reach at the appointed hour. As a result A had to miss his train. A can make a complaint against the Taxi Stand for
deficiency in service. (iv)
A trade or service provider, as the case may be,
has charged for the goods or for
the services mentioned in the complaint, a price in excess of the price fixed by any law
or
displayed on the goods or any package containing such goods
or
displayed on the price list exhibited by him
or
agreed between the
parties; Illustration. A bought a Maruti Car from an authorised dealer of the Company
who charged him Rs. 4000 over and above the price displayed on the price list of the Maruti Company. A can file a complaint against
the dealer. (v)
Goods which will be hazardous to life and safety when used,
are
being offered for sale to the public in contravention of
any
standards relating to safety of such goods as required to be complied with by any law
or
if the trader could have known with due diligence that the goods
so offered are unsafe to the
public;
Under the Sale of Goods Act also there is
an implied warranty on the part of the seller to disclose the dangerous nature of goods to the ignorant buyer.
If there is breach of this warranty, the
buyer is entitled to claim compensation for the

injury caused to him. Illustration. C purchases a tin of disinfectant powder from A. A knows that the lid of the tin is to be opened in a specific manner and if it is opened without special care it may be dangerous, but tells nothing to C. C opens the tin in the normal way whereupon the disinfectant powder flies into her eyes and causes injury. C can make a complaint against A
as he should have warned C of the probable danger. (
vi)
Services
which are hazardous or likely to be hazardous to life and safety of the public when used,
are being offered
by the service provider which such person could have known with due diligence to be injurious to life and safety.
Note: The terms 'unfair trade practice', 'restrictive trade practice', 'defect', 'deficiency', 'trader', etc., as defined under the Act have been discussed after the next heading.
Time Frame Within Which a Complaint Can be Filed (Limitation Period). Section 24A provides that a complaint can be filed
before the Forums constituted under the Act (
District Forum, State Commission or National Commission)
within two years from the date on which the cause of action
has arisen.
There are no set rules to decide the point of time when cause of action arises. It depends on the facts and circumstances of each case.
Consumer Protection Act, 1986 Self-Instructional Material 327 NOTES Illustration. (a) B got his eye operated by A in 1989. He got a certificate of blindness on 18th December, 1989. He was still in
the hope of regaining his eyesight and went for
second operation in 1992 and was discharged on 21-1-1992. He filed a complaint against
A for deficiency of service on 11-1-1994. A opposed the petition on the ground that the suit was not maintainable as more than two years have elapsed after 18-12-1989. It was held that in the instant case
the cause of action for filing the complaint would arose after the second operation when
B lost complete hope of recovery. Thus the suit is maintainable (Mukundlal Ganguly vs Dr. Abhijit Ghosh 12). (b) A house was alloted on 15th May, 2004. Defects in construction of the house appeared on 25th May, 2004. Here the cause of action will arise on 25th May, 2004. It may be noted that the Section further provides that
a complaint
may be entertained after the expiry of period of limitation specified above, if the complaintant satisfies the Consumer Forum that he had sufficient cause for not
filing the complaint within the prescribed period.
However, the Forum must record its reasons for condonation of delay. 27.5 UNFAIR TRADE PRACTICE Section 2(1) (r) defines "unfair trade practice" as follows: "
Unfair trade practice" means a trade practice which, for the purposes of promoting the sale, use or supply
of
any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following
practice, namely,— 1.
The practice of making any statement, whether orally
or
in writing or by visible representation which, — (i)
falsely represents that
the
goods are of a particular standard, quality, quantity, grade, composition, style or model; (
ii)
falsely represents that the services are of a particular standard,
quality or
grade; (
iii)
falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods; (iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods
or services

do not have; (v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have; (vi) makes
a
false or misleading representation concerning the need for, or the usefulness of, any goods or services; (vii) gives
to
the public any warranty or guarantee of the performance, efficacy or length of life of a product
or of any goods that is not based on an adequate or proper test thereof: (
viii)
makes to the public a representation in a form that purports to be — (a)
a warranty or guarantee of a product or of any goods or services; or (b) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result. If such purported warranty or guarantee
or promise is materially misleading or if there
is no
reasonable prospect that such warranty, guarantee or promise will be carried out; (ix)
materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to
price shall be deemed to refer to the price at 12 (1995), 111
CPJ 64.
Consumer Protection Act, 1986 328 Self-Instructional Material NOTES
which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly
specified to be
the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made; (
x) gives false or misleading facts disparaging the goods, services or trade
of another person.
Explanation. For the purpose of
this
clause, a statement that is: (a)
expressed on an article offered or displayed for sale, or on its wrapper or container; or (b) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or (c) contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public.
Shall be deemed to be a statement made to the public by the person who had caused the statement to be so expressed, made or contained. 2. Permits the
publication of any advertisement whether in any newspaper or otherwise, for the sale
or
supply at a bargain price, of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement. Explanation. For the purpose of this clause, “bargain price” means: (a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise, or (b) a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold. 3. Permits: (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole; (b) the conduct of any contest, lottery, games of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use
or
supply of any product or any business interest. 4.
Withholding from the participants of any scheme offering gifts, prizes or other items free of charge, on its closure the information about final results of the scheme.
Explanation. For the purpose of this clause,
the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time published prominently in the same newspapers in which the scheme was originally advertised. 5. Permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason

to
believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods. 6. Permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusual raises or tends to raise or is intended to raise, the cost of those or other similar goods or services. 7. Manufacture of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services.
Consumer Protection Act, 1986 Self-Instructional Material 329 NOTES 27.6 RESTRICTIVE TRADE PRACTICE Section 2(1) (nnn) defines "restrictive trade practice" as follows: "
Restrictive trade practice" means a trade practice which tends to bring about manipulation of price or
its
conditions of delivery or to affect flow of supplies in the market relating to
goods or services in such a manner as to impose on the consumers unjustified costs or restrictions
and
shall include: (a)
delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price; (
b)
any trade practice which requires
a consumer to buy, hire or avail of any goods or, as
the case may be, services
as condition
precedent
to buying, hiring or availing of other goods or services.
The definition of the expression "restrictive trade practice" reveals, inter-alia, that where sale or purchase of a product or service is made conditional on the sale or purchase of one or more other products and services, it amounts to restrictive trade practice. Thus where a cooking gas distributor insists his customers to buy gas stove as a condition to give gas connection, it amounts to restrictive trade practice. However, where there is no such precondition and the buyer is free to take either product, no tying arrangement could be alleged even though the seller may offer both the products as a single unit at a composite price. Illustration. A furniture dealer offers to sell a Sofa at Rs. 20,000 and Double Bed at Rs. 15,000. He has an offer that whoever will buy Sofa and Bed both, he will charge Rs. 30,000 only. Here the choice is open to the customer to buy the products single or composite. This is not a restrictive trade practice. Defect [Sec. 2(1) (
f)]. "
Defect"
means
any fault, imperfection or
shortcoming in the quality, quantity, potency, purity or standard
which
is required to
be
maintained
by
or under any law
for the time being in force
or
under
any
contract, express or implied, or as is
claimed by the trader in any manner
whatsoever in relation to any goods.
This is
an exhaustive definition. It means that the Act recognises only those defects which are covered by the definition. For example, A sells a stolen car to B. B wants to sue A for defect in the title of the car. B cannot sue A under the Consumer Protection Act as the defect in title of goods does not constitute defect in goods as defined under the Act.
Deficiency [Sec. 2(1) (
g)]. "
Deficiency"

means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which
is required to be
maintained
by or under any law
for the time being
in force
or
has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service. Illustrations. (i) A boarded a train. The compartment in which he travelled was in bad shape–fans and shutters of windows were not working, rexin of the berth was badly torn and there were rusty nails which caused some injury to his wife who was also travelling along with him. A made a complaint against the Railways for deficiency in service. It was held that the faults or shortcomings pointed out in the plaint constituted 'deficiency in service' and the compensation of Rs. 1500 was awarded to A (General Manager, South Eastern Railway vs Anand Prasad Sinha 13). (ii) Intentional withholding of delivery of car for two months after receipt of full payment to take advantage of price hike was held as 'deficiency in service' (Mohinder Pratap Das vs Modern Automobiles 14). (iii) Non-intimation by the Carrier to the consignee about arrival of the goods at the destination, and non-compliance with subsequent instruction of the consignor for reshipment of the goods to a new consignee was held as 'deficiency in service' (Saddler Shoes Pvt. Ltd. vs Air India 15). 13 (1991), 1 CPJ 10 (12) NC. 14 (1995), 3 SCC, 581 15 (2001), 8 SCC 390.
Consumer Protection Act, 1986 330 Self-Instructional Material NOTES But if abnormal circumstances beyond the control of the person performing service prevent him from rendering service of the desired quality and manner of performance, such person should not be penalised for the same. For example, L undertook to supply water to B for irrigation of crops. Due to power grid failure of the State, L could not get sufficient power to perform the service. L cannot be held liable for 'deficiency in service'. However, negligence on the part of performer of service may not be excused under the cover of circumstances beyond control. Illustration. A agreed to supply water to B for irrigation of crops. He failed to do so because of a power breakdown due to burning of his transformer. As a result crops were damaged. B sued A for 'deficiency in service'. The National Commission held that it was the duty of A to get the transformer repaired immediately. Since he was negligent in doing so, he is liable for the deficiency in service (Orissa Lift Irrigation Corpn. Ltd. vs Birakishore Raut 16). Manufacturer [Sec. 2(1) (
j)]. "
Manufacturer"
means a person who — (i) makes or manufactures any goods or part thereof; or (
ii)
does not make or manufacture any goods but assembles parts thereof made or manufactured by others;
or (
iii)
puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer.
The explanation to the clause provides that
where a manufacturer despatches any goods or part thereof to any branch office maintained by him, such branch office shall not be deemed to be the manufacturer even though the parts so despatched to it are assembled at such branch office and are sold or distributed from such branch
office.
Thus a manufacturer is a person who either himself manufactures goods, or assembles parts of any goods manufactured by others, or puts his own mark (trade mark) on the goods manufactured by others. Illustration. M Ltd. used to buy components and assemble ceiling fans therefrom. It was selling them under the brand name 'Pearson'. B bought a 'Pearson' fan which turned out to be defective. B can hold M Ltd. liable for the loss as it will be deemed manufacturer of 'Pearson' fans under the Act. Trader [Sec. 2(1) (
q)]. "
Trader"
in relation to any goods means a person who sells or distributes any goods
for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof.

Generally speaking 'trader' means any person who carries on a trade. Under the Consumer Protection Act, 'trader' is a wider term which includes a manufacturer and a packer also. For example, (a) A got an agency of 'Polar Fans'. He sells and distributes these fans in North India. He is a trader under the Act. (b) Polar Co. Ltd. manufactures the fans. It is a trader under the Act. (c) B provides cartons to pack the detergent manufactured by M. B is a trader under the Act. Generally when a consumer finds defects in the goods, he sues the person from whom he bought the goods. Reason being privity of contract. It can well be imagined that the purchaser may not even know who the manufacturer is. As such it is not the requirement of the Act that alongwith the trader, manufacturer must also be made a party in the suit. Of course, if the defect is a manufacturing defect, the consumer may sue the manufacturer also along with the seller. This is an option with the consumer. Thus the manufacturer is a possible 16 (1991), 2 CPJ 213 (NC).
Consumer Protection Act, 1986 Self-Instructional Material 331 NOTES party, and not a necessary party. For example, in case the vehicle has any defect, the buyer may sue the seller alone or the seller and manufacturer both. But where excess price has been charged it is only the seller to bear the liability, for it is his own act and not that
of the manufacturer.
Consumer Dispute [Sec. 2(1) (
e)]. "
Consumer dispute" means a dispute
where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.
Thus, where the claim of insurance is repudiated by the Insurance Company, it amounts to consumer dispute. On the other hand, where the respondent agreed to supply specified quantity of iron rods to the appellant at a fixed rate and the respondent charged a higher price, the matter is purely one of the description of breach of contract. In no way it amounts to consumer dispute as envisaged by the Consumer Protection Act. The appellant in the instant case must approach the civil court. 27.7 CONSUMER PROTECTION COUNCILS The Consumer Protection Councils are established at Centre level, State level and District level. We have one Central Council, many State Councils and many District Councils. These Councils work towards the promotion and protection of the rights of the consumers. They give publicity to the matters concerning consumer interests, take steps towards furthering consumer education and protecting consumer from exploitation. They advice the Government in matters of policy formulation regarding protection of the consumer rights. The Government has notified "The Consumer Protection Rules, 1987" 17 with a view to prescribe procedure in regard to the transaction of business by the Central Council and to prescribe the rules as to the composition of the Central Council. These Rules also prescribe
the terms and conditions of service of the members of the National Commission,
procedure to be followed for conduct of business and for hearing of appeal by the National Commission. 27.7.1 Central Consumer Protection Council (Central Council) Section 4 provides that: 1.
The Central Government shall, by notification, establish
with effect from such date as it may specify in such
notification,
a council to be known as the
Central
Consumer Protection Council (
hereinafter referred to as
the Central Council). 2. The Central Council shall consist of the following members, namely,: (
a)
the Minister-in-charge of Consumer Affairs in the Central Government, who shall be its Chairman,
and (
b)
such number of other official or non-official members representing such interests as may be prescribed.
Constitution of Central Council. The
constitution of Central Council
has since been prescribed under Rule 3 of the Consumer Protection Rules, 1987. It provides
that
the Central Council shall consist of the following members, not exceeding 150, namely, — (i) The Minister-in-charge of Consumer Affairs in the Central Government who shall be
the Chairman of the Central Council. (ii) The Minister of State (where he is not holding independent charge) or Deputy Minister-in-charge of Consumer Affairs in the Central Government who shall be
the Vice-Chairman of the Central Council. 17
These Rules have been amended by the Consumer Protection (Amendment) Rules, 2004.
Consumer Protection Act, 1986 332 Self-Instructional Material NOTES (iii)

The Minister-in-charge of Consumer Affairs in States. (iv) Eight Members of Parliament — five from Lok Sabha and three from the Rajya Sabha. (v) The Secretary of the National Commission for Scheduled Castes and Scheduled Tribes. (vi) Representatives of the Central Government Departments and autonomous organisations concerned with consumer interests — not exceeding twenty. (
vii) The Registrar, National Consumer Disputes Redressal Commission, New Delhi. (viii)
Representatives of the Consumer Organisations or Consumers — not less than thirty-five. (
ix) Representatives of women — not less than ten. (x)
Representatives of farmers, trade and industries — not exceeding twenty. (xi) Persons capable of representing consumer interests not specified above — not exceeding fifteen. (
xii)
The Secretary-in-charge of Consumer Affairs in the Central Government shall be
the member secretary of the
Central Council.
It may thus be observed that members of the Council are selected from various areas affecting Consumer interest, who are leading members of statewide organisations representing segments of the consumer public, so as to establish a broadly based and representative Central Council. Term. The term of the Council shall be three years.
Vacancy. Any member may, by writing under his hand to the Chairman of the Central Council, resign from the Council. The vacancies, so caused or otherwise,
shall be
filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred.
Procedure for meetings of the Central Council. (Sec. 5).
The Central Council shall meet as and when necessary, but at least one meeting
of the Council
shall be held every year. It
shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of business as may be prescribed.
Rule 4 of the Consumer Protection Rules, 1987 provides that the Central Council shall
observe the following
procedure in regard to the transaction of its business: 1.
The meeting of the Central Council shall
be
presided over by the Chairman. In the absence of the Chairman, the Vice-Chairman shall preside over the meeting of the Central Council. In the absence of the Chairman and the Vice-Chairman, the Central Council shall elect a member to preside over that meeting of the Council. 2.
Each meeting of the Central Council shall be called by giving not less than ten days from the date of issue, notice in writing to every member. 3. Every notice of a meeting of the Central Council
shall specify the place and the day and hour of the meeting
and shall contain statement of business to be transacted
thereat. 4.
No proceeding of the Central Council shall be invalid merely by reasons of existence
of any vacancy in or any defect in the constitution of the
Council. 5.
For the purpose of performing its functions, the Central Council
may constitute from amongst its members, such working groups as it may deem necessary to perform the assigned functions. The findings of such working groups shall be placed before the Central Council for its consideration.
Consumer Protection Act, 1986 Self-Instructional Material 333 NOTES 6. The non-official members attending meetings of the Council or its Working Group shall be entitled to travelling and daily allowances at the specified rates. 7.
The resolution passed by the Central Council shall be recommendatory in nature. Objects of the Central Council (
Sec. 6). Infact the objects of the Central Council are the various rights of consumers recognised under the Act which are to be promoted and protected by the Council.
Thus the Act (under Section 6) has enumerated some rights of consumers which need to be protected by the Council. These
rights of consumers are: 1. Right to safety. This right has been recognised by Section 6(a)
as, "
the
right to be protected against the

marketing of goods and services which are hazardous to life and property."
The
rationale behind this provision is to ensure physical safety of the consu- mers. The law seeks to ensure that those responsible for bringing goods to the market, in particular, manufacturers, distributors, retailers and the like should ensure that the goods are safe for the users. In case of
dangerous or risky goods, consumer should be informed of
the risk involved in improper use of goods. Vital safety information
should be conveyed to consumers. Illustration. M bought an insecticide from N. N did not inform M that touching this insecticide with bare hands can create skin problem. M, while using the insecticide came in contact with it and suffered from skin problem consequently. Here N can be held liable under the Act. 2. Right to information. Under Section 6(b) this right has been recognised as, "
the right to be informed about the
quality, quantity, potency, purity, standard and price of goods
or
services,
as
the case may be,
so as to protect
the consumer against unfair trade practices."
Adequate information is very important in order to make a right choice
of goods to be purchased. This right ensures that the consumer should be made aware of the quality, weight, contents and price of the product at the very pre-purchase stage. The fixing of I.S.I. mark and Agmark enables the consumer to know about its quality. Under some other legislations it is mandatory for the manufacturers and packers to provide information on the package to the consumers about the contents, weight, purity and potency of the pro- duct being sold. Consumers suffer much on the price front as the prices often printed or tagged in the product are misleading and no price control is there except with respect to essential commodities. Advertisements also often mislead the consumers. 3. Right to choose. This right has been recognised by Section 6(c) as, "
the
right to be assured, wherever possible, access to a variety of goods and services at competitive
prices."
Fair and effective competition must be encouraged so as to provide
consumers with maximum information about the vide variety of competing goods available in the market. Shoppers or buyers guide should be made available to the consumers by the Government or Business Organisations to protect this right of consumers. 4. Right to be heard. This right is ensured by Section 6(d) as, "
the
right to be heard and to be assured that consumers' interests will receive due consideration at appropriate forums."
The
Consumer Protection Act, 1986 has well taken care of this right by
providing three stages redressal machinery to the consumers, namely, District Forum, State Commission and National Commission.
Every
consumer has a right to file complaint and be heard in that context.
Further, with a
view to providing better protection of this right various public and private sector undertakings have provided Consumer Ombudsman (Complaint cells) to provide redressal to consumer complaints outside the courts. 5. Right against exploitation. This right is guaranteed under Section 6(e) of the Act as, "
the right to seek redressal against unfair trade practices or
restrictive trade practices or unscrupulous exploitation of consumers."
Consumers are the most helpless lot in our country due to very many factors. When consumers are exploited, adequate remedy must be made available. The Act has thus ensured to prevent exploitation of consumers by invoking the jurisdiction of Consumer Forums in cases involving unfair trade practices and restrictive trade practices.
Consumer Protection Act, 1986 334 Self-Instructional Material NOTES 6. Right to education. This right has been recognised under Section 6(f) of the Act as, "the right to consumer
education." The right to consumer education is a right which ensures that consumers are informed about the practices prevalent in the market, their rights and the remedies available to them.

Unless the consumers are aware of their rights and remedies, protection of their interest shall remain a myth. In this connection the role of Consumer Protection Councils is very vital. The Central Council must ensure to educate the consumers about their rights and remedies under the Act throughout the country and the State Councils and the District Councils must ensure to educate about these rights to consumers within their territories. For spreading this education, media, school curriculum and cultural activities, etc. may be used as a medium. 27.7.2
State Consumer Protection Councils (State Concils) The power to establish State Councils is with the States. Section 7 provides that: 1.
The
state Government shall, by notification, establish
with effect from such date as it may specify in such
notification,
a council to be known as the
State Consumer
Protection Council (
hereinafter referred to as
the State Council). 2. The State Council shall consist of the following
members,
namely,: (
a)
the Minister-in-charge of Consumer Affairs in the State Government who shall be its Chairman; (b) such number of other official or non-official members representing such interests as may be prescribed by the State Government; (
c) such number of other official or non-official members, not exceeding ten, as
may be nominated by the Central Government. 3. The State Council shall meet
as and when necessary but not less than two meetings
shall
be held every year. 4. The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed
by the State
Government.
It may thus be observed that the State Government has been empowered to decide the number and qualifications of the members of State Council besides the members nominated by the Central Government. The State Government has been further empowered to prescribe
the procedure to be followed by the State Council
in regard to the transaction of its business.
Objects of the State Council (Sec. 8). "
The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in
Clauses (a) to (f) of Section 6." Thus the
objects of the
State Councils are same as that of the Central Council discussed above. 27.7.3 District Consumer Protection Councils (District Councils) Sections 8-A and 8-B of the Consumer Protection Act added by the Amendment Act of 2002 deals with the establishment of the District Councils at district level. Section 8-A provides as follows: 1.
The State Government shall establish for every district, by
notification, a council to be known as the District Consumer Protection Council
with effect from such data as it may specify in such notification. 2.
The District Consumer Protection Council (
hereinafter referred to as the District Council) shall consist of the following members, namely,:
Consumer Protection Act, 1986 Self-Instructional Material 335 NOTES (
a)
the Collector of the district (by whatever name called), who
shall be its Chairman; and (b) such number of other official and non-
official members representing such interests
as
may be prescribed by the State Government. 3. The District Council shall meet as and when necessary but not less than two meetings shall
be
held every year. 4. The District Council shall meet at such

time
and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. Objects of
the District Council (Sec. 8-B). "The objects of every District Council shall be to promote and protect within the district the rights of the consumers as laid down in
clauses (a) to (f) of Section 6."
These Clauses have already been discussed under the sub-heading — Objects of the Central Council. 27.8 CONSUMER DISPUTES REDRESSAL AGENCIES The Consumer Protection Act, 1986 provides for a three-tier remedial machinery for speedy redressal of consumer disputes.
According to Section 9,
there shall be established for the purposes of this Act,
the following agencies namely,: 1.
Consumer Disputes Redressal Forum to be known as the "District
Forum".
It is to be
established by the State Government is each district of the State by notification. The State Government may, if it deems fit, establish more than one District Forum in a district. 2.
State Consumer Disputes Redressal Commission (
SCDRC) to be known as "State Commission."
This is also to be
established by the State Government in the State
by notification. 3. National Consumer Disputes Redressal Commission (
NCDRC) to be known as "National Commission".
This is to be established by the Central Government by notification. These Forums have not taken away the jurisdiction of the civil courts but have provided an alternative remedy. Their prime objective is to relieve the conventional courts of their burden which is ever increasing and delaying the disposal of suits due to technicalities. These agencies are quasi-judicial bodies. They are manned by qualified persons and have been vested with considerable powers. They are required to assign reasons for their conclusions. Obligation to give reasons not only introduces clarity but it also excludes, or at least minimises, the chances of arbitrariness. 27.9 DISTRICT FORUM 27.9.1 Composition of the District Forum Section 10 elaborates upon the composition of the
District Forum. It provides that: 1.
Each District Forum shall
consists of,: (
a) a person who
is, or has been, or is qualified to be a
District Judge,
who shall be its President; (b)
two other members,
one of whom shall be a woman
who shall have the following qualifications, namely,:
Check Your Progress 1. Define the term 'Consumer'. 2. What do you understand by the term 'Service'? 3. Explain the term 'unfair trade practice'.
Consumer Protection Act, 1986 336 Self-Instructional Material NOTES (i)
be
not less than 35 years of age; (ii) possess a bachelor's degree from a recognised university;
and (
iii)
be persons of ability, integrity and standing, and have adequate knowledge and experience of at least 10 years in dealing with
problems relating to
econo- mics, law, commerce, accountancy, industry,
public affairs or administration.
Disqualifications.
A person shall be disqualified for appointment as member if: (
a) he has been convicted and sentenced to imprisonment for an offence
involving moral turpitude 18 ; or (b) he is an undischarged insolvent; or (c)
he

has been adjudged to be of unsound mind;
or (d) he
has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government;
or (e)
he
has,
in the opinion of the State Government,
such financial or other interest as is likely to affect prejudicially
the discharge by him of his functions as a member;
or (f) he has such other disqualifications as may be prescribed by the State Government.
Appointing authority [Sec. 10(1-
A)]. Every
appointment of the President and members of the District Forum
shall be made
by the State Government on the recommendation of
a selection committee consisting of the following: (i) President of the State Commission — Chairman. (ii) Secretary, Law Department of the State — Member. (iii) Secretary in-charge of
the Department dealing with consumer affairs in the State —
Member.
Where the President of the State Commission is, by reason of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting judge of that High Court to act
as Chairman.
Term of office [
Sec. 10(2)].
Every
member of the District Forum shall
hold office for a term of 5 years or
up to the age of 65
years, whichever is earlier.
However, he shall be eligible for re-appointment
subject to similar conditions as stated here-in-before.
Terms
and conditions of service [Sec. 10(3)].
The salary or honorarium and other
allowances payable to, and the
other
terms
and conditions of service of the members of the District Forum shall be such as may be prescribed
by the State Government.
In terms of proviso to Section 10(3),
the appointment of a member on whole-time basis
shall be made by the State Government on the recommendation of the President of the State
Commission
taking into consideration such factors as may be prescribed
including the work load of the District Forum. 27.9.2 Jurisdiction
of the District Forum
The term jurisdiction may be defined as authority or legal power to hear and decide the cases. Thus a court may adjudicate only those matters which fall
under its
jurisdiction. The question of jurisdiction has to be considered with reference
to the value, place and the nature of subject-matter. For example, where A and B reside in Bombay and they have 18
Anything done contrary to justice, honesty or good morals is done with turpitude, so that embezzlement involves moral turpitude.

some dispute, their dispute may be subjected to the jurisdiction of the Bombay courts only. Courts of any other place cannot adjudicate the issue.
Pecuniary jurisdiction [Sec. 11(1)].
The District Forum shall have jurisdiction to
entertain complaints where the value of goods or services
and the compensation, if any, claimed does not exceed
Rs. 20 lakhs. 19
In Farook Haji Ismail vs Gavabhai Bhesania, 20 the Gujarat High Court held that the pecuniary jurisdiction depends upon the amount of relief claimed and not upon the value of the subject-matter, nor upon the relief allowed by the Forum. Thus the
District Forum entertains the cases where the value of claim is upto Rs. 20 lakhs. Where a claim exceeds this limit, the matter is beyond the jurisdiction of the Forum.
Territorial jurisdiction [Sec. 11(2)].
A
complaint shall be instituted in a
District Forum within the local
limits
of whose jurisdiction: (
a)
the opposite party or
each
of the opposite parties, where there are more than one,
at the time of the institution of
the complaint, actually and voluntarily resides or carries on business, or has a branch office or personally works for gain; or (
b)
any
of the opposite parties, where there are more then one,
at the time of the institution of the complaint,
actually or
voluntarily resides, or carries on business or has a branch office, or personally works for gain,
provided
the other parties not so residing or working agrees or the District Forum gives permission in this regard;
or (c) the cause of action, wholly or in part,
arises.
It may be recalled that a limitation period has also been prescribed under Section 24-A. Accordingly, a complaint can only
be lodged
within two years from the date on which the cause of action
has arisen. 27.9.3
Manner in Which Complaint Shall be Made (Sec. 12) Section 12(1) lists the persons who can file a complaint. This has been explained earlier under the side-heading — "Who can file a Complaint". The expression "Complaint" has also been explained earlier. Section 12(2) (3) (4) elaborates the manner in which complaint shall be made. It provides that: 1. Every complaint filed with a District Forum
shall be accompanied with such amount of fee and payable in such manner as may be prescribed.
The fee for making complaints before District Forum and the manner in which the fee shall be payable has since been prescribed under Rule 9A 21 of the Consumer Protection Rules, 1987. It provides that: Every complaint filed with a District Forum shall be accompanied by a fee, as specified in the table given below, in the form of crossed Demand Draft drawn on nationalised bank or through a crossed India Postal Order drawn in favour of the Registrar of the State Commission and payable at the respective place where the State Commission is situated. The concerned District Forum shall deposit the amount of fee so received in the State Government Receipt Account. 19 This limit was increased from Rs. 5 lakhs to Rs. 20 lakhs, vide the Consumer Protection (Amendment) Act, 2002, w.e.f. 15-3-2003. 20 (1991), II CPJ 452 Gujarat. 21 Rule 9A was inserted by the Consumer Protection (Amendment) Rules, 2004 (w.e.f. 5-3-2004).
Consumer Protection Act, 1986 338 Self-Instructional Material NOTES Sl.No. Value of goods or services and the Compensation claimed Amount of fee payable (1) (2) (3) 1. Upto one lakh rupees Rs. 100 2. One lakh rupees and above but less than five lakh rupees Rs. 200 3. Five lakh rupees and above but less than Rs. 10 lakh Rs. 400 4. Ten lakh rupees above but not exceeding Rs. 20 lakh Rs. 500 2.

On receipt of a complaint, the District Forum may, by order, admit the complaint or reject the same. However, a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant. The admissibility of the complaint shall ordinarily be decided within 21 days from the date on which the complaint was received. 3. Where a complaint is admitted, the District Forum shall follow the procedure prescribed in Section 13 (explained under the next heading). 4. Once a complaint is admitted by the District Forum, it shall not be transferred to any other court or tribunal set up under any other law. Note: The above provisions of Section 12 and the rules made thereunder regarding the fee payable for making complaints shall also be applicable the disposal of disputes by the State Commission and National Commission as per Section 18 and Section 22(1) respectively. 27.9.4 Procedure to be followed on Admission of a Complaint (Sec. 13) The procedure to be followed by the District Forum on admission of a complaint can be discussed under the following two heads: I. Where laboratory test is required to determine the defects in goods. II. Where no laboratory test is required to determine the defects in goods or the complaint relates to services. I. Where laboratory test is required to determine the defects in goods. The procedure to be followed is as follows: (a) The District Forum shall refer a copy of the admitted complaint, within 21 days from the data of its admission, to the opposite party directing him to give his version of the case within a period of 30 days which can be extended by a period upto 15 days. (b) Where the opposite party, on receipt of the complaint referred to him, admits the allegation, the District Forum shall decide the matter on the basis of merits of the case and documents before it. (c) Where the opposite party, on receipt of a complaint referred to him, denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Forum, the District Forum would take the following steps to settle this dispute: (i) The District Forum may require the complainant to deposit specified fee for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question. (ii) The District Forum will obtain a sample of the goods from the complainant, seal it, authenticate it and refer the sample so sealed to the appropriate laboratory for an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect and to report its findings thereon to the District Forum within a period of 45 days of the receipt of the reference or within such extend period as may be granted by the District Forum.

(iii) The District Forum will remit the fees to the appropriate laboratory to enable it to carry out required analysis or test. (iv) Upon receiving the laboratory's report, its copy will be forwarded by the District Forum to the opposite party alongwith its own remarks. (v) In the event of any party disputing the correctness of the findings, or the methods of analysis or test adopted by the appropriate laboratory, the District Forum shall require the objecting party to submit his objections in writing. (vi) The District Forum will give a reasonable opportunity of being heard to the objecting party. (d) The District Forum shall issue an appropriate order under Section 14 after hearing the parties. II. Where no laboratory test is required to determine the defects in goods or the complaint relates to services. In such a case the following procedure is followed: (

a) The District Forum shall
refer a copy of the admitted complaint, within 21 days from the date of its admission,
to
the opposite party directing him to give his version of the case within
a period of 30 days
which can be extended by a period not exceeding 15 days. (b) The opposite party on receipt of
the complaint referred to him may: (i) admit the allegation, or (ii) deny
or dispute
the allegations contained in the complaint, or (iii) omit or fail to respond within the time given by the District Forum. (
c)(i) Where the opposite party admits the allegation,
the District Forum shall decide the matter on the basis of the merits of the case. (ii)
Where the opposite party denies or disputes the allegations made in the complaint,
the
District Forum will proceed to settle the dispute on the basis of evidence brought to its notice by both the
parties. (iii) Where the opposite party
omits
or fails to respond within the time given by the District Forum,
the Forum will proceed to settle the dispute
ex-parte on the basis of evidence brought to its notice by the
complainant. (d) The
District Forum shall issue an appropriate order, under Section 14, after hearing the parties and taking into account
available evidence. (e)
Where the complainant fails to appear on the date of hearing before the District Forum, the Forum may either dismiss
the complaint for default or decide it on merits.
Time limit for disposal of complaint [Sec. 13(3A)].
Every complaint
shall be heard
as expeditiously as possible and endeavour shall be made to decide the complaint
within
a period of 3 months from the date of
receipt of notice
by opposite party
where the complaint does not require analysis or testing of commodities and within 5 months if it requires analysis or
testing of commodities.
In the event of a complaint being disposed of after the period specified above, the
District Forum shall record in writing the reasons for the same.
Power to pass interim order [Sec. 13(3B)].
Where during the pendency of any proceeding before the District Forum, it appears to it necessary, it may pass such
interim order as is just and proper in the facts and circumstances of the case.
Note:
The above provisions of Section 13 regarding procedure to be followed by the District Forum on admission of a
complaint shall also
be applicable to the disposal of disputes by the State Commission
and National Commission as per Section 18 and Section 22(1) respectively.
Consumer Protection Act, 1986 340 Self-Instructional Material NOTES 27.10
STATE COMMISSION After the District Forum, State Commission is next in the hierarcy of Consumer Disputes Redressal
Agencies under the Act. 27.10.1
Composition
of the State Commission Section 16 contains the provisions regarding the composition of
the
State Commission. These are: 1.
Each State Commission shall consists of: (
a)
a person who
is or has been a judge of a High Court,
appointed by the State Government, who shall be its president.
But no such appointment

shall be made except
after consultation with the Chief Justice of the High Court; (
b) at least two other members or
such higher number
of members as may be prescribed,
one of whom shall be a women,
who
shall have the following qualifications, namely: (
i) be
not less than 35 years of age; (ii) possess a bachelor's degree from a recognised university;
and (
iii)
be persons of ability, integrity and standing, and have adequate knowledge and experience of at least 10 years in dealing with
problems relating to economics, law, commerce, accountancy, industry,
public affairs or administration:
Provided that not more than 50 per cent of the members shall be from amongst persons having a judicial background.
Explanation. For the purposes of this clause,
the expression "persons having judicial background" shall mean persons having knowledge and
experience for at least a period of 10 years as a presiding officer at the district level court or any tribunal at equivalent level.
Disqualifications.
A person shall be disqualified for appointment as member if: (
a) he has been convicted and sentenced to imprisonment for an offence
involving moral turpitude; or (b) he is an undischarged insolvent; or (c)
he
has been adjudged to be of unsound mind;
or (d) he
has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government;
or (e)
he
has,
in the opinion of the State Government,
such financial or other interest, as is likely to affect prejudicially
the discharge by him of his functions as a member;
or (f) he has such other disqualifications as may be prescribed by the State Government.
Appointing authority [Sec. 16(1-A)]. The provisions as to the process of appointment of the President and members of the State Commission are similar to those discussed in the context of appointment of the President and members of the District Forum. Refer preceding centre heading "District Forum" for details. Benches [Sec. 16(1-B)].
The jurisdiction, powers and authority of the State Commission may be exercised by Benches thereof. A Bench may be constituted by the President with one or more members as the President
may deem fit.
If the members of
a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the members are equally divided,
they shall state the point or points on which they differ,
and make a reference to the President who shall either
Consumer Protection Act, 1986 Self-Instructional Material 341 NOTES
hear the point(s) himself or refer the case for hearing on such point(s) by one or more or the other members and such point(s) shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it.
Terms
and conditions of service [Sec. 16(2)].
The salary or honorarium and other
allowances payable to, and the
other

terms
and conditions of service of the members of the State Commission shall be such as may be prescribed
by the State Government.
Provided that the appointment of a member on whole-time basis
shall be made by the State Government on the recommendation of the President of the State
Commission
taking into consideration such factors as may be prescribed
including the work load
of
the
State Commission.
Term of office [Sec. 16(3)].
Every
member of the State Commission shall hold office for a term of 5 years or
up to the age of 67
years, whichever is earlier.
However, he shall be eligible for re-appointment
subject to similar conditions as stated here-in-before.
Further, a person appointed as President of the State Commission shall also be eligible for re-appointment. 27.10.2
Jurisdiction of the State Commission Pecuniary
jurisdiction [Sec. 17(1)].
The State Commission shall have jurisdiction to
entertain complaints where the value of goods or services
and compensation, if any, claimed exceeds Rs. 20 lakhs but does not exceed
Rs.
one crore.
It may be recalled that the decisive factor regarding pecuniary jurisdiction is the value of claim. Thus the State Commission entertains cases where the value of claim is more than Rs. 20 lakhs but is upto Rs. one crore. Territorial jurisdiction [Sec. 17(2)].
A suit can
be instituted in the State Commission within the local
limits
of whose jurisdiction: (a)
the opposite party or
each
of the opposite parties, where there are more than one,
at the time of the institution of
the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain;
or (
b)
any of the opposite parties, where there are more than one,
at the time of the institution of
the complaint,
actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain,
provided
the
other parties not so residing or working agrees or the State Commission gives permission in this regard;
or (c) the cause of action, wholly or in part, arises.
Appellate jurisdiction [Sec. 17(1) (a) (ii)].
The State Commission has power to entertain the
appeals
against the orders of any District Forum within the State,
within 30 days from the date of service of the order to the appellant. Revisional jurisdiction [Sec. 17(1) (b)].
The State Commission has power
to
call for the
records and pass appropriate orders in any consumer dispute which is pending before or has been decided by

any District Forum within the State,
where
State Commission is of the view that the District Forum: (i) has exercised
a
jurisdiction/power which it was not entitled to, or (ii) has failed to exercise
a power which was vested in it, or (iii)
has exercised its authority illegally or with material irregularity. Such revisional power may be exercised by the
State
Commission either on its own or on the application of a party.
Procedure to be followed by the State Commission. As observed earlier, the provisions of Section 13 regarding procedure to be followed by the District Forum, which have Check Your Progress 4. Explain the term 'restrictive trade practice'. 5. Explain the objects of the Central Council.
Consumer Protection Act, 1986 342 Self-Instructional Material NOTES already been discussed, shall
be applicable also to the disposal of disputes by the State Commission
as per Section 18. 27.11
NATIONAL COMMISSION The National Commission is the top most layer in the three level hierarchy of the Consumer Disputes Redressal Agencies. 27.11.1 Composition of the National Commission Section 20 elaborates upon the composition of National Commission. It provides that: 1.
The National Commission
shall consist
of: (a)
a person who is or has been a judge of the Supreme Court,
to be
appointed by the
Central
Government, who shall be its President.
But no such appointment shall be made except after consultation with the Chief Justice of India; (
b) at least four other members or such higher
number of members as may be prescribed, and one of whom shall be a woman.
The provisions as to the qualifications and disqualifications of the members of National Commission are similar to those discussed under the preceding Centre heading: "State Commission". Appointing authority.
The appointment of members of the National Commission is
made
by the Central Government on the recommendation of a Selection Committee consisting of
the
following: (i)
a person who is
a judge of the Supreme Court, to be nominated by the
Chief Justice of India — Chairman. (ii) the secretary in the Department of Legal Affairs in the Government of India — Member. (iii)
Secretary of the
Department dealing with consumer affairs in the Government of India —
Member.
Benches [Sec. 20(1
A)].
The jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof. A Bench may be constituted by the President with one or more members as the President
may deem fit.
Term of office [Sec. 20(3)].
Every
member of the
National Commission shall hold office for a term of 5 years or
up to the age of 70
years, whichever is earlier.
However, he shall be eligible for re-appointment
subject to similar conditions as stated here-in-before.
Further, a person appointed as President of the National Commission shall also be eligible for re-appointment. 27.11.2

Jurisdiction of National Commission Pecuniary jurisdiction [Sec. 21(a) (i)].
The National Commission shall have jurisdiction to entertain complaints where the value of goods or services and compensation, if any, claimed exceeds
Rs. one crore.
Since National Commission
is the highest level of Consumer Forums, it entertains all the cases where the value of claim is more than Rs. one crore.
Territorial jurisdiction. The territorial jurisdiction of the National Commission is
the
whole of India except the State of Jammu and Kashmir.
Consumer Protection Act, 1986
Self-Instructional Material 343 NOTES Appellate jurisdiction [Sec. 21(a) (ii)].
The National Commission has jurisdiction to entertain appeals against the order of any State Commission, within 30 days from the date of service of the order to the appellant. Revisional jurisdiction [Sec. 21(b)].
The National Commission
has power
to
call for the
records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any
State Commission, where it
is of the view that the State Commission: (i) has exercised
a jurisdiction/power not vested in it by law, or (ii) has failed to exercise a power which was vested in it, or (iii) has exercised its authority illegally or with material irregularity. Such revisional power may be exercised by the National Commission either on its own or on the petition of a party. 27.11.3 Procedure to be followed by the National Commission Rule 14 of the Consumer Protection Rules, 1987, as amended by the Consumer Protection (Amendment) Rules, 2004, lays down the procedure, which is as follows: 1. A complaint containing the following particulars shall be presented by the complainant in person or by his agent to the National Commission or be sent by registered post: (a) the name, description and address of the complainant; (b) the name, description and address of the opposite party or parties, as the case may be, so far as they can be ascertained; (c) the facts relating to complaint and when and where it arose; (d) documents in support of the allegations contained in the complaint; (e) the relief which complainant claims. 2. Every complaint filed with the National Commission shall be accompanied by the relevant fee as is specified in Rule 9A of the Consumer Protection Rules, 1987. For details refer to the Side Heading: “Manner in which complaint shall be made to the District Forum” (given before). 3. The National Commission shall, in disposal of any complaint before it, as far as possible, follow the procedure as laid down in Section 13 in relation to the complaints received by the District Forum (discussed already under the Side-Heading: “Procedure to be followed on Admission of a Complaint”). Section 22(1) also provides to the same effect. 4. On the date of hearing, it shall be obligatory on the parties or their agents to appear before the National Commission. Where the complainant or his agent fails to appear, the National Commission
may either dismiss the complaint for default or decide it on merits.
Where the opposite party or its agent
fails to appear on the date of hearing, the National Commission may decide the complaint ex-parte. 5. The complaint shall be decided, as far as possible,
within a period of three months from the date of
notice received by
the
opposite party where complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities.
In the event of a complaint being disposed of after the period specified above, the National Commission shall record in writing the reasons for the
delay. 6. After the proceedings, the National Commission shall issue an appropriate order under Section 14. It shall also have the power to direct that any order passed by it, where no appeal has been preferred under Section 23, be published in the Official Gazette or through any other media.
Consumer Protection Act, 1986 344 Self-Instructional Material NOTES 27.12 POWERS OF THE CONSUMER FORUMS For the purpose of adjudicating a consumer dispute, Section 13(4) has vested the Consumer Forums, namely,
District Forum, State Commission and National Commission, with certain powers of a civil court.

Apart from these powers, the Central Government has provided some additional powers to them under Rule 10 of the Consumer Protection Rules, 1987. Finally Section 14(1) has given them the power to issue orders. Powers similar to those of civil court [Sec. 13(4)]. The Consumer Forums
are vested with the powers of
a civil court,
while trying a suit, in respect of the following matters: (i) summoning and enforcing
the
attendance of any defendant or witness and examining the witness on oath; (ii) discovery and production of any document or other material object producible as evidence; (iii) receiving of evidence on affidavits; (iv) requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source; (v) issuing of any commission for the examination of any witness;
and (vi) any other matter which may be prescribed.
Sub-section (5) of Section 13 further provides that every proceeding before
the District Forum,
the State Commission or the National Commission, as the case may be,
shall
be deemed to be a judicial
proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code (
punishment for false evidence and intentional insult or interruption to publich servant sitting in judical proceeding) and the Forums shall be deemed to be civil courts for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (
prosecution for contempt and provisions as to offences affecting the administration of justice). Additional powers of the consumer forums (Rule 10 of the Consumer Protection Rules, 1987). The National Commission, the State Commission and the District Forum have the following additional powers: (a) Requiring production of any books, accounts, documents, or commodities from any person and getting them examined by an officer specified in this behalf. (b) Obtaining information required for the purpose of the proceedings from any person. (c) Authorising any officer to enter and search any premises and seize from premises such books, papers, documents and commodities as are required for the purpose of proceedings under the Act. (d) On examination of such seized documents or commodities, ordering the retention thereof or returning them to the party concerned. Power to issue order [Sec. 14(1)]. If, after the proceeding conducted under Section 13 (explained earlier),
the National Commission,
the State Commission or the District Forum,
as the case may be,
is satisfied that the
goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things: (a) to remove the defect pointed out by the appropriate laboratory from the goods in question; (
b) to replace the goods with new goods of similar description which shall be free from any defect;
Consumer Protection Act, 1986 Self-Instructional Material 345 NOTES (
c)
to return to the complainant the price, or, as the case may be, the charges paid by the
complainant; (d) to pay such amount as may be awarded by it as
compensation to the consumer
for any loss or injury suffered
by the consumer due to the negligence of the opposite party.
The Consumer Protection (Amendment) Act, 2002 has further empowered these Forums to grant punitive damages in such circumstances as it deems fit; (
e) to remove
the defects in goods or
deficiencies in the services in question; (f) to discontinue the unfair trade practice or the restrictive trade practice or not to repeat it; (
g) not to offer
the hazardous goods for sale; (h) to withdraw the
hazardous goods from being offered for
sale; (i) to cease manufacture of hazardous goods and to desist from offering services
which are hazardous in nature; 22 (

j) to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently, provided that
the minimum amount of sum so payable shall not be less than 5% of the value of such defective goods sold or service provided, as the case may be, to such consumers, and the amount so obtained shall be credited in favour of such person and utilized in such manner as may be prescribed; 23 (
k) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement; 24 (l) to provide for adequate costs to parties. Sub-section (2) of Section 14 provides that every proceeding is required to
be conducted by the President of the Forum and at least one member thereof sitting together.
Where the member, for any reason, is unable to conduct the proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member. Sub-section (2A) of Section 14 provides that every order made under this Section shall be signed by the President and the member or members who conducted the proceedings. 27.12.1 Special Powers of State Commission Through Consumer Protection (Amendment) Act, 2002 two new provisions have been added for conferring additional powers on the State Commission in the interest of justice. These provisions are as follows: 1. Transfer of cases (Sec. 17A). On the application of the complainant or of its own motion, the State Commission may, at any stage of proceeding, transfer any complaint pending before the District Forum to another District Forum within the state if the interest of justice so requires. It may thus be noticed that the State Commission has been given the power to transfer cases from one District Forum to another, that too at any stage of proceeding. The transfer of case can be ordered either on the application of the complainant or on its own motion. However, the defendant cannot move for transfer of case. 2. Circuit Benches (Sec. 17B). The State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government 22 Inserted by the Consumer Protection (Amendment) Act, 2002. 23 Ibid. 24 Ibid. Consumer Protection Act, 1986 346 Self-Instructional Material NOTES may, in consultation
with the State Commission, notify in the Official Gazette, from time to time. 27.12.2
Special Powers of National Commission The National Commission too has been conferred additional powers by the Consumer Protection (Amendment) Act, 2002 which are as follows: 1. Power to set aside ex-parte orders (Sec. 22A). Where an order is passed by the National Commission ex-parte against the opposite party or a complainant, as the case may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice. It may be observed that the insertion of this new Section will obviously lessen the number of appeals from going to the Supreme Court from the orders of the National Commission. 2. Transfer of cases (Sec. 22B). On the application of the complainant or on its own motion, the National Commission may, at any stage of proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one State to a District Forum of another State or before one State Commission to another State Commission. 3. Circuit Benches (Sec. 22C). The National Commission shall ordinarily function at New Delhi and perform its functions
at such other place as the Central Government may, in consultation
with the
National Commission, notify in the Official Gazette, from time to time. 4.
Power to make regulations (Sec. 30A). The National Commission
may, with the previous approval of the Central Government, by notification,
make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act. In particular,
such regulations may make provisions for the cost of adjournment of any proceeding
before
the District Forum,
the State Commission or the National Commission, as the case may be,
which a
party may be ordered to pay. Enforcement of Orders of the Consumer Forums (Sec. 25). Regarding the enforcement of orders of the District Forum, State Commission or the National Commission, Section 25 provides as follows: 1.
Where an interim order made under this Act is not complied with,
the District Forum or
the State Commission or the National Commission, as the case may be,
may order the property of the person not complying with such order to be attached. 2. No attachment made under sub-section (1) (stated above) shall remain in force for more than 3 months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof,
the District Forum or the State Commission or the National Commission may
award such damages as it thinks fit to the complainant and shall pay

the
balance, if any, to the party entitled thereto. 3. Where any amount is due from any person under an order made by a District Forum,
State Commission or the National Commission, as the case may be,
the
person entitled to the amount may make an application to the concerned Forum
and such Forum
may
issue a certificate for the said amount to the Collector of the District and the Collector shall proceed
to recover the amount in the same manner as arrears of land
revenue. 27.12.3
Appeals Against Orders of the Forums 1. Appellate power
of the State Commission (Sec. 15).
Any person aggrieved by an order made by the District Forum
may prefer an appeal against such order
to
the State Commission
within a period of 30
days from the date of the order
or within such extended time as
the Commission may
allow
if
it is satisfied that there was sufficient cause for not
Check Your Progress 6. Describe the procedure to be followed by the 'District Forum' on admission of a complaint. 7. Describe the jurisdiction of District forums, state Commission and national Commission 8. Discuss the powers of the consumer forums.

filing it within that period. However,
no appeal by a person, who is required to pay any amount
in terms
of an order of the District Forum, shall be entertained unless
the appellant has deposited fifty percent of that amount
or Rs. 25,000, whichever is less. It
is worth noting here that High Court is not a statutory appellate authority under the provisions of the Consumer Protection Act, 1986. 2. Appellate power
of the
National Commission (Sec. 19).
Any person aggrieved by an order made by the State Commission
may prefer an appeal against such order
to the National Commission within a period of 30
days from the date of the order.
The National Commission
may, however,
entertain
an
appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause
for
not
filing
it within that period.
But
no appeal by a person, who is required to pay any amount
in terms
of an order of the State Commission, shall be entertained unless the appellant has deposited fifty per cent of that amount or Rs. 35,000, whichever is less. Hearing of appeal (Sec. 19A) 25 .
An appeal filed before the State Commission or the National Commission

shall be heard as expeditiously as possible and an
endeavour shall be made to
finally dispose
of the appeal within a period of 90 days from the date of
its admission. 3.
Appeal to the Supreme Court (Sec. 23).
Any person aggrieved by an order made by the National Commission
may prefer an appeal
against such order
to the Supreme Court
within a period of 30 days from the date
of the order
or within such time as the
Supreme Court
allows.
However,
no appeal by a person, who is required to pay any amount
in terms
of an order of the National Commission, shall be entertained unless the appellant has deposited fifty per cent of that amount
or Rs. 50,000, whichever is less. 27.12.4 Administrative Control Section 24B gives power to the National Commission to exercise administrative control over all the State Commissions. It also empowers the State Commissions to exercise administrative control overall the District Fora within their respective jurisdiction. Vacancies or Defects in Appointment not to invalidate Orders (Sec. 29A). No act or proceeding
of the District Forum, the State Commission or the National Commission
shall be invalid by reason only of the existence of any vacancy amongst its members or any defect in the constitution thereof.
Dismissal of Frivolous or Vexatious Complaints (Sec. 26). Where a complaint instituted before
the District Forum, the State Commission or, as the case may be,
the National Commission, is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, dismiss the complaint and make an order that the complainant shall pay to the opposite party such cost, not exceeding Rs. 10,000, as may be specified in the order. 27.12.5 Penalties
Section 27 provides as follows: 1.
Where a trader or a person against whom a complaint is made
or
the complainant fails or omits to comply with any order made by the District Forum,
the State Commission or the National Commission, as the case may be,
such trader or person or complainant
shall be punishable with
imprisonment for
a term
which shall not be less than one month but
which may extend
to
three years,
or with
fine ranging between Rs. 2,000 and Rs. 10,000, or with both. 25 Inserted by the Consumer Protection (Amendment) Act, 2002.
Consumer Protection Act, 1986 348 Self-Instructional Material NOTES 2.
The District Forum or
the State Commission or the National Commission, as the case may be,
shall
have the power of a Judicial Magistrate of the First Class for the trial of offences under this Act, and on such conferment of powers,
they
shall be deemed to be a Judicial Magistrate of the First Class for the purpose of the Code of Criminal Procedure, 1973. 3.
All offences under this Act may be tried summarily by

the District Forum or
the State Commission or the National Commission, as the case may be. 27.13
TEST QUESTIONS 1. Explain the objectives of Consumer Protection Act, 1986. 2. Define the following terms as used in the Consumer Protection Act, 1986: (a) Consumer (b) Service (c) Deficiency (d) Manufacturer (e) Trader 3. Discuss the grounds on which a complaint can be made under the Consumer Protection Act, 1986. Who
can file a complaint? Explain. Describe the time frame within which a complaint can be filed
before the consumer disputes redressal agencies as provided under the Consumer Protection Act, 1986. 4. Explain the terms "Unfair Trade Practice", and "Restrictive Trade Practice" as defined under the Consumer Protection Act, 1986. 5. Discuss the various rights of consumers recognised under the Consumer Protection Act, 1986 which
are to be promoted and protected by the Consumer Protection Councils. 6. Explain the composition and
jurisdiction of District Forums. 7. Who can file a complaint to the District Forum? Explain. State the fee payable for every complaint filed with a District Forum. Discuss the procedure to be adopted by the District Forum on admission of a complaint. 8. Explain the composition and jurisdiction of the State Commission. 9. Discuss the composition and jurisdiction of the National Commission. 10. Discuss the procedure to be adopted by the National Commission on admission of a complaint. 11. Discuss the powers of the Consumer Forums, namely, District Forum, State Commission and National Commission, under the Consumer Protection Act, 1986. 12. State the provisions of the Consumer Protection Act, 1986 relating to 'enforcement of orders of the Consumer Forums' and 'appeals against the orders of the Forums'.
General Provisions Regarding Arbitration Self-Instructional Material 349 NOTES UNIT 28 GENERAL PROVISIONS REGARDING ARBITRATION Structure 28.0 Introduction 28.1 Unit Objectives 28.2 Types of Arbitration 28.3 Arbitration Defined 28.4 Arbitration Agreement 28.5 Test Questions 28.6 Practical Problems 28.0 INTRODUCTION The law relating to arbitration is contained in the Arbitration and Conciliation Act, 1996 1 . The Act has been brought into force with effect from the 25th January, 1996. The Act repeals the Arbitration Act, 1940 which mainly governed
the law relating to arbitration earlier. The Act extends to the whole of India.
But Part I dealing with 'Arbitrations conducted in India', Part III dealing with 'Conciliation' and Part IV dealing with supplementary provisions of this Act
extend to the State of Jammu and Kashmir only in so far as they relate to 'international commercial arbitration' or, as the case may be, 'international commercial conciliation'.
The new Act is broadly based on the Model Law on Arbitration adopted by the United Nations Commission on International Trade Law (UNCITRAL) which represents the internationally accepted modern concept of arbitration. It consolidates
and amends the law relating to 'domestic arbitration', 'international commercial arbitration' and
provides for the enforcement of 'foreign awards' (i.e., those given by arbitral tribunals outside India). It also introduces the law relating to 'Conciliation'. The new law has brought about major changes in the Indian Arbitration Law to attract foreign investors by creating circumstances so that they may have confidence in the system of commercial disputes resolution and enforcement of foreign award in India. This has been done by removing obstacles in the commercial dispute resolution machinery outside the court and attempting to create environment whereby court interference is minimised. For example, unlike the previous law, now an arbitral award need not be filed in a Court of Law to obtain a decree, from the Court in terms of the award, for enforcement and it is directly enforceable, upon expiry of the time given to challenge the award (Sec. 36). Besides, Arbitrator's powers are increased and the grounds for challenging the Award are made more specific than under the previous law. Further, the new law, for the first time in India, provides a detailed statutory framework for the conduct of independent 'conciliation' proceedings outside the court as a machinery of "Alternative Dispute Resolution" (ADR) as well. The term "Alternative Dispute Resolution" (ADR) means alternative to litigation, and hence it includes both 'arbitration' and 'Conciliation'. However, sometimes it is taken to mean alternative to the imposed decision processes of litigation and arbitration and hence it excludes arbitration. The 'International Centre for Alternative Dispute Resolution' (ICADR), Delhi, 1 The references to Sections, unless otherwise specifically stated, are references to Sections of the Arbitra- tion and Conciliation Act, 1996. The word 'Act' wherever used means the Arbitration and Conciliation Act, 1996.
General Provisions Regarding Arbitration 350 Self-Instructional Material NOTES is a unique centre which provides ADR services to disputing parties not only in India but also to parties all over the world. It maintains panels of trained mediators and arbitrators to help resolve the disputes outside of court. A significant form of ADR that has evolved in India is Lok Adalats. So far the system of Lok Adalats has been ad hoc and need based. With the amendment effected in 2002 in the Legal Services Authorities Act, 1987, permanent Lok Adalats are being set up all over the country to adjudicate cases relating to public utility services upto the value of Rs. 10 lakhs. 28.1 UNIT OBJECTIVES ? Understand the concept of arbitration ? Be aware of the various essentials of a valid arbitration agreement ? Understand
the capacity of various persons to submit disputes to arbitration ?

Know the matters that can and can't be referred to arbitration 28.2 TYPES OF ARBITRATION The Arbitration and Conciliation Act, 1996, broadly classifies arbitrations as follows: 1. Foreign arbitration. This arbitration takes place outside India, i.e., where arbitral award is delivered in a foreign country by foreign arbitrators under foreign laws and in which a foreign country is involved. The arbitral award delivered in a foreign arbitration is called a "foreign award". The Part II of the new Act contains special provisions with regard to the "Enforcement of Certain Foreign Awards". 2. Arbitration conducted in India. It is an arbitration in which arbitral award is delivered in India. Part I of the Act deals with such arbitrations. 'Arbitrations conducted in India' are further classified into: (a) International commercial arbitration. It is an arbitration in which one of the parties is either a foreign national or a non-resident or body corporate which is either incorporated or controlled in any foreign country or the Government of a foreign country [Sec. 2(l)(f)]. This may also be referred to as 'International Arbitration'. (b) Domestic arbitration. All other arbitrations except referred to in subclause (a) above fall under this category. 3. Ad hoc arbitration. It is an arbitration in which the parties agree for arbitration themselves and appoint an arbitrator or arbitrators of their own choice. Arbitration proceedings under such arbitration are conducted
as per the provisions of the Arbitration and Conciliation Act
which lack comprehensive rules of procedure. As a result in ad hoc arbitrations the parties may have to rush to court repeatedly to get orders even on ordinary procedural matters. For example, the Act does not contain any criterion for scales of fees to be paid to the arbitrators, and if there is any dispute between the parties and the arbitrators in this regard, it has to be settled by the Court. 4. Institutional arbitration. 'An institutional arbitration is one in which reference is made to a tribunal or arbitration of various trade associations, such as Chamber of Commerce or other bodies having machinery for adjudication of disputes by arbitration and rules framed for the Same'. 2 Arbitration proceedings under such arbitration are conducted under the Rules laid down by an established arbitral organisation. Such Rules are meant to supplement 2 Chowdhary S.K. Roy and Saharay H.K., "Law of Arbitration and Conciliation", Fourth Edition, 1996, p. 240. General Provisions Regarding Arbitration Self-Instructional Material 351 NOTES provisions of the Arbitration and Conciliation Act in matters of procedure. The Indian Council of Arbitration, New Delhi, and the Federation of Indian Chambers of Commerce and Industry (FICCI), New Delhi are among the most important arbitral institutions in India. The role of Arbitral Institutions has for the first time been recognised in the new law. Section 6 provides that
the parties, or the arbitral tribunal with the consent of the parties, may arrange for
the administrative assistance of a suitable arbitral institution.
Section 11 contains provisions relating to the appointment of arbitrators. The Section, inter alia, provides that when the parties are not in a position to agree on a procedure for appointment of arbitrators, the Chief Justice of India in case of an 'international commercial arbitration', and the Chief Justice of the State High Court in case of a 'domestic arbitration' would appoint the arbitrator. The Chief Justice may nominate a person by name or ex-officio or an institution which is specialising in the field of arbitration to act as arbitrator. It is hoped that specialised institutions will be entrusted with this function. 28.3 ARBITRATION DEFINED An arbitration may be defined 'as the settlement of disputes and differences relating to civil matters (e.g., money or property or breach of contract) between one party and another in a judicial manner, by the decision of one or more persons, called arbitrators, appointed by the contending parties, without having recourse to a court of law'. The essence of arbitration, therefore, is that it is the arbitrator(s) who decides the case out of court, though court may have to intervene to regulate arbitration proceedings. The practice of referring matters to a Panch or settling disputes by arbitration has always been a widely used method of deciding many a dispute in our country. The corresponding words for 'arbitrator' and 'arbitration', i.e., Panch and Panchayat are probably as old as Indian history. The word Panchayat suggests a proceeding before a specified number of persons (generally five persons), who act as the sole and final judges of the matter referred to them by the opposing parties for decision. The method of settling disputes through abritration possesses certain merits as compared to a suit in a regular court of law. It is less costly. It saves time and irritation arising from delays in court proceedings. It is much more simple in procedure. Moreover, the 'award' of the arbitrator is final and binding upon the parties
in the same manner as if it were a decree
of the court.
Hence, commercial contracts frequently contain an 'arbitration clause' providing for a reference to arbitration in case of any dispute relating to the contract. 28.4
ARBITRATION AGREEMENT Section 7 defines 'arbitration agreement' as "
an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship whether contractual or not."
Section 7 further provides that— 1.
An
arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement. 2.
It must be in writing.
It shall be presumed to be

in writing if it is contained in: (
a) a document signed by the parties, (b) an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or
Check Your Progress 1. How will you define the term arbitration. 2. What do you understand by foreign arbitration? 3. Distinguish between ad hoc and institutional arbitration.
General Provisions Regarding Arbitration 352 Self-Instructional Material NOTES (
c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other
party. 3. A document containing an arbitration clause
may be adopted by making a reference to it in a contract in writing so
as to make that arbitration clause part of the contract. 28.4.1
Essential of A Valid Arbitration Agreement The essentials of a valid and binding arbitration agreement are as follows: 1. The agreement must be in writing. To be valid, the terms of an arbitration agreement must be expressed in writing. It is, however, not necessary that the agreement must be contained in a formal document executed by both the parties thereto, nor is it required to be signed by both of them (Banarsi Das vs Cane Commissioner 3). The agreement may be gathered from several documents, or even be inferred from correspondence between the parties. What is required is that the terms of the arbitration agreement must be reduced in writing and it must be established that the parties agreed to the settlement of disputes by arbitration. Thus, if an arbitration clause is included in an indent, and goods are supplied in pursuance of the indent, and even the bills prepared by the seller are with reference to the indent, there would be an arbitration agreement in existence between the parties (Shalimar Paints vs Omprakash Singhania 4) 2. The agreement should be to refer either a present or future dispute to arbitration. The existence of a dispute or difference is essential to the validity of a reference to arbitration. A dispute implies an assertion of right by one party and repudiation thereof by another. If the agreement was entered into with respect to future differences, no reference to arbitration can be made until such differences have arisen and unless they are still subsisting. If there is no dispute, the arbitration agreement will not operate. Mere refusal to pay is not a dispute (Inder Smgh Rekhi vs D.D.A. 5). Thus, where a demand is made by a creditor on a debtor to pay the amount due and the debtor while admitting his liability requests for extending the time for payment, there is no dispute which may be referred to arbitration and the creditor would be entitled to file a suit in the court for his money, though the transaction out of which the debt arose contains an 'arbitration clause' (Rai & Sons vs Poysha Industries 6). Therefore, the arbitration clause is not in a sense an integral part of the contract. A contract with an arbitration clause, rolls, as it were, two contracts into one. It is worth noting that inspite of a dispute concerning a contract containing an arbitration clause, the parties are not bound to have recourse to arbitration. They may settle the dispute directly and agree not to invoke the arbitration clause for that purpose. They may also enter into a substituted agreement in complete supersession of the original contract and thereby abrogate the contract and the arbitration clause contained in it (Union of India vs Kishori Lal 7). 3. It is not necessary that an arbitrator should be named in the arbitration agreement. The name of person or persons who will act as arbitrator may be fixed after entering into the agreement of arbitration. But when fixed they should be fixed definitely. An arbitration agreement to refer to either X or Y is bad for uncertainty. An arbitration agreement usually includes a provision for the mode of appointment of arbitrator(s). If the above conditions are satisfied, the arbitration contract is valid and it is immaterial whether or not the terms 'arbitration' or 'arbitrator' have been used in it. Of course, besides the above essentials, an arbitration agreement must have all the essential elements 3 AIR, (1963), S.C. 1417. 4 AIR, (1967), Cal. 372. 5 AIR, (1988), S. C. 10. 6 AIR, (1972), A.P. 302. 7 AIR, (1953), Cal. 642.
General Provisions Regarding Arbitration Self-Instructional Material 353 NOTES of a valid contract. For example, the parties must be ad-idem on the question of reference of their own free will, the parties must be competent to contract, the terms must be definite and certain, the matter to be referred to arbitration must not be immoral, illegal or opposed to public policy. Thus, where all the parties interested in the matter of dispute have not consented to the arbitration clause or agreement, such an agreement is invalid and the 'award' will not bind even the consenting panics. Similarly, where the arbitration clause provided that in case of a dispute the same can be settled by a reference, it was held that it was not an agreement to submit disputes to arbitration for it lacked certainty as the words used do not indicate a determination to go to arbitration but a mere possibility (Jyoti Brothers vs Durga Mining Co. 8). Again, where there is an arbitration clause in a contract which is avoided on the ground of fraud or misrepresentation, the arbitration clause remains operative (State of Bombay vs Adamjee 9). 28.4.2 Effect of an Arbitration Agreement With a view to promoting the sanctity of contracts, the court ordinarily requires the parties to an arbitration contract to resort, for resolving disputes covered under the contract, to the tribunal contemplated by them at the time of the contract. Thus, if a party to an arbitration agreement disregards the agreement and files a suit in a court of law with respect to the subject matter of such agreement, the other party to the agreement has a right to file an application for staying the suit so as to enable arbitration to proceed in terms of the agreement. Section 8 of the Arbitration and Conciliation Act provides as follows in this regard: 1.

A judicial authority before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than when his first statement on the substance of the dispute is submitted, refer the parties to arbitration. 2.
The application referred to above
shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof. 3. Notwithstanding that
such an application (as referred above)
has been made and that
the issue is pending before the judicial authority, an arbitration may be commenced or continued and an arbitral award made.
Thus, Section 8 empowers the court to make a stay order, if the following conditions are satisfied: (i) There must be a valid arbitration agreement in existence. (ii) The suit must have been filed by a party to the arbitration agreement against another party to the agreement. (iii) The subject-matter of the suit in question must be within the scope of the arbitration agreement. (iv) The applicant for stay must be a party to the legal proceeding and he must have taken no steps in connection with the defence against the suit (e.g., filing the written statement) after appearance. It will thus be observed that mere existence of an arbitration agreement is no bar to a suit in a court of law. But if all the above mentioned conditions are satisfied, the court in which the suit is filed may stay the proceeding by making a stay order, so as to force the parties to abide by the arbitration agreement. It may be noted that the jurisdiction of the Court is confined to the District Court or (where the High Court has ordinary original jurisdiction) to the High Court. No inferior Court shall have jurisdiction in matters arising under the Arbitration and Conciliation Act, 1996 [Sec. 2 (1)(e)]. 8 AIR, (1956), Cal. 280. 9 AIR, (1951), Cal. 147.
General Provisions Regarding Arbitration 354 Self-Instructional Material NOTES 28.4.3 Who Can Refer Disputes to Arbitration? As a general rule, capacity to submit disputes to arbitration is coextensive with capacity to contract. Thus, only those who have a general legal capacity to contract and also possess such power in relation to the subject-matter of the 'submission' or arbitration agreement as will enable them to carry into effect any order which could be legally laid upon them by the 'award' can refer
disputes to arbitration. The capacity of various persons to submit disputes to arbitration is as follows: 1. A minor or lunatic is not competent to enter into a contract and therefore there cannot be a valid submission to arbitration by him. But the natural or legal guardian of a minor or lunatic can refer disputes to arbitration on his behalf, provided he acts in good faith and for the benefit of the minor or lunatic. (A de-facto guardian can do so only with the leave of the court). 2. In the case of a partnership, a partner may enter into an arbitration agreement on behalf of the partnership, only if he is so authorised in writing by the other partners or in the partnership agreement itself. 3. A joint stock company can refer disputes to arbitration, subject to the restrictions, if any, contained in its Memorandum of Association or Articles of Association. 4. The Karta of a joint Hindu family, acting bonafide, may enter into an arbitration agreement on behalf of the family so as to bind other coparceners. 5. An agent cannot refer disputes to arbitration unless specially authorised by the principal. 6. An attorney or a solicitor engaged in a case has no implied authority to refer the dispute to arbitration unless he is specially authorised for that purpose in writing by the terms of his vakalatnama. 7. An Official Assignee or a Receiver can make a valid submission with the permission of the court, but the insolvent cannot as he is incapable of dealing with his property. 8. Under Section 43 of the Indian Trusts Act, a trustee has the power to submit disputes to arbitration unless a contrary intention is expressed in the instrument of trust. The death of any party to an arbitration agreement will not affect the agreement, it will continue to be enforceable by or against his legal representatives except in such cases where the right of action is extinguished by his death, e.g., where the cause of action is based on tort and the wrongdoer dies before the 'award' is made, it will not be binding on the heirs of the deceased party. Where the right to sue or be sued survives and is not extinguished by the death of a party, his heirs shall continue to be bound by the arbitration agreement. But if a party dies during arbitration proceedings (i.e., before the hearing has been concluded), his legal representatives must be brought or record or given notice of the proceedings, otherwise they cannot be made bound by those proceedings. 28.4.4 What may be Referred to Arbitration? Section 2(3) of the new Arbitration and Conciliation Act provides that the provisions in Part I (which apply to arbitration which takes place in India)
shall not affect
any other law for the time being in force by
virtue of which certain disputes may not be submitted to arbitration.
Thus, generally speaking, all matters in dispute which can be decided by a civil court, with a few exceptions given below, may be referred to arbitration. Disputes relating to matters which are purely criminal in nature cannot be referred to arbitration because if such disputes are allowed to be referred to arbitration, the resultant arbitration agreement shall be in the nature of 'an agreement stifling criminal prosecution' which is void under Section 23 of the Indian Contract Act as its object is unlawful. Check Your Progress 4. Describe the essential elements of a valid arbitra- tion agreement. 5. Describe the cases which cannot be referred to arbitration.

General Provisions Regarding Arbitration Self-Instructional Material 355 NOTES What can be referred ? The following matters can be validly referred to arbitration: 1. Matters of a civil nature, e.g., disputes about property or money, disputes about the amount of damages payable for breach of contract, questions of law. 2. Matters relating to personal rights between the parties, e.g., a question of validity of marriage or maintenance payable to wife, terms of separation between husband and wife. 3. Disputes regarding dignity and respect. 4. Time-barred claims. What can't be Referred ? The following matters cannot be referred to arbitration: 1. Disputes relating to matrimonial relations like a suit for divorce or restitution of conjugal rights. 2. Testamentary matters, e.g., the question of genuineness or otherwise of a 'will'. 3. Insolvency matters, i.e., adjudging a person as an insolvent. 4. Questions relating to public charities or
charitable trusts. 5. Matters relating to the guardianship of a minor or a lunatic. 6.
Criminal matters and disputes. Disputes relating to matters specified above affect public at large and therefore must be decided by a court of law. 28.5 TEST QUESTIONS 1. Define the term arbitration. What is an arbitration agreement ? Discuss the requisites of a valid arbitration agreement. Is it necessary to name an arbitrator in the arbitration agreement? 2. Discuss the essential elements of an arbitration agreement. What is the effect of an arbitration agreement ? 3. Who may refer disputes to arbitration? What matters can and what matters cannot be referred to arbitration? 28.6 PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A,
B and C carry on partnership business. A dispute about partnership accounts is referred to arbitration by A and B. Is the reference competent? [Hint. As all the parties interested in the matter of dispute are not ad-idem on the question of reference, the reference is invalid and the 'award' will not bind even the consenting parties.] 2. X was robbed of his watch by Y. X institutes a suit against Y for robbery. Later, on persuation of a common friend both X and Y agree to refer the matter to arbitration and X promises to drop the prosecution. Is the arbitration agreement valid? [Hint. No, the arbitration agreement is void, because robbery is a criminal matter and as such cannot be the subject of arbitration.]
MODULE - 8
Arbitral Tribunal Self-Instructional Material 359 NOTES UNIT 29 ARBITRAL TRIBUNAL Structure 29.0 Introduction 29.1 Unit Objectives 29.2

Test Questions 29.10 Practical Problems 29.0 INTRODUCTION Arbitration is a legal technique for the resolution of disputes outside the courts, wherein the parties to a dispute refer it to one or more persons—the 'arbitrators', 'arbiters' or 'arbitral tribunal'— by whose decision or 'award' they agree to be bound. It is a settlement technique in which a third party reviews the case and imposes a decision that is legally binding for both sides. An arbitrator is defined as a private, neutral person who is
chosen to arbitrate a disagreement, as opposed to a court of law.
He or she can be used for settling any non- criminal dispute. This unit deals with the provisions for the appointment, removal, jurisdiction and duties of an arbitrator. 29.1 UNIT OBJECTIVES ? Know about arbitrator and his qualifications. ? Understand the provisions of law relating to appointment of arbitrators. ? ?now the powers and duties of arbitrators. 29.2 ARBITRATOR A person who is appointed by the parties themselves by their mutual consent to act as a judge to decide their dispute out of court is called
an 'arbitrator'. The person who is so appointed must also give his consent to act as an arbitrator.
The powers and duties of the arbitrator will be governed by the arbitration agreement provided the same are not contrary to any provision of law. Some of the powers and duties are also prescribed by law and judicial decisions. Who may be Appointed ? Law does not prescribe any qualifications for an arbitrator. It is open to the parties to appoint any person who is of age and of sound mind as an arbitrator. They may choose an incompetent or unfit person to be an arbitrator, for every person is at liberty to choose one whom he likes best to be his judge. Corporate bodies and association of persons may be appointed arbitrators. Even a person interested in the subject matter of dispute or in one or more of the parties (being a relation or friend) may be appointed an arbitrator provided his interest is well known to the parties before they sign the submission. Section 12 provides that the arbitrator before accepting his appointment shall disclose in writing to the parties
Arbitral Tribunal 360 Self-Instructional Material NOTES such matters as are
likely to give rise to justifiable doubts about his independence or impartiality.

Subsequent acquisition of interest or concealed interest in the subject matter of the reference disqualifies an arbitrator from continuing with the proceedings (Blanchard vs Sun Fire Office 1). Similarly, undisclosed relationship of an arbitrator to one of the parties will affect the validity of an award (Trustees of the Firm of Motharam Dowlatram vs Firm of Mayadas Dowlatram 2). Parties should be very careful in the matter of appointment of arbitrators, for if the original appointment is bad, the award would be null and void. Normally such persons who are impartial and in whom the parties have complete confidence must be selected to act as arbitrators. 29.3 APPOINTMENT OF ARBITRATORS The Act gives
the parties the freedom to fix the number of arbitrators, provided that such number shall not be an even number.
If they fail to determine

Sec. 10) Section 11 contains provisions regarding the appointment of arbitrators. It provides as under: 1.
A person of any nationality may be an arbitrator, unless otherwise agreed by the parties. 2. The parties are free to agree on a procedure for
appointment of an arbitrator or arbitrators. Generally, the parties to the dispute select the arbitrator or arbitrators by mutual consent. The name of person or persons who will act as arbitrators) may or may not be mentioned in the agreement. If either of the appointed arbitrators neglects or refuses to act, or is incapable of acting, or dies, the parties may, by mutual consent, appoint a new arbitrator in his place. The parties to an arbitration agreement may also agree to the appointment of arbitrator or arbitrators by some third party designated in the agreement either by name or by office. For example, the parties may agree that the arbitrator or arbitrators shall be appointed by Mr A or Messrs C.D. or by the Delhi Stock Exchange or by the Principal, Shri Ram College of Commerce, Delhi. Alternatively, the procedure for appointment may provide that each party to the dispute shall nominate one or more arbitrators and all such persons shall jointly act as arbitrators. In such a case if either of the appointed arbitrators neglects or refuses to act, or is incapable of acting, or dies, the party who appointed him may appoint a new arbitrator in his place. 3. If the parties fail to agree on a procedure for appointment of an arbitrator or arbitrators, the following procedure shall apply: (
a)
In an arbitration with three arbitrators, each party shall appoint one arbitrator,
and
the two appointed arbitrators shall appoint the third arbitrator who shall act as the presiding arbitrator.
It may be noted that the presiding arbitrator has not been given any special power and he acts as arbitrator as any other arbitrator: (b) If
a party fails to appoint an arbitrator within 30 days from the receipt of a request to do so from the other party; or if the two appointed arbitrators fail to agree on the third arbitrator within 30 days from the date of their appointment, the appointment shall be made, upon request of a party, by the
Chief Justice or any person or institution designated by him. (
c)
In an arbitration with a sole arbitrator, if the parties fail to agree on the arbitrator within 30 days from receipt of a request by one party from the other party to so agree, the appointment shall be made,
upon request of a party, by the Chief Justice or any person or institution designated by him. 1 6,
T.L.R. 365. 2 ATR, (1925), Sindh. 150.
Arbitral Tribunal Self-Instructional Material 361 NOTES 4.
Where, under
an appointment procedure agreed upon by the parties— (i) a party fails to act as required
under the
procedure; or (ii)
the parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or (iii) a person, including an institution, fails to perform any function entrusted to him or it under that procedure,
a party
may request the Chief Justice or any person or institution designated by him to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.
The decision of the Chief Justice or the person or institution designated by him
is final in all matters referred above. However, the Chief Justice or his designate,
in appointing an arbitrator, shall have due regard to the qualifications of arbitrators agreed between
the parties and other considerations as are likely to secure the appointment of an independent and impartial arbitrator. 5.
In the case of appointment of sole arbitrator or third arbitrator in an international commercial arbitration, the

Chief Justice of India or the person or
institution designated by him may appoint an arbitrator of a nationality other than nationalities of the parties, where the parties belong to different nationalities. 6.
Where more than one request has been made under the above provisions
to the Chief Justice of
different High Courts or their designates, the Chief Justice or his designate to whom the request has been first made shall alone be competent to decide on the request. 7.
The reference to "Chief Justice" in all matters referred above shall be construed as a reference to the "Chief Justice of India" in case of international commercial arbitrations, and to the "Chief Justice of State High Court" in case of domestic arbitrations. Grounds for challenging the appointment (Sec. 12) The appointment of an arbitrator may be challenged by a party to the reference
only if: (a) circumstances exist that give rise to justifiable doubts as to his independence or impartiality, or (b) he does not possess the qualifications agreed to by the parties. A party may challenge
the appointment of an arbitrator
only for reasons of which he becomes aware after the appointment has been made.
Procedure for
challenge (Sec. 13).
The parties are free to agree on a procedure for challenging
the appointment of an arbitrator. In absence of any such agreement, a party to the reference
who intends to challenge an arbitrator shall, within 15 days after becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstances
giving
rise to justifiable doubts as to his independence or impartiality,
send
a written statement of the reasons for the challenge to the Arbitral Tribunal.
The
tribunal shall decide on the challenge unless (a) the arbitrator under challenge resign of his own, or (b) the other party agrees to the withdrawal of the arbitrator under challenge. Where a challenge
is not successful, the arbitral tribunal shall continue the arbitral proceedings and make an arbitral award. If an arbitral award is made, the party challenging the arbitrator may make an application
to the Court
for setting aside such an award in accordance with Section 34. Where
the
arbitral
award is set aside, the court may decide as to whether the arbitrator who is challenged is entitled to any fees. 29.4

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EFFECT OF DEATH OR INSOLVENCY OF A PARTY TO ARBITRATION

An arbitration agreement shall not be discharged by the death of any party thereto, either as respects the deceased or as respects any other party, but shall in such event
be enforceable
Check Your Progress 1. What do you understand by the arbitral tribunal? 2. Explain various provisions regarding appointment of arbitrators. 3.
An arbitration agreement shall not be discharged by the death of any party.
Elucidate.
Arbitral Tribunal 362 Self-Instructional Material NOTES
by or against the legal representative of the deceased. Further, the authority of an arbitrator shall not be revoked by the death of any party by whom he was appointed. (
Sec. 40)
An arbitration agreement shall not be discharged by the insolvency of any party thereto.
It shall be binding on the Official Assignee or Receiver, if he elects to adopt the contract 3 . (Sec. 41) 29.5 REMOVAL OF ARBITRATOR As per Section 14 (1), the mandate or authority of an arbitrator can be terminated,
if he becomes de jure or de facto unable to perform his duties, or fails to act without undue delay
due to some other reasons. The authority or mandate is also terminated if the arbitrator resigns of
his own or the parties agree to the termination of his mandate. In case a controversy

arises about an arbitrator's inability to perform his duties or occurrence of undue delay, the matter may be referred to the Court [Sec. 14 (2)]. Substitution of arbitrator (Sec. 15).
Where the mandate of an arbitrator terminates, a substitute arbitrator shall be appointed according to the rules that were applicable to the appointment of the arbitrator being replaced.
In the absence of any agreement between the parties, where an arbitrator
has been replaced, he may hold hearings afresh or may start from the point left by the previous arbitrator. Further, unless otherwise agreed,
an order or ruling of the arbitral tribunal made prior to the replacement of an arbitrator shall not be invalid merely because there has been a change in the composition of the arbitral tribunal. 29.6
JURISDICTION OF ARBITRAL TRIBUNALS Section 16 empowers the arbitral tribunal to rule on its own jurisdiction like a court. It can also decide
any objection with regard to the existence or validity of the arbitration agreement.
In deciding these questions, the arbitral tribunal shall take into account the following factors: (
a) an arbitration clause which forms part of a contract will be treated as an agreement independent of the other terms of the contract, and (b) a decision by the arbitral tribunal that the contract is null and void will not entail ipso jure the invalidity of the arbitration clause. The plea that the arbitral tribunal does not have any jurisdiction can be raised not later than the submission of the statement of defence. A party may, however, raise such a plea even if he has appointed, or participated in the appointment of, an arbitrator.
Similarly, a plea
may be raised
that the arbitral tribunal is exceeding the scope of its authority
during the course of arbitral
proceedings. The arbitral tribunal may, in either of the aforestated cases, admit a
later plea if it considers the delay justified.
Where the arbitral tribunal takes a decision rejecting the plea, the arbitral tribunal shall continue with the arbitral proceedings and make an arbitral award. A party aggrieved by such an award may make an application
to the court for setting aside such an award in accordance with Section 34. 29.7 POWERS OF ARBITRATORS The arbitration agreement may define the rights, powers and duties of the arbitrators), provided the same are not contrary to any provision of law. Some of the powers and duties are also prescribed by law and judicial decisions. Stated briefly, the arbitrators shall, unless a contrary intention is expressed in the arbitration agreement, have the following powers: 3
Under Section 62 (1) of the Presidency Towns Insolvency Act, the Official Assignee has the right to disclaim onerous or unprofitable contracts.
Arbitral Tribunal Self-Instructional Material 363 NOTES (i) To administer oath to the parties and witnesses appearing before him. (ii) To refer matters of law or the award for the opinion of the court. (iii) To correct in the award any clerical mistake or error arising from any accidental slip or omission. (iv) To put necessary interrogatories to any party to the arbitration. Besides the above powers, an arbitrator has also the following powers, unless otherwise agreed: (a) To award interest upto the date of the award. (b) To determine by and to whom the costs of reference and the award shall be paid. (c) To allow payment by instalments. (d) To make an interim award. (e) To order for the specific performance of the contract. (f) To appoint experts for his guidance on questions of a scientific or technical nature. 29.8 DUTIES OF ARBITRATOR The more important duties of arbitrators are as follows: (i) To enter into the reference
with all reasonable dispatch and make an award within the prescribed time. (
ii) To act impartially, as he holds a quasi-judicial position. An arbitrator should never consider himself to be the advocate of the cause of the party appointing him. (iii) To observe the rules of evidence based on principles of natural justice. Thus, an arbitrator cannot rely upon evidence which is not binding on one of the parties, such as a previous statement recorded in his absence (Mulk Rai vs Hem Raj 4). Both parties must be given a hearing after proper notice to them stating the date, time and place of hearing. An arbitrator ought not to hear or receive evidence from one side in the absence of the other side, without giving the other side affected by such evidence an opportunity of meeting and cross-examining the witness. Of course, the arbitrator is entitled to proceed ex-parte if it is clear that the party to whom reasonable notice has been given does not appear or if there is clear indication that he has no intention of appearing. (iv) Not to
misconduct himself or the proceedings in any way, e.g., by accepting bride from a party or by

absenting from meetings of arbitrators. (v) To act within the scope of his authority as expressed in the arbitration agreement. (vi) To disclose to the parties before accepting the work of arbitration, if he has any interest in the subject-matter of dispute or in any party to the dispute. (vii) Not to delegate his authority to somebody else. He must perform all functions personally except those of ministerial character. (viii) Not to make use of his personal knowledge unless authorised to do so. (ix) To be present at every meeting of arbitrators in case there are any. Even where the parties agree that the award of the majority of arbitrators would prevail, it is essential that all the arbitrators must be present at all the meetings and at every stage of the proceedings. Absence of any of the arbitrators from a part of the hearing would 4 AIR, (1974), JK 40. Check Your Progress 4. Describe duties of arbitrator. 5. George and Abraham appointed Newton, a person of 16 years, as their arbitrator to settle a dispute. Explain whether the appointment of Newton is valid or not.
Arbitral Tribunal 364 Self-Instructional Material NOTES vitiate the judicial character of the proceeding (Badrilal vs Lakshya 5). But where the reference explicitly provides that in the event of some of the arbitrators being absent, the arbitration should be continued by the remaining arbitrators, the award made by them is a valid award (Situ Rum vs Shanti Lal 6). (x) To give a final award on all matters referred to him. To sign the award and make it available to the parties to the arbitration agreement within a reasonable time. 29.9 TEST QUESTIONS 1. Who may be appointed an arbitrator? State the provisions of law relating to the appointment of arbitrators. 2. Discuss the powers and duties of an arbitrator. 29.10 PRACTICAL PROBLEMS Attempt the following problems, giving reasons for your answers: 1. A
dispute arose between P and Q regarding possession of certain goods. They agreed to get this matter settled through arbitration and appointed R as an arbitrator, R proposed that the matter be decided by draw of lots. P wins the draw and claims the possession of the goods. Q challenges the award. Will he succeed? [Hint. Yes, Q will succeed and the court will set aside the award because a valid award must be the result of judicial decision.] 2. A and B appointed M, a person of 17 years, as their arbitrator to settle a dispute. Is the appointment of M valid ? [Hint. The appointment of M, who is a minor, as arbitrator is invalid, since an arbitrator must be a person who is of age and of sound mind.] 3. An arbitrator sends notice by registered post to parties to appear before him on a certain date. One of the parties fails to appear. The arbitrator records the evidence of the other party in his absence and gives an award. Examine the validity of the award. [Hint. The award is valid and binding upon the parties, for although the arbitrator has recorded the evidence of one party in the absence of another party but the other party affected by such evidence has been given a proper notice to enable him to cross examine the opponent.] 4. An arbitrator dines with one of the parties to the reference in the absence of the other. Can this be treated as misconduct on the part of the arbitrator ? [Hint. Dining with one of the parties in the absence of the other does not amount to 'misconduct' of the arbitrator unless it is proved that the intention of the party was to corrupt or influence the arbitrator.] 5. Some matters in dispute between A and B were referred to arbitration of three named persons. The arbitrators held five meetings but one of the arbitrators could not be present at the two meetings. The arbitrators give their award by majority vote. Is the award valid ? [Hint. It is the duty of every arbitrator to be present at all the meetings and at every stage of proceedings. Absence of any of the arbitrator from a part of the hearing would vitiate the judicial character of the proceedings (Badrilal vs Lakshya, AIR., 1936, Nag. 29). The award, in the instant case, is therefore invalid.] 5 AIR, (1936), Nag. 29. 6 (1952), VP. 26.
Arbitration Proceedings Self-Instructional Material 365 NOTES UNIT 30 ARBITRATION PROCEEDINGS Structure 30.0 Introduction 30.1 Unit Objectives 30.2

Test Questions 30.0 INTRODUCTION The term arbitral tribunal is used to denote the arbitrator or arbitrators sitting to determine the dispute. The composition of the arbitral tribunal can vary enormously, with either a sole arbitrator sitting, two or more arbitrators, with or without a chairman or umpire, and various other combinations. In most jurisdictions, an arbitrator enjoys immunity from liability for anything done or omitted whilst acting as arbitrator unless the arbitrator acts in bad faith. The Indian Arbitration and Conciliation Act, 1996 applies to both domestic arbitration in India and to international arbitration. 30.1 UNIT OBJECTIVES ? Know the types of decisions to be made by the 'arbitral tribunal' ? Know the form and contents of 'arbitral award' 30.2 EQUAL TREATMENT OF PARTIES Section 18 lays down two obligations on the arbitral tribunal, namely, (a) to treat all the parties with equality, and (b) to give full opportunity to each party to present his case. The provisions of this Section lay down the basic features of natural justice and should be complied with during the entire arbitral proceedings. The first principle of arbitration procedure is to treat all the parties equally irrespective of colour, race or geographical barrier. Secondly, the arbitral tribunal must give full opportunity to each party to present documents, witnesses and arguments. The parties are entitled to avail the services of an advocate for presenting the case. 30.3 RULES OF PROCEDURE FOR ARBITRATION According to Section 19(1), the arbitral tribunal is neither bound by the Code of Civil Procedure, 1908, nor by the Indian Evidence Act, 1872. Thus, the arbitral tribunal is not bound to follow the procedure as followed by a court. However, the procedure adopted by arbitral tribunal should be according to the principles of natural justice and fail play.
Arbitration Proceedings 366 Self-Instructional Material NOTES Section 19 (2) provides that
the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting its proceedings, appointment of arbitrators, filing of pleadings, furnishing of oral and documentary evidence, hearing of parties and making of award. The rules of arbitral institutions usually deal with procedural matters in detail. Parties generally incorporate arbitration rules of a particular institution by reference to the same in the arbitration agreement. As per Section 19 (3), where parties fail
to decide on the procedure to be followed by the arbitral tribunal in conducting its proceedings,
the arbitral tribunal
can follow such procedure as it considers appropriate. 30.4 PLACE AND COMMENCEMENT
OF ARBITRATION Section 20 provides that parties are free to agree on the
place of arbitration.
Where the parties have not agreed
on the place of arbitration, the arbitral tribunal has to determine the place of arbitration having regard to the circumstances of the case, including the convenience of the parties.
The
place of arbitration is important because Section 31 (4) requires that
the 'award' shall state its date and the place of arbitration.
Unless otherwise agreed by the parties, the arbitral tribunal may meet at
any place (specific address) it considers appropriate for — (a) consultation among its members; (b)
hearing witnesses, experts or the parties; or (c) inspection of documents, goods or other property.
Applicable Law (Sec. 28). Where the place of arbitration is in India, the following rules apply on the law applicable to arbitration: (a)
In 'domestic
arbitration', the arbitral tribunal shall decide the dispute in accordance with the substantive law for the time being in force in India. (
b) In 'international commercial arbitration', the
parties have been given freedom to designate law applicable to the substance of the dispute and the arbitral tribunal may apply the provisions of law agreed by the parties.
Failing any designation of the law by the parties, the arbitral tribunal has to apply the rules of law which it considers appropriate, taking into account the circumstances surrounding the dispute,
as also the usages of trade applicable to the transaction. Section 21 gives freedom to the parties to agree on the date of commencement of arbitral proceedings. In the absence of an agreement between

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the parties, the arbitral proceedings in respect of a particular dispute

commence on the date on which
the respondent receives the request for referring the matter to arbitration. Language to be used in arbitral proceedings (Sec. 22). The parties are given the liberty

to agree upon the language or languages to be used in the arbitral proceedings. In the absence of any such agreement the arbitral tribunal shall determine the language or languages to be used in arbitral proceedings.
Generally, the
language of arbitration is English, it being an international language. The arbitral tribunal may ask for translation of any documentary evidence into the agreed language. 30.5 ARBITRATION PROCEDURE After the appointment of the arbitrator and the claimant serving a written notice to the respondent for referring the dispute to arbitration, parties usually exchange claims, counterclaims, rejoinders, documents, etc., on which they relied, according to the directions of the arbitrator.
Arbitration Proceedings Self-Instructional Material 367 NOTES The claimant files his 'statement of claim' before the arbitrator. The 'statement of claim' is nothing but a sort of plaint that one files in a suit, wherein one puts all of his allegations and claims and causes of the action
and
the prayers.
The person who makes the cram is called the Claimant and the person against whom the claim is made is called a Respondent. The arbitrator asks for a reply to the claim from the respondent. Upon receiving the reply it is quite possible that the claimant would want to add something further in reply to what the respondent has stated in his reply. This could be stated in a document which would be called a Rejoinder. Upon receiving the rejoinder, the respondent again might want to file something further in his reply to the rejoinder and this will be called Sur-Rejoinder. The claimant may, thereafter, be allowed to file his Sur-Rejoinder. Statements of claim and defence Section 23 makes detailed provisions as to
statements of claim and defence. It provides that: 1.
Within the period of time agreed upon by the parties or determined by the arbitral tribunal, the claimant shall state the facts supporting his claim, the points at issue and the relief sought. The respondent must then state his defence. 2.
The parties may submit with their statements all documents they consider to be relevant or may add a reference to the documents or other evidence they will submit. 3.
Unless otherwise agreed by the parties, either party may amend or supplement
the
claim or defence during the course of the arbitral proceedings.
Hearing and written proceedings Section 24 contains provisions for hearing and written submissions before the arbitral tribunal. It provides that: 1.
Unless otherwise agreed by the parties,
the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted on the basis of documents and other materials. 2.
The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purposes of inspection of documents, goods or other property. 3. All documents/statements/other information/ expert report received by the arbitral tribunal from one party must be communicated to the other parties. Effect of default of a party (Sec. 25)
Unless otherwise agreed by the parties, where, without showing sufficient cause, — (a) the claimant fails to file his statement of claim
within the predetermined time,
the arbitral tribunal shall terminate the proceedings; (b) the respondent fails to submit his statement of defence, the arbitral tribunal shall continue the proceedings
ex-parte; (c) a party fails to appear at the oral hearing or produce any documentary evidence in support of his statement, the arbitral tribunal may continue the proceedings ex-parte and make the arbitral award.
An arbitrator is authorised to proceed ex-parte, if one of the parties to the reference, after having been duly summoned, fails or neglect to attend before the arbitrator, and the arbitrator is of the opinion that the party is absenting intentionally to prevent justice. But an arbitrator should not proceed ex-parte if there is a reasonable excuse for non-attendance of a party (Juggilal Kamlapat vs Genral Fibre Dealers Ltd. 1). 1 AIR, (1995), Cal. 354. Check Your Progress 1. Explain the arbitration procedures. 2. What do you understand by arbitral award?
Arbitration Proceedings 368 Self-Instructional Material NOTES
Court assistance in taking evidence (Sec. 27) The arbitral tribunal, or a party (
to the arbitration agreement)
with the approval of the arbitral tribunal, may apply to, the court for assistance in taking evidence.
The
court, on hearing the application, may pass necessary order and issue summons to witness to appear directly before the arbitral tribunal. Where a witness fails to comply with the order or summon, it will amount to contempt of arbitral tribunal and he will be penalised or punished

by order of the court, on representation by the arbitral tribunal, as
if such default had been committed in suits tried before the court. Decision-making by the arbitral tribunal (Sec. 29)
There are two types of decisions to be made by the arbitral tribunal, namely, (a) Decision of the dispute.
Unless otherwise agreed by the parties, in arbitral proceedings with more than one arbitrator any decision of the arbitral tribunal
on merits of the dispute is to be made by a majority of all its members. (b) Decision on questions of procedure. If all the parties to the arbitration agreement
or all the members of the arbitral tribunal authorise, questions of procedure may be decided by the presiding arbitrator. In the absence of such authorisation by the parties or members of the tribunal, the decision on question of procedure is also to be made by majority of members of the arbitral tribunal. In case there is no majority decision, i.e., where all members have different opinion, it can be said that arbitral tribunal has failed to decide the dispute. For such a situation, no solution has been provided in the new Act. However, Section 32 (2) (c) provides that the arbitral tribunal shall issue an order for
termination of arbitration proceedings where the arbitral tribunal finds that continuation of the proceedings has for any reason become unnecessary or impossible.
Thus, where there is no majority, the arbitral tribunal may terminate the proceedings under this clause since continuation of the proceedings has become impos- sible. It may be noted that the presiding arbitrator has not been given any special power and he acts as arbitrator as any other arbitrator. All arbitrators have been given equal power irrespective of mode of appointment. 30.6 ARBITRAL AWARD A judgement or final decision of an arbitrator or arbitrators on all matters referred to arbi- tration is called the 'arbitral award' or 'award'. The document containing the decision of the arbitrators) is also called 'award'. No particular form or word is requisite for the validity of an award. Of course, an award must be the result of judicial decision and not arrived at by drawing lots or in some similar way. If it is the result of an absolute discretion exercised by a person, it cannot, by very nature of things, be an award (V.C. Gandhi vs T.C. Munshaw 2). The arbitral award is required to be made on stamp paper of prescribed value (as applicable at the place of making the award) (Darshan Singh vs Forward India Finance Pvt. Ltd. 3). If an award is insufficiently stamped or not stamped at all, it is not admissible in evidence. On payment of duty and penalty it becomes admissible in evidence (I. Srinivas vs I. Vekanta Rao 4). The party seeking his claim on the instrument will not be defeated on the ground of initial defect in the instrument (Hindustan Steel Ltd. vs Dilip Construction 5). An award 2 AIR, (1954). Born. 121. 3 AIR, (1984), Del. 140. 4 AIR, (1963). AP. 193. 5 AIR, (1969). SC.1238.
Arbitration Proceedings Self-Instructional Material 369 NOTES must also be compulsorily registered under the Transfer of Property Act if it deals with immovable property of the value of Rs 100 or above (Sher Bahadur vs Ram Narain 6) Further, an award must be as final and certain as possible. If it is vague, it will be bad for uncertainty and, if it leaves undecided any important point, it is bad for want of finality. The authority of arbitrators ceases as soon as an award is made, and no action of the parties by way of consent or otherwise would give the arbitrators authority to make a second award [Sec. 32(1)]. The new Act does not lay down any time limit for making the award. However, Section 14 provides that an arbitrator can be removed if he is guilty of undue delay. The earlier Act provided four months time limit for making the award unless extended by the parties. 30.7 FORM AND CONTENTS OF ARBITRAL AWARD Section 31 lays down the requirements of
the form and contents of arbitral award as follows: 1. An arbitral award shall be made in writing.
An oral decision is not an award under the law. 2. The award
shall be signed by the members
of the arbitral tribunal. Where there are more than one arbitrator, the signatures of the majority of all the
members shall be sufficient provided that the reason for any omitted signature is stated. 3. The award must state the reasons upon which it is based.
In other words the arbitral tribunal must give a speaking award or reasoned award setting out the reasons which led the arbitrator to arrive at the conclusions upon the questions or issues that arise in the arbitration proceedings. However, there are two exceptions where award without reasons is valid. These exceptions are: (a) Where the arbitration agreement expressly provides
that no reasons are to be given, or (b) Where the award
has been made under Section 30 of the new Act, i.e., where the parties settled the dispute themselves and requested the arbitral tribunal to record the settlement in the form of an 'award' and accordingly the tribunal gives the award in terms of the settlement. 4. The arbitrator may make an 'interim award' on any matter on which Final award may be made. An interim award remains in force till the final award is made. 5.
The arbitral award shall state its date and the place of arbitration as determined in accordance with Section 20 and the award shall be deemed to have been made at that place.
Place of arbitration is important for the determination of rules of law applicable to arbitration, and recourse against the award. 6.

Unless otherwise agreed by the parties, where the award is for the payment of money, the arbitral tribunal may include in the sum for which award is made interest, at such rate as
it deems reasonable, upto the
date of award and also a direction regarding future interest. Unless the award otherwise directs, the awarded sum shall carry
interest at the rate of 18 per cent per annum from the date of
the award to the date of payment. 7.
After the award is made, a signed copy should be delivered to each party
for appropriate action like implementation or recourse against arbitral award.
Finality and enforcement of awards.
An arbitral award shall be final and binding on the parties and persons claiming under them (
Sec. 35). Unlike the Arbitration Act, 1940, under the new Act arbitral awards are directly enforceable, without confirmation by the court,
in the same manner as if it were a decree
of the court,
upon expiry of the time given to challenge the award under Section 34 or upon court's refusal to set aside the award (Sec. 36). Check Your Progress 3. Describe the types of decisions made by arbitral tribunal? 4. What are the grounds on which an 'award' may be set-aside by the Court? 6 AIR, (1945). Avadh. 1.
Arbitration Proceedings 370 Self-Instructional Material NOTES 30.8 COSTS OF ARBITRATION AND DEPOSITS Section 31 (8) provides that
unless otherwise agreed by the parties, the costs of an arbitration shall be fixed by the arbitral tribunal.
The tribunal shall specify (i) the party entitled to costs, (ii) the party who shall pay the costs, (iii) the amount of costs or method of determining that amount, and (iv) the manner in which the costs shall be paid. The term 'costs' means reasonable costs relating to (a)
the fees and expenses of the arbitrators and witnesses, (b) legal fees and expenses, (c) any administration fees of the institution supervising the arbitration, and (d) any other expenses incurred in connection with the arbitral proceedings and the arbitral award.
Section 38 provides that
the arbitral tribunal may fix provisionally the amount of deposit as an advance for the 'costs'
of arbitration and may ask the parties to pay the amount of deposit in equal shares in advance. Where a
party fails to pay his share of the deposit, the other party may pay that share. But where the other party also does not pay the aforesaid share, the arbitral tribunal may suspend or terminate the arbitral proceedings.
Upon termination of the arbitral proceedings, the tribunal shall render accounts to the parties of the deposits received and shall return any unexpended balance to the party or parties, as the case may be.
Section 39 provides that
the tribunal shall have a lien on the arbitral award for any unpaid costs of the arbitration.
Where a tribunal refuses to deliver its award except on payment of costs demanded by it,
a party may make a petition to the court for deciding the reasonable sum of costs of arbitration. 30.9 CORRECTION AND INTERPRETATION OF AWARD Section 33 provides that the award may be corrected by the arbitral tribunal on application made to it
within 30 days from the receipt of the award. For that purpose,
a party, with notice to the other party, may request the tribunal to correct (i) any computation errors, (ii) any clerical or typographical errors, or (iii) any other errors of similar nature occurring in the award. Further, if so agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to give an interpretation of a specific point or part of the award.
Such request may also be made within 30 days from the receipt of the award. The aforestated period of 30 days may be extended by mutual agreement
of the parties.
If the tribunal finds that the request is justified, it shall make the correction or give the interpretation within 30 days from the receipt of the request and the interpretation shall be treated as part of the award. Besides, the arbitral tribunal
of its own initiative may correct any error
within 30 days from the date of the award. However,
the tribunal may extend, if necessary, the period of
time within which it shall make a correction give an interpretation
of arbitral award. 30.10 ADDITIONAL AWARD Section 33(4) (5) and (6) provides that
unless otherwise agreed by the parties, a party, with notice to the other party, may request the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the arbitral award.

Such request may be made within 30 days from the receipt of
the arbitral award. If the tribunal considers the request to be justified, it shall make the additional award within 60 days from the receipt of such request. The tribunal may extend the period of
time
for such purpose, if necessary.
Arbitration Proceedings Self-Instructional Material 371 NOTES Setting Aside of an Award (Sec. 34) An aggrieved party may apply to the court, within three months 7 of receipt of the arbitral award, for setting aside the award. The grounds on which the award may be challenged before the Court are as follows: 1. Incapacity of a party. 2. Invalidity of the arbitration agreement. 3.
The party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case. 4. The award deals with dispute not
referred
to arbitration. But
if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside. 5. The composition of the arbitral
tribunal
was defective
or the arbitral procedure was not in accordance with the agreement of the parties. 6.
The subject matter of the dispute is not capable of settlement by arbitration under the law for the time being in force. 7. The arbitral award is in conflict with the public policy.
Explanation to subsection (2) (b) provides
that an award would be in conflict with public policy if it is induced or affected by fraud or corruption or
violates Section 75 or Section 81 of the Act relating to confidentiality and admissibility of evidence in other proceedings.
Appeals (Sec. 37) An appeal shall lie to the competent court of appeals from the following orders only (and from no others): (a) An order granting or refusing to grant any measure under Section 9. (b) An order
setting aside or refusing to set aside on arbitral award under Section 34. An appeal shall also lie to a court from
the following orders of the arbitral tribunal: (a) An order accepting the plea that the arbitral tribunal does not have jurisdiction or
that the arbitral tribunal is exceeding the scope of its authority
under subsections (2) and (3)
of Section 16. (b)
An order granting or refusing to grant an interim measure under Section 17. No second appeal shall lie from an order passed in
an appeal under this Section. But the right to appeal to the Supreme Court is not barred. The Supreme Court may in its discretion grant special leave to appeal where the needs of justice demand an interference by the highest court of the land. 30.11 TEST QUESTIONS 1. Explain the provisions of the Arbitration and Conciliation Act, 1996 relating to arbitration procedure. 2. What do you mean by an 'arbitral award'? Discuss the form and contents of an 'arbitral award'. Is an arbitral award enforceable without the sanction of the court? 3. Discuss the grounds on which an 'award' may be set-aside by the Court. 7 Provison to sub-section (3) of Section 34 empowers the court to extend this period by 30 days on justified grounds.

Conciliation Self-Instructional Material 373 NOTES UNIT 31 CONCILIATION Structure 31.0 Introduction 31.1 Unit Objectives 31.2 Procedure for Conciliation 31.3 Confidentiality 31.4 Deposits 31.5 Test Question 31.0 INTRODUCTION For the first time the Arbitration and Conciliation Act, 1996 has added the concept of 'Conciliation', it is based on the Conciliation Rules adopted by UNCITRAL (United Nations Commission on International Trade Law) in 1980. Sections 61 to 81 make express provisions for the conduct of independent conciliation proceedings outside the court for settlement of disputes. Conciliation or Mediation is an informal process in which the conciliator or mediator (the third party) tries to bring the disputants to agreement, by lowering tensions, improving communications, interpreting issues and exploring potential solutions, so that they can discuss their dispute and come to a negotiated settlement. The conciliator makes no deci- sions and does not impose his view of what a fair settlement should be. Hence there is no 'award' as such from the conciliator, whereas in case of arbitrator, after hearing the argu- ments of both the parties the arbitrator gives the 'award'. A conciliator does not engage in any formal hearing, though he may informally consult the parties separately or together. Thus, unlike an arbitrator, a conciliator is not a judge, but only a facilitator. The conciliator derives authority from the parties. In discharge of his duties, he is to be guided by the principles of objectivity, fairness and justice. His main function is to induce the parties to come to a settlement themselves. Out of the two processes, namely, 'conciliation' and 'arbitration', conciliation is preferable because it is quicker, less expensive, less stressful, more private and the parties retain much more control over the outcome than arbitration because they, the parties, ultimately make the decision. Conciliation can be resorted to in relation to disputes arising out of a legal relationship, whether contractual or not, provided the parties have chosen to refer their dispute
to conciliation (Sec. 61). Commencement of Conciliation Proceedings (Sec. 62) The party initiating conciliation must send a written invitation to
the other party to concili- ate a particular dispute between them. Conciliation proceedings are deemed to commence when the other party accepts in writing the invitation to conciliate. If the other party
does not accept the invitation, then there will be no conciliation proceedings. If the party initiat- ing conciliation does not receive a reply within 30 days from the date on which he sends the invitation, or within such other period of time as specified in the invitation, he may elect to treat this as a rejection of the invitation to conciliate and if he so elects, he must inform in writing the other party accordingly. Number of Conciliators
and their Appointment (Secs. 63 and 64) 1. There will be only one conciliator, unless the parties agree to have two or three concili- ators. In any event, the maximum number of conciliators is three.
Conciliation 374 Self-Instructional Material NOTES (2) Where there is more than one conciliator, then as a rule, they ought to act jointly. (3) In case there is only one conciliator, then
the parties may agree upon his name. (4) In case there are
two conciliators, each party may appoint one conciliator. (5) In case there are three conciliators, each party may appoint one, and the parties may agree on the name of the third conciliator, who shall act as presiding conciliator.
Institutional assistance. In each of the above cases, the parties may either appoint a conciliator on their own or they may enlist the services of any institution or person to assist them in the matter of appointment of a conciliator. The institution or person may be requested to recommend or to directly appoint the conciliator or conciliators. In recommending or appointing a sole or third conciliator, the institution or person
shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.
It may be noted that in conciliation proceedings,
the term "conciliator" applies
to a sole conciliator, two or three conciliators as the case may be. 31.1
UNIT OBJECTIVES ? Understand the concept of conciliation ? Know the procedure for conciliation ? Know the circumstances under which conciliation proceedings may be terminated 31.2 PROCEDURE FOR CONCILIATION
Sections 65 to 73 contain provisions relating to the procedure for conciliation. There provisions may briefly be stated as follows: 1.
The conciliator, upon his appointment, may request each party to submit to him a brief written statement describing the general nature of the dispute and the points at issue. Each
party shall send a copy of such statement to the other party. If necessary, the parties may be asked to submit further written statement of his position and the facts and grounds in support thereof, supplemented by any documents and other evidence. Copy of such statement, document and other evidence
is to be given to the other party. 2.
The conciliator shall assist the parties in an 'independent and impartial manner' in their attempt to reach an amicable settlement of
the dispute. The conciliator is to be guided by the

principles of 'objectivity, fairness and justice', giving consideration to: (a) rights and obligations of the parties; (b) trade usages; and (c) circumstances surrounding the dispute, including any previous business practices between the parties. 3. The conciliator may conduct the conciliation proceedings in such a manner as he
con- siders appropriate. He may, at any stage of the conciliation proceedings, propose a settle- ment of the dispute, even orally, and without stating
the reasons for the proposal. 4.
In order to facilitate the conduct of the conciliation proceedings, the parties, or the conciliator with the consent of the parties, may arrange for administrative assistance by a suitable institution or person. 5. The conciliator may invite the parties to meet him
for discussion. Similarly, he
may communicate with them orally or in writing. He may meet or communicate with the parties together or with each of them separately.
Conciliation Self-Instructional Material 375 NOTES 6. The parties to the conciliation may decide the place of meeting. However, if they do not do so then the conciliator may decide the meeting place in consultation with the parties. 7. When the conciliator receives factual information concerning the dispute from a party,
he
is required to
disclose the substance of that information to the other party, so that the other party may
present his explanation if he so desires. But information given on the condition of confidentiality cannot be so disclosed. 8. The parties must in good faith cooperate with the conciliator. They must supply the needed written material, provide evidence and attend meetings when called by the concili- ator. Further,
each party may, on his own initiative or at the invitation of the conciliator, submit to the conciliator suggestions for the settlement of the dispute. 9.
If the conciliator feels
that there exist "elements of a settlement which may be acceptable to the parties",
then
he shall formulate the terms of a possible settlement and submit
the same to the parties for their observation. On receipt of
the observations of the parties, the conciliator may reformulate the terms of a possible settlement in the light of such observa- tions and again submit the same to the parties. 10. If ultimately a settlement is reached, then the parties may draw and sign a written settlement agreement. The parties
may also take the help of the conciliator in drawing up the same. The settlement agreement is to be authenticated by the conciliator. Such a 'settle- ment agreement' shall be final and binding on
the parties.
Status and Effect of Settlement Agreement (Sec. 74) The settlement agreement
duly signed by the parties and authenticated by the conciliator has
the same status and
effect as if it is an arbitral award on agreed terms on the substance of the dispute rendered by an arbitral tribunal under Section 30.
In other words, the settle- ment agreement can be enforced as a decree of court by virtue of Section 36. 31.3 CONFIDENTIALITY As per Section 75,
the conciliator and the parties are required to
keep confidential all matters relating to the conciliation proceedings. This obligation extends also to the
settle- ment
agreement,
except where its disclosure is necessary for purposes of implementation and enforcement.
No Resort to Arbitral Proceedings etc. In order to avoid multiplicity of proceedings, Section 77 restrains the parties to a concilia- tion proceedings from initiating arbitral or judicial proceedings on the same dispute during the continuance of conciliation proceedings. But the Section permits a party to initiate any such proceedings if the same
is necessary for preserving his rights. Termination of Conciliation Proceedings (Sec. 76) The conciliation proceedings shall be terminated under the following circumstances: (
a) By the signing of the settlement agreement by the parties, on the date of the agree- ment. (b) By a written declaration of the conciliator that further efforts at conciliation are no longer justified, on the date of the declaration. (c) By a written declaration of the parties addressed to the conciliator that the conciliation proceedings are terminated, on the date of the declaration. (d) By a written declaration of a party to the other party and the conciliator that the conciliation proceedings are terminated, on the date of the declaration.

Check Your Progress 1. What do you mean by the term conciliation? 2. Differentiate between conciliation and arbitration. 3. Describe the procedure for conciliation.
Conciliation 376 Self-Instructional Material NOTES Costs (Sec. 78)
Upon termination of the conciliation proceedings, the conciliator shall fix the 'costs' of the conciliation and give written notice thereof to the parties. The term 'costs' means reasonable costs relating to — (a) the fee and expenses of the conciliator and witnesses requested by the conciliator with the consent of the parties; (b) any expert advice requested by the conciliator with the consent of the parties; (c) any administrative assistance
by
a suitable institution or person
provided pursuant to Section 64(2) (b) and Section 68. (
d) any other expenses incurred in connection with the conciliation proceedings and the settlement agreement. The costs shall be borne equally by the parties unless the settlement agreement provides
otherwise. 31.4 DEPOSITS Section 79 contains provisions relating to 'deposits' which are as follows: 1.
The conciliator may direct each party to deposit an equal amount as an advance for the 'costs'
referred to in Section 78 (stated above)
which he expects will be incurred. 2. During the course of the conciliation proceedings, the conciliator may direct supplementary deposits in an equal amount from each party. 3.
If the aforestated
required deposits are not paid in full by both parties within 30 days, the conciliator may suspend the proceedings or may make a written declaration of termination of the proceedings to the parties, effective from the date of that declaration. 4. Upon termination of the conciliation proceedings, the conciliator shall render accounts to the parties of the deposits received and shall return any unexpended balance to the parties.
Conciliator Not to act as Arbitrator etc. Section 80 states that,
unless otherwise agreed by the parties, the conciliator cannot act as arbitrator or as representative or counsel of a party in any arbitral or judicial
proceeding in respect of
the conciliated dispute. The parties are also prohibited from "presenting" the conciliator
as a witness in such proceedings. No
Admissibility of Evidence (Sec. 81) The parties shall not rely on or introduce as evidence in arbitral or judicial proceedings, whether or not such proceedings relate to the conciliated dispute, — (a) views expressed or suggestions made by the other party in respect of a possible settlement of the dispute; (b) admissions made by the other party in the course of the conciliation proceedings; (c) proposals made by the conciliator; (d) the fact that the other party had indicated his willingness to accept a proposal for settlement made by the conciliator. 31.5
TEST QUESTION 1. What do you mean by the term 'conciliation' ? Discuss the provisions of the Arbitration and Conciliation Act, 1996 relating to the procedure for conciliation.
Enforcement of Certain Foreign Awards Self-Instructional Material 377 NOTES UNIT 32 ENFORCEMENT OF CERTAIN FOREIGN AWARDS Structure 32.0 Introduction 32.1 Unit Objective 32.2 New York Convention Awards 32.3 Geneva Convention Awards 32.4 Test Question 32.0 INTRODUCTION The part II (consisting of Sections 44-60) of the Arbitration and Conciliation Act, 1996, contains the following two chapters dealing with 'enforcement of certain foreign awards': 1. Chapter I (Sections 44-52) — New York Convention Awards, and 2. Chapter II (Sections 53-60) — Geneva Convention Awards. The provisions of both the Chapters (Conventions) are generally similar, however there are certain differences. 32.1 UNIT OBJECTIVE Know the law relating to "
enforcement of certain foreign awards. 32.2 NEW YORK CONVENTION AWARDS (CHAPTER-I) (SECTIONS 44-52) 32.2.1 Definition (Sec. 44) In this Chapter-
I (consisting of Sections 44-52),
unless the context otherwise requires, "foreign award" means an arbitral award on differences between persons arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India, made on or after 11th October, 1960 — (a) in pursuance of an agreement in writing for arbitration to which the Convention set forth in the "First Schedule" applies, and (b) in one of such territories as the Central Government,
on the basis of reciprocity, may
declare to be territories to which the said Convention applies.
Note. The "First Schedule" has been reproduced in the Appendix at the end of this chapter.
Power of Judicial Authority to Refer Parties to Arbitration (Sec. 45)
A judicial authority,
when seized of an action in a matter in respect of which the parties have made an agreement referred to in Section 44 above, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

Enforcement of Certain Foreign Awards 378 Self-Instructional Material NOTES When Foreign Award Binding (Sec. 46) Any foreign award which would be enforceable under this Chapter shall be treated as binding for all purposes on the parties thereto. It may be relied on by any of those parties either by way of defence, set-off or otherwise in any legal proceedings in India. Any references to enforcing a foreign award shall be construed as including references to relying on an award. Evidence Required for Enforcement of Foreign
Award (
Sec. 47) The party applying for the enforcement of a foreign award shall, at the time of application, produce before the Court the
following documents : (
a) The original award or a copy thereof duly authenticated in
accordance with
the law of the country in which it was made. (b) The original agreement for arbitration or a duly certified copy there of. (
c) Such other evidence as may be necessary to prove that the award is a foreign award. If the award and the arbitration agreement are written in a language other than English, the applicant shall produce the translated copies into English duly certified as correct by a diplomatic or consular agent of the country to which that party belongs or certified as correct in some other manner as may be sufficient according to the law in force in India.
Conditions for Refusal to Enforce Foreign Awards (Sec. 48) The
enforcement of a foreign award may be refused, at the request of the party against whom it is invoked, only if that party submits any of the following proofs
to the court: (i) The parties to the agreement were under some incapacity under the law applicable to them or the arbitration agreement is not valid under the law to which the parties have subjected it or under the law of the country where the award was made. (ii) The party against whom the award is invoked
was not given proper notice of the appointment of the arbitrator or of the arbitral proceedings or was otherwise unable to present his case. (
iii) The award
contains decisions on matters beyond the scope of the submission to arbitration. But if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters, submitted to arbitration may be enforced. (iv) The composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with
the law of the country where the arbitration took place. (v) The award has not yet become binding on the parties, or has been set aside or suspended by a competent court of the country in which, or under the law of which, that award was made. (
vi)
The subject-matter of the difference is not capable of settlement by arbitration under the law of India. (vii) The enforcement of the award would be contrary to the public policy of India. As per the Explanation added to this clause, an award is in conflict with the public policy of India if the making of the award was induced by fraud or corruption.
If an application for the setting aside or suspension of the award
is pending in a competent court, the application for enforcement of the award may be adjourned. Enforcement of Foreign Awards (Sec. 49)
Where the court is satisfied that the foreign award is enforceable,
it shall pronounce judgement according to the award and
the award shall be deemed to be a decree of the Court. No appeal shall lie from
such a decree.
Enforcement of Certain Foreign Awards Self-Instructional Material 379 NOTES Appeals (Sec. 50) An appeal shall lie to the competent court from the following orders: (a) An order refusing to refer the parties to arbitration under
Section 45. (b) An order refusing to enforce a foreign award under Section 48.
No second appeal shall lie from an order passed in appeal under this Section.
But
the right to appeal to the Supreme Court is not barred. 32.3 GENEVA CONVENTION AWARDS (CHAPTER-II) (SECTIONS 53-60) 32.3.1 Definition (Sec. 53) In this Chapter-II (consisting of Sections 53-60), "
foreign award" means on arbitral award on differences relating to matters considered as commercial under the law in force in India made after 28th July, 1924— (a) in pursuance of an agreement for arbitration to which the Protocol set forth in the "Second Schedule" applies, (b) between persons of whom one is subject to the jurisdiction of some one of such Powers as the Central Government,
on the basis of reciprocity, may

declare to be parties to the Convention set forth in the "Third Schedule", and of whom the other is subject to the jurisdiction of some other of the Powers aforesaid, and (c) in one of such territories as the Central Government, on the basis of reciprocity, may
declare to be territories to which the said Convention applies, and for the purposes of this Chapter an award shall not be deemed to be final if any proceedings for the purpose of contesting the validity of the award are pending in the country in which it was made.
Note. The "Second Schedule" and the "Third Schedule" have been reproduced in the Appendix at the end of this chapter.
Power of Judicial Authority to Refer Parties to Arbitration (Sec. 54)
A judicial authority,
on being seized of a dispute regarding a contract made between persons to whom Section 53 applies and including an arbitration agreement, whether referring to present or future differences, which is valid under that Section and capable of being carried into effect, shall refer the parties on the application of either of them or any person claiming through or under him to the decision of the arbitrators and such reference shall not prejudice the competence of the judicial authority in case the agreement or the arbitration cannot proceed or becomes inoperative. Foreign Awards when Binding (Sec. 55) Any foreign award which would be enforceable under this chapter shall be treated as binding for all purposes on the parties thereto. It may be relied on by any of those parties by way of defence, set off or otherwise in any legal proceedings in India. Any references in this chapter to enforcing a foreign award shall be construed as including references to relying on an award. Evidence Required for Enforcement of Foreign
Award (
Sec. 56) The party applying for the enforcement of a foreign award shall, at the time of application, produce before the Court the
following documents: (
a) The original award or a copy thereof duly authenticated in
accordance with
the law of the country in which it was made.
Enforcement of Certain Foreign Awards 380 Self-Instructional Material NOTES (b) The
evidence proving that the award has become final. (c) Such other evidence as may be necessary to prove that the conditions mentioned in clauses (a) and (c) of sub-section (1) of Section 57 are satisfied. If any
of the aforestated documents
is in a language other than English, the applicant shall produce a translation into English, duly certified as correct by a diplomatic or consular agent of the country to which that party belongs or certified as correct in some other manner as may be sufficient according to the law in force in India.
Conditions for Enforcement of Foreign Awards (Sec. 57) 1. In order that a foreign award may be enforceable under this chapter, it shall be necessary that — (a) the award has been made in pursuance of a submission to arbitration which is valid under the law applicable thereto; (b)
the subject-matter of the award is capable of settlement by arbitration under the law
of India; (c) the award has been made by the arbitral tribunal provided for in the submission to arbitration or constituted in the manner agreed upon by the parties and inconformity with the law governing the arbitration procedure; (d) the award has become final in the country in which it has been made, in the sense that it will not be considered as such if it is open to opposition or appeal or if it is proved that any proceedings for the purpose of contesting the validity of the award are pending; (e) the enforcement of the award is not contrary to the public policy or the law of India. As per the Explanation added to this clause,
an award is in conflict with the public policy of India if
the making of the award was induced by fraud or corruption. 2.
Even if the conditions laid down in sub-section (1) (stated above)
are fulfilled, enforcement of the award shall be refused if the Court is satisfied that — (i) the award has been annulled in the country in which it was made; (ii) the party against whom it is sought to use the award was not given notice of the arbitration proceedings in sufficient time to enable him to present his case; or that, being under a legal incapacity, he was not properly represented; (iii) the award does not deal with the differences
contemplated by or falling within the terms of the submission to arbitration or that it contains decisions on matters beyond the scope of the submission to arbitration. But if the

award has not covered all the differences submitted to the arbitral tribunal, the Court may, if it thinks fit, postpone such enforcement or grant it subject to such guarantee as the Court may decide. 3. If the party against whom the award has been made proves that under the law. Governing the arbitration procedure there is a ground, other than the grounds referred to in clauses (a) and (c) of sub-section (1) and clauses (ii) and (iii) of sub-section (2) entitling him to contest the validity of the award, the Court may, if it thinks fit, either refuse enforcement of the award or adjourn the consideration thereof, giving such party a reasonable time within which lo have the award annulled by the competent tribunal. Enforcement of Foreign Awards (
Sec. 58) When
the Court is satisfied that the foreign award is enforceable under this Chapter,
it shall pronounce judgement in terms of the award and
the award shall be deemed to be a decree of the Court. No appeal shall lie from
such a decree. Check Your Progress 1. What are the conditions for refusal to enforce foreign awards under the New York Convention? 2. What are the evidences required for enforcement of foreign award under the Geneva Convention? Enforcement of Certain Foreign Awards Self-Instructional Material 381 NOTES Appeals (Sec. 59) An appeal shall lie to the competent court from the following orders : (a) An order refusing to refer the parties to arbitration under
Section 54. (b) An order refusing to enforce a foreign award under Section 57.
No second appeal shall lie from an order passed in appeal under this Section.
But
the right to appeal to the Supreme Court is not barred. APPENDIX THE FIRST SCHEDULE (see Section 44)
CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS ARTICLE I 1. This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought. 2. The term “arbitral awards” shall include not only awards made by arbitrators appointed for each case but also those made by permanent arbitral bodies to which the parties have submitted. 3. When signing, ratifying or acceding to this Convention, or notifying extension under Article X hereof,
any
State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial
under the
national law of the State making such declaration. ARTICLE II 1. Each Contracting State shall recognise an agreement in writing under
which the parties undertake
to submit to arbitration all or any differences which have arisen or which may arise
between them in respect of defined legal relationship, whether contractual or not, concerning a
subject-matter capable of settlement by arbitration. 2. The term “agreement in writing” shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams. 3. The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this Article, shall, at the request of one of the parties, refer the parties to arbitration, unless it Finds that the said agreement is null and void, inoperative
or
incapable of being performed. ARTICLE III Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards. ARTICLE IV 1. To obtain the recognition and enforcement mentioned in the preceding article, the party applying for recognition and enforcement shall, at the time of the application supply— (a) the duly authenticated original award or a duly certified copy thereof;
Enforcement of Certain Foreign Awards 382 Self-Instructional Material NOTES (

b) the original agreement referred to in Article II or a duly certified copy thereof. 2. If the said award or agreement is not made in an official language of the country in which the award is relied upon, the party applying for recognition and enforcement of the award shall produce a translation of these documents into such language. The translation shall be certified by an official or sworn translator or by a diplomatic or consular agent. ARTICLE V 1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that— (a) the parties to the agreement referred to in Article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made ; or (b) the party against whom the award is invoked
was not given proper notice the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case ; or (c) the award deals with a.difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognised and enforced ; or (d) the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with
the law of the country where the arbitration took place; or (e) the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made. 2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that— (a)
the subject-matter of the difference is not capable of settlement by arbitration under the law
of that country ; or (b) the recognition or enforcement of the award would be contrary to the public policy of that country. ARTICLE VI If an application for the setting aside or suspension of the award has been made to a competent authority referred to in Article V (1) (e), the authority before which the award is sought to be relied upon may, if it considers it proper, adjourn the decision on the enforcement of the award and may also, on the application of the party claiming enforcement of the award, order the other party to give suitable security. ARTICLE VII 1. The provisions of the present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States nor deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon. 2. The Geneva Protocol on Arbitration Clauses of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927 shall cease to have effect between Contracting States on their becoming bound and to the extent that they become bound by this Convention.

ARTICLE VIII 1. This Convention shall be open until 31st December, 1958 for signature on behalf of any Member of the United Nations and also on behalf of any other State which is or hereafter becomes member of any specialised agency of the United Nations, or which is or hereafter becomes a party to the Statute of the International Court of Justice, or any other State to which an invitation has been addressed by the General Assembly of the United Nations. 2. This Convention shall be ratified and the instrument of ratification shall be deposited with the Secretary-General of the United Nations. ARTICLE IX 1. This Convention shall be open for accession to all States referred to in Article VIII. 2. Accession shall be effected by the deposit of an instrument of accession with the Secretary- General of the United Nations. ARTICLE X 1. Any State may, at the time of signature, ratification or accession, declare that this Convention shall extend to all or any of the territories for the international relations of which it is responsible. Such a declaration shall take effect when the Convention enters into force for the State concerned. 2. At any time thereafter any such extension shall be made by notification addressed to the Secretary-General of the United Nations and shall take effect as from the ninetieth day after the day of receipt by the Secretary-General of the United Nations of this notification, or as from the date of entry into force of the Convention for the State concerned, whichever is the later. 3. With respect to those territories to which this Convention is not extended at the time of signature, ratification or accession, each State concerned shall consider the possibility of taking the necessary steps in order to extend the application of this Convention to such territories, subject, where necessary for constitutional reasons, to the consent of the Governments of such territories. ARTICLE XI In the case of a federal or non-unitary State, the following provisions shall apply— (a) with respect of those Articles of this Convention that come within the legislative jurisdiction of the federal authority, the obligations of the Federal Government shall to this extent be the same as those of Contracting States which are not Federal States; (b) with respect to those Articles of this Convention that come within the legislative jurisdiction of constituent States or provinces which are not, under the constitutional system of the federation, bound to take legislative action, the Federal Government shall bring such Articles with a favourable recommendation to the notice of the appropriate authorities of constituent States or provinces at the earliest possible moment; (c) a Federal State Party to this Convention shall, at the request of any other Contracting State transmitted through the Secretary-General of the United Nations, supply a statement of the law and practice of the federation and its constituent units in regard to any particular provision of this Convention, showing the extent to which effect has been given to that provision by legislative or other action. ARTICLE XII 1. This Convention shall come into force on the ninetieth day following the date of deposit of the third instrument of ratification or accession. 2. For each State ratifying or acceding to this Convention after the deposit of the third instrument of ratification or accession, this Convention shall enter into force on the ninetieth day after deposit by such State of its instrument of ratification or accession.

ARTICLE XIII 1. Any Contracting State may denounce this Convention by a written notification to the Secretary-General of the United Nations. Denunciation shall take effect one year after the date of receipt of the notification by the Secretary-General. 2. Any State which has made a declaration or notification under Article X may, at any time thereafter, by notification to the Secretary-General of the United Nations. Declare that this Convention shall cease to extend to the territory concerned one year after the date of the receipt of the notification by the Secretary-General. 3. This Convention shall continue to be applicable to arbitral awards in respect of which recognition or enforcement proceedings have been instituted before the denunciation takes effect. ARTICLE XIV A Contracting State shall not be entitled to avail itself of the present Convention against other Contracting States except to the extent that it is itself bound to apply the Convention. ARTICLE XV The Secretary-General of the United Nations shall notify the States contemplated in Article VIII of the following: (a) signatures and ratifications in accordance with Article VIII ; (b) accessions in accordance with Article IX ; (c) declarations and notifications under Articles I, X and XI ; (d) the date upon which this Convention enters into force in accordance with Article XII; (c) denunciations and notifications in accordance with Article XIII. ARTICLE XVI 1. This Convention, of which the Chinese, English, French, Russian and Spanish texts shall be equally authentic, shall be deposited in the archives of the United Nations. 2. The Secretary-General of the United Nations shall transmit a certified copy of this Convention to the States contemplated in Article XIII. THE SECOND SCHEDULE (

see Section 53)

PROTOCOL ON ARBITRATION CLAUSES The undersigned, being duly authorised, declare that they accept, on behalf of the countries which they represent, the following provisions: 1. Each of the Contracting States recognises the validity of an agreement whether relating to existing or future differences between parties subject respectively to the jurisdiction of different Contracting States by which the parties to a contract agree to submit to arbitration all or any differences that may arise in connection with such contract relating to commercial matters or to any other matter capable of settlement by arbitration, whether or not the arbitration is to take place in a country, to whose jurisdiction none of the parties is subject. Each Contracting States reserves the right to limit the obligation mentioned above to contracts which are considered as commercial under its national law. Any Contracting State which avails itself of this right will notify the Secretary-General of the League of Nations in order that the other Contracting States may be so informed. 2. The arbitral procedure, including the constitution of the Arbitral Tribunal, snail be governed by the will of the parties and by the law of the country in whose territory the arbitration takes place.
Enforcement of Certain Foreign Awards Self-Instructional Material 385 NOTES The Contracting States agree to facilitate all steps in the procedure which require to be taken in their own territories, in accordance with the provisions of their law governing arbitral procedure applicable to existing differences. 3. Each Contracting State undertakes to ensure the execution by its authorities and in accordance with the provisions of its national laws of arbitral awards made in its own territory under the preceding articles. 4. The Tribunals of the Contracting Parties, on being seized of a dispute regarding a contract made between persons to whom Article I applies and including an Arbitration Agreement whether referring to present or future differences which is valid in virtue of the said Article and capable of being carried into effect, shall refer the parties on the application of either of them to the decision of the Arbitrators. Such reference shall not prejudice the competence of
the
judicial tribunals in case the agreement or the arbitration cannot proceed or becomes inoperative. 5. The present Protocol, which shall remain open for signature by all States, shall be ratified. The ratification shall be deposited as soon as possible with the Secretary-General of the League of Nations, who shall notify such deposit to all the Signatory States. 6. The present Protocol will come into force as soon as two ratifications have been deposited. Thereafter it will take effect, in the case of each Contracting State, one month after the notification by the Secretary-General of the deposit of its ratification. 7. The present Protocol may be denounced by any Contracting State on giving one year's notice. Denunciation shall be effected by a notification addressed to the Secretary-General of the League of Nations, who will immediately transmit copies of such notification to all the other Signatory States and inform them of the date on which it was received. The denunciation shall take effect one year after the date on which it was notified to the Secretary-General, and shall operate only in respect of the notifying State. 8. The Contracting States may declare that their acceptance of the present Protocol does not include any or all of the undermentioned territories: that is to say, their colonies, overseas possessions or territories, protectorates or the territories over which they exercise a mandate. The said States may subsequently adhere separately on behalf of any territory thus excluded. The Secretary-General of the League of Nations shall be informed as soon as possible of such adhesions. He shall notify such adhesions to all Signatory States. They will take effect one month after the notification by the Secretary-General to all Signatory States. The Contracting States may also denounce the Protocol separately on behalf of any of the territories referred to above. Article 7 applies to such denunciation. THE THIRD SCHEDULE (
see Section 53)
CONVENTION ON THE EXECUTION OF FOREIGN ARBITRAL AWARDS Article 1 —(1) In the territories of any High Contracting Party to which the present Convention applies, an arbitral award made in pursuance of an agreement whether relating
to
existing or future differences (hereinafter called "a submission to arbitration") covered by the Protocol on Arbitration Clauses opened at Geneva on 24th September, 1923, shall be recognised as binding and shall be enforced in accordance with the rules of the procedure of the territory where the award is relied upon, provided that the said award has been made in a territory of one of the High Contracting Parties to which the present Convention applies and between persons who are subject to the jurisdiction of one of the High Contracting Parties. 2. To obtain such recognition or enforcement, it shall, further, be necessary— (a) 'that the award has been made in pursuance of a submission to arbitration which is valid under the law applicable thereto;
Enforcement of Certain Foreign Awards 386 Self-Instructional Material NOTES (
b)
that the subject-matter of the award is capable of settlement by arbitration under the law of the

country in which the award is sought to be relied upon ; (c) that the award has been made by the Arbitral Tribunal provided for in the submission to arbitration or constituted in the manner agreed upon by the parties and in conformity with the law governing the arbitration procedure ; (d) that the award has become final in the country in which it has been made, in the sense that it will not be considered as such if it is open to opposition, appeal or pourvoien cassation (in the countries where such forms of procedure exist) or if it is proved that any proceedings for the purpose of contesting the validity of the award are pending ; (e) that the recognition or enforcement of the award is not contrary to the public policy or to the principles of the law of the country in which it is sought to be relied upon. Article 2 — Even if the conditions laid down in Article I hereof are fulfilled, recognition and enforcement of the award shall be refused if the Court is satisfied— (a) that the award has been annulled in the country in which it was made; (b) that the party against whom it is sought to use the award was not given notice of the arbitration proceedings in sufficient time to enable him to present his case; or that, being under a legal incapacity, he was not properly represented ; (c) that the award does not deal with the differences contemplated by
of
falling within the terms of the submission to arbitration or that it contains decisions on matters beyond the scope of the submission to arbitration. If the
award has not covered all the questions submitted to the arbitral tribunal, the competent authority of the country where recognition or enforcement of the award is sought can, if it thinks fit, postpone such recognition or enforcement or grant it subject to such guarantee as that authority may decide. Article 3—If the party against whom the award has been made proves that, under the law governing the arbitration procedure, there is a ground, other than the grounds referred to in Article I (a) and (c), and Article 2(b) and (c), entitling him to contest the validity of the award in a Court of Law, the Court may, if it thinks fit, either refuse recognition or enforcement of the award or adjourn the consideration thereof, giving such party a reasonable time within which to have the award annulled by the competent tribunal. Article 4 — The party relying upon an award or claiming its enforcement must supply, in particular: 1. the original award or a copy thereof duly authenticated, according to the requirements of the law of the country in which it was made; 2. documentary or other evidence to prove that the award has become final, in the sense defined in Article 1(d), in the country in which it was made; 3. when necessary, documentary or other evidence to prove that the conditions laid down in Article 1, paragraph (I) and paragraph 2(a) and (c), have been fulfilled. A translation of the award and of the other documents mentioned in this Article into the official language of the country where the award is sought to be relied upon may be demanded. Such translations must be certified correct by a diplomatic or consular agent of the country to which he party who seeks to rely upon the award belongs or by a sworn translator of the country where the award is sought to be relied upon. Article 5 — The provisions of the above Articles shall not deprive any interested party of the right of availing himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon. Article 6 — The present Convention applies only to arbitral awards made after the coming into force of the Protocol on Arbitration Clauses opened at Geneva on 24th September, 1923. Article 7 — The present Convention, which will remain open to the signature of all the signatories of the Protocol of 1923 on Arbitration Clauses, shall be ratified. It may be ratified only on behalf of those Members of the League of Nations and Non-Member States on whose behalf the
Enforcement of
Certain Foreign Awards Self-Instructional Material 387 NOTES
Protocol of 1923 shall have been ratified. Ratification shall be deposited as soon as possible with the Secretary-General of the League of Nations, who will notify such deposit to all the signatories. Article 8 — The present Convention shall come into force three months after it shall have been ratified on behalf of two High Contracting Parties. Thereafter, it shall take effect, in the case of each High Contracting Party, three months after the deposit of the ratification on its behalf with the Secretary-General of the League of Nations. Article 9 — The present Convention may be denounced on behalf of any Member of the League or Non-Member State. Denunciation shall be notified in writing to the Secretary-General of the League of Nations, who will immediately send a copy thereof, certified to
be

in conformity with the notifications, to all the other Contracting Parties, at the same time informing them of the date on which he received it. The denunciation shall come into force only in respect of the High Contracting Party which shall have notified it and one year after such notification shall have reached the Secretary-General of the League of Nations. The denunciation of the Protocol on Arbitration Clauses shall entail, ipos facto, the denunciation of the present Convention. Article 10 — The present Convention does not apply to the colonies, protectorates or territories under suzerainty or mandate of any High Contracting Party unless they are specially mentioned. The application of this Convention to one or more of such colonies, protectorates or territories to which the Protocol on Arbitration Clauses opened at Geneva on 24th September, 1923, applies, can be effected at any time by means of a declaration addressed to the Secretary-General of the League of Nations by one of the High Contracting Parties. Such declaration shall take effect three months after the deposit thereof. The High Contracting Parties can at any time denounce the Convention for all or any of the colonies, protectorates or territories referred to above. Article 9 hereof applied to such denunciation. Article 11 — A certified copy of the present Convention shall be transmitted by the Secretary- General of the League of Nations to every Member of the League of Nations and to every Non- Member State which signs the same. 32.4
TEST QUESTION 1. Discuss the provisions of the Arbitration and Conciliation Act. 1996 relating to the “enforcement of certain foreign awards”.
MODULE - 9
Information Technology Act, 2000 Self-Instructional Material 391 NOTES UNIT 33 INFORMATION TECHNOLOGY ACT, 2000 Structure 33.0 Introduction 33.1 Unit Objectives 33.2 Rationale behind the IT Act, 2000 33.3 Information Technology Act, 2000 33.4 Scheme of the IT
Act, 2000 33.5 Digital Signature 33.6

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Electronic Governance 33.7 Attribution, Acknowledegment and Despatch of Electronic Records 33.8 Secure Electronic Records and Secure Digital Signatures 33.9 Regulation of Certifying Authorities 33.10 Powers of Controller 33.11 Duties of Certifying Authority 33.12 Digital Signature Certificates 33.13 Duties of Subscribers 33.14 Penalties and Adjudication 33.15 The Cyber Regulations Appellate Tribunal 33.16

Offences 33.17
Test Questions 33.0 INTRODUCTION The term ‘information technology’ (IT) is not having a precise meaning. It is generally applied to broad area of activities and technologies associated with the use of computers and communication. We can explain IT as an application of computers to create, store, process and use of information particularly in the field of commerce. Basically, IT enables the corporate management to have access to timely, accurate and relevant data, with the use of computers, communication, telephone. Internet, etc., which helps in informed deci- sion-making, minimises the response time and enables better coordination in the organisation resulting in reduced costs or increased profits.
33.1 UNIT OBJECTIVES ? Know the rationale of IT Act, 2000 ? Identify those documents where provisions of the IT Act, 2000 are not applicable ? Understand the law relating to digital signature ? Know provisions of IT Act, 2000 relating to e-governance ? Know the functions and duties of certifying authorities ? Understand the purpose of the digital signature certificate ? Know the penalties for various offences under the IT Act, 2000
Information Technology Act, 2000 392 Self-Instructional Material NOTES 33.2 RATIONALE BEHIND THE IT ACT, 2000
The “Statement of Objects and Reasons” appended to the “Information Technology Bill, 2000,” explains the rationale behind the IT Act, 2000. Excerpts from the said statement are given below: “New
communication systems and digital technology have made dramatic changes in the way we live. A revolution is occurring in the way people transact business. Businesses and consumers are increasingly using computers to create, transmit and store information in the electronic form instead of traditional paper documents. Information stored in electronic form has many advantages. It is cheaper, easier to store, retrieve and speedier to communicate.
Although people are aware of these advantages, they are
reluctant to conduct business or conclude any transaction in the electronic form due to lack of
appropriate legal framework. The two principal hurdles which stand in the way of facilitating electronic commerce and electronic governance are the requirements as to writing and signature for legal recognition. At present many legal provisions assume the existence of paper based records and documents and records which should bear signatures. The law of evidence is traditionally based upon
paper based records and oral testimony. Since electronic commerce eliminates the need for paper based transactions, hence to facilitate e-commerce,
the need for legal changes have become an urgent necessity. International trade through the medium of e-commerce is growing rapidly in the past few years and many countries have switched over from traditional paper based commerce to e-commerce.” “

There is a
need for bringing in suitable amendments in the existing laws in our country to facilitate e-commerce.
It is, therefore, proposed to provide for legal recognition of electronic records and digital signatures. This will enable the conclusion of contracts and the
creation of rights and obligations through the electronic medium." "
With a view to facilitate Electronic Governance, it is proposed to provide for the
use and acceptance of electronic records and digital signatures in the Government offices and its agencies." 33.3 INFORMATION TECHNOLOGY ACT, 2000 The law relating to "information technology" is contained in the Information Technology (IT) Act, 2000 1 which came into force on 17th October, 2000. It is the first Cyber Law in India. It is mainly based
on the UNCITRAL Model Law.
The United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on
Electronic Commerce
in 1996.
This Model Law provides for equal legal treatment of users of electronic communication and paper based communication. The Information Technology (IT) Act, 2000 has been designed to give boost to Electronic Commerce (e-commerce), e-transactions and similar activities associated with commerce and trade, and also to facilitate Electronic Governance (e-governance) by means of reliable electronic records. With a view to making the citizens interaction with the Government offices hassle free, the IT Act provides
for the
use and acceptance of electronic records and digital signatures in the Government
offices.
To prevent the possible misuse arising out of the
transactions and other dealings concluded over the electronic medium, the IT Act also provides
for
a regulatory regime to supervise the Certifying Authorities issuing Digital
Signature Certificates. Briefly stated, it may be said that IT Act mainly contains provisions relating to e-commerce, e-governance, electronic record and digital signature. The term Electronic Commerce (e-commerce) refers to the business transacted electroni- cally. In common usage, the term refers to trading of goods over the Internet. It is on-line 1 References to Sections in this Chapter, unless otherwise indicated, are to the "Information Technology Act, 2000." The word 'Act' wherever used in this Chapter means the IT Act, 2000.
Information Technology Act, 2000 Self-Instructional Material 393 NOTES sale and purchase of goods and services for value by using internet technologies, such as internet processing, e-mail and world wide web (www) or just web browsing. E-commerce in its present form is in the stage of infancy in India. During the four years of post IT Act period, the increase in e-commerce is taking place at a slow rate mainly because the IT Act is silent on all aspects of payment. There is no concept of e-payment or digital money. The term Electronic Governance refers to the application of information technology to the processes of Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) governance.
It involves electronic filing of documents with the government agencies and creating a network of e-services and e-administration. Electronic Governance (e-governance) is fast catching up and more and more government processes are going on-line resulting in less bureaucracy, more transparency and openness. Companies will be able to file any form, application or any other document in the electronic form and get Licenses/Certificates on-line. 33.4 SCHEME OF THE IT ACT, 2000 The Information Technology Act, 2000 consists of 13 Chapters divided into 94 Sections. Chapters I to VIII are mostly digital signature related. Chapters IX to XIII are regarding penalties, offences, etc. The Act has four Schedules on consequential amendments in respect of certain other Acts. The First Schedule makes amendments to the Indian Penal Code, 1860, and the Second Schedule makes amendments to Indian
Evidence Act, 1872 to provide for necessary changes in the various provisions which deal with offences relating to documents and paper based transactions.
The Third Schedule makes amendments to the Bankers' Books Evidence Act, 1891 to give legal sanctity for books of account maintained in the electronic form by the banks. The Fourth Schedule makes amendments to
the Reserve Bank of India Act, 1934 to facilitate electronic fund transfers between
the financial institutions and banks. Exceptions [Sec. 1(4)].
The provisions of the IT Act, 2000 shall not apply to the following documents: 1.
Execution of
a Negotiable Instrument (other than cheque) under the Negotiable Instruments Act, 1881. 2. Execution of a Power of Attorney under the Powers of Attorney Act, 1882. 3.
Creation of a Trust under Indian Trusts Act, 1882. 4. Execution of a 'Will' under

the Indian Succession Act, 1925 including any other testamentary disposition by whatever name called. 5. Entering into a contract for the sale or conveyance of immovable property or any interest in such property. 6. Execution of such class of documents or transactions as may be notified by the Central Government in the Official Gazette. The reason for excluding the above-mentioned documents from the purview of the Act is that such documents are required to be authenticated only by the handwritten signatures. Moreover, these require special attestation and/or registration formalities, which also explain their exclusion. 33.5 DIGITAL SIGNATURE The Law of Information Technology recognises the digital signature so that the Internet contract is authenticated and becomes binding on the parties. These are the electronic equivalent of the handwritten signatures. In an electronic message or transaction affixing Information Technology Act, 2000 394 Self-Instructional Material NOTES handwritten signature is not possible. Authentication of the record has to be achieved by some electronic or digital method. "Affixing digital signature" has been defined in Section 2(l)(d) of the Act to mean adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of "digital signature".

The expression "digital signature" has been defined in Section 2(l)(p) of the Act to mean authentication of any electronic record by a subscriber, i.e., a person in whose name the "Digital Signature Certificate" is issued, by means of an electronic method or procedure in accordance with the provisions of Section 3. 33.5.1 Authentication of Electronic Records (Sec. 3)

Any subscriber may authenticate an electronic record by affixing his digital signature.

The authentication of the electronic record shall be effected by the use of 'asymmetric crypto system' and 'hash function' which envelop and transform the initial electronic record into another electronic record.

Explanation — For the purposes of this subsection, "hash function" means an algorithm mapping or translation of one sequence of bits into another, generally smaller, set known as "hash result" such that an electronic record yields the same hash result every time the algorithm is executed with the same electronic record as its input making it computationally infeasible— (a) to derive or reconstruct the original electronic record from the hash result produced by the algorithm; (b) that two electronic records can produce the same hash result using the algorithm. Verification. Any person by the use of a public key of the subscriber can verify the electronic record. The private key and the public key are unique to the subscriber and constitute a functioning key pair.

In the case of electronic transmission of business or legal message/documents, it is necessary to ensure that these are authentic and have not been tampered with by any person during transmission. With this end in view, the above stated Section 3 provides that authentication of the electronic record is to be effected by the use of " asymmetric cryp to system", i.e., by using 'encryption' (coding) and 'decryption' (decoding) methodologies and software tools. An 'encryption software program' takes the normal, readable text message ("plain text") and scrambles the message into unreadable coded text or "ciphertext". The recipient then uses another software program (the corresponding decryption program) to decrypt such ciphertext back into normal plaintext. Any one who intercepts the message will, therefore, not be able to read or tamper with the message, unless he has the key, i.e., the corresponding decryption program, thereby rendering it secure. In "asymmetric crypto system", each person will have two corresponding and matched keys — one called the 'private key' which is always kept secure with such person, and the other called the 'public key' which the person shares with others and makes available to others on specialised databases called 'repositories' or through Certification Authorities. These two keys, public key and private key, are used to encrypt and decrypt the message respectively. The sender uses the intended receiver's public key (which he can freely obtain from the receiver or download from a public repository) to encrypt the message. The receiver, on receiving the coded message, uses his corresponding private key (which is available only with him) to decrypt the encrypted message. The public key and the private key of any person or entity would be so mathematically linked that a message encrypted using one key can only be decrypted by using the corresponding other. The various expressions used above have been defined in the Act as follows:

Information Technology Act, 2000 Self-Instructional Material 395 NOTES Asymmetric crypto system [Sec. 2(l)(f)]. It means

a system of a
secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature.
Electronic record [Sec. 2(l)(t)]. It
means
data, record or data generated, image or sound stored, received or sent in an electric form or microfilm or computer generated
microfiche.
Key pair [Sec. 2(l)(x)]. In an asymmetric crypto system, "key pair"
means
a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key.
Private key [
Sec. 2(l)(zc)]. It
means
the key of a key pair used to create a digital signature. Public key [
Sec. 2(l)(zd)]. It
means
the key of a key pair used to verify a digital signature and listed in the Digital Signature
Certificate.
Subscriber [Sec. 2(l)(zg)]. It
means
a person in whose name the Digital Signature Certificate is issued.
Verify [
Sec. 2(l)(
zh)]. "
Verify" in relation to a digital signature, electronic record or
public key, with
the
grammatical variations and cognate expressions means to determine whether— (a) the initial electronic record was affixed with the digital signature by the use of private key corresponding to the public key of the subscriber; (b) the initial electronic record is retained intact or has been altered since such electronic record was so affixed with the digital signature. 33.6
ELECTRONIC GOVERNANCE With a view to facilitating electronic governance, IT Act, 2000 accords legal recognition to electronic records, digital signatures and electronic form of dealing with Government offices and its agencies. The retention of information in electronic format has also been accorded legal recognition provided the information remains accessible and usable in future. The Act contains the following provisions to facilitate e-governance: 1.
Legal Recognition of Electronic Records (Sec. 4)
Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then,
notwithstanding anything contained
is
such law,
such requirement shall be deemed to have been satisfied if such information or matter is — (
a) rendered or made available in an electronic form; and (b)
accessible so as to be usable for a subsequent reference. 2.
Legal Recognition of Digital Signatures (
Sec. 5)
Where any law provides that information or any other matter shall be
authenticated by affixing the signature
or any document shall be signed or bear the signature of any person
then, notwithstanding anything contained in such law,
such
requirement
shall be deemed to have been satisfied, if such information or matter is
authenticated by means of
digital signature
affixed

in
such manner as may be prescribed by the Central Government. Explanation—For the purposes of
this Section, "signed", with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing
of his handwritten
signature or any mark on any document and the expression "signature" shall be construed accordingly. 3.
Use of Electronic Records and Digital Signatures in Government and its Agencies (
Sec. 6) Where any law provides for—
Information Technology Act, 2000 396 Self-Instructional Material NOTES (
a)
the filing of any form, application or any other document with any office, authority, body or agency owned or controlled by the appropriate Government
in a particular manner; (b)
the issue or grant of any licence, permit, sanction or approval
by whatever name called
in a particular manner; (c) the receipt or payment of money in a particular manner,
then,
notwithstanding anything contained in any other law
for the time being in force,
such requirement shall be deemed to have been satisfied
in such filing, issue of
grant,
receipt or payment, as the case may be, is effected by means of such electronic form as may be prescribed by the appropriate Government.
The appropriate Government may, by rules, prescribe— (a) the manner and format in which such electronic records shall be filed, created or issued; (b) the manner or method of payment of any fee or charges for filing, creation or issue of any electronic record
under clause (a)
stated above. It may be observed that this Section lays down the foundation of electronic
governance. 4.
Retention of Electronic Records (Sec. 7)
Where any law provides that documents, records or information shall be retained for specific period, then, that requirement shall be deemed to have been satisfied if such
documents, records or information are retained in the electronic form, if— (
a) the information contained therein remains
accessible so as to be usable for a subsequent reference; (
b)
the
electronic record is retained in the format in which it was originally generated, sent or received
or in a format which can
be demonstrated to
represent accurately the information originally generated, sent or received; (c) the details which will facilitate the identification of the origin, destination, date and time of despatch or receipt of
such electronic record are available in the electronic record.
However,
the above rule
does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record
to be despatched or received.
Further, the
Section shall
not apply
to any law that expressly provides for the retention of documents, records or information
in the form of electronic records.
Legal requirement for retaining record is generally laid down for accounting and tax purposes. 5. Publication of Rules, Regulations, etc., in Electronic Gazette (Sec. 8)
Where any law provides that any

rule, regulation, order, bye-law, notification
or any other matter
shall be
published in the Official Gazette, then, such requirement shall be deemed to have been
satisfied if such
rule, regulation, order,
bye-law,
notification or any other matter is published in the Official Gazette or electronic
Gazette.
Provided that
where any
rule, regulation, order, bye-law,
notification or any other matter is published in the Official Gazette or Electronic
Gazette, the date
of publication
shall be deemed to be the date of the Gazette which was first published in any form.
Electronic Gazette means Official Gazette published in the electronic form [Sec. 2(l)(s)]. 6. No Right to insist that the Document should be accepted in Electronic Form (Sec. 9) Sections 6, 7 and 8 shall
not
confer a right upon any person to insist that any Ministry or Department of the Central Government or
the State Government or any authority or body
Information Technology Act, 2000 Self-Instructional Material 397 NOTES
established by or under any law or controlled or funded by the Central or State Government
should accept, issue, create, retain and
preserve any document in the form of electronic records or effect any monetary transaction
in the electronic form. 7.
Central Government empowered to make Rules in respect of Digital Signature (Sec. 10) The Central Government is empowered to make rules in respect of digital signature prescribing— (
a)
the type of digital signature; (b) the manner and format in which the digital signature shall be affixed; (c) the manner or procedure which facilitates
identification of the person affixing the digital signature; (
d) control processes and procedures to ensure adequate integrity, security and confidentiality of
electronic records
or
payments; and (
e)
any other matter which is necessary to give legal effect to digital
signatures.
The Central Government has notified 2 the "Information Technology (Certifying Authorities) Rules, 2000. Rule 3 of these Rules provides the manner in which the information is to be authenticated by means of digital signature. Rule 4 provides the manner of creation of digital signature, and Rule 5 provides the manner of verification of digital signature. The IT Act, 2000 has defined the various expressions used above as follows: Information [Sec. 2(l)(v)]. It
includes data, text, images, sound, voice, codes, computer programmes, software and
databases or micro film or computer generated micro
fiche.
Electronic form [Sec. 2(l)(
r)]. "
Electronic form," with reference to information,
means any information
generated, sent, received or stored in media, magnetic, optical, computer memory, microfilm, computer generated micro fiche or similar device.
Accessibility or Access [Sec. 2(l)(
a)]. It
means
gaining entry into, instructing or communicating with the logical, arithmetical or memory function resources of a computer, computer system or computer network.

The various expressions used in the above definitions have been defined in the Act as follows: Computer [Sec. 2(l)(i)]. It means any electronic,
magnetic, optical or other high-speed data processing device or system which performs
logical, arithmetic, and memory functions by manipulations of electronic, magnetic or optical impulses, and
includes all input, output, processing, storage, computer software, or communication facilities which are connected or related to the computer in a computer system or computer network.
Computer network [
Sec. 2(l)(j)]. It
means the
interconnection of one or more computers through— (i) the use of satellite, microwave, terrestrial line or other communication media; and (ii) terminals or a complex consisting
of
two or more interconnected computers
whether or not the interconnection is continuously maintained.
Computer
resource [
Sec. 2(l)(k)]. It
means
computer, computer system, computer network, data, computer database or software. Computer system [
Sec. 2(l)(i)]. It
means
a device or collection of devices, including input and output support devices and excluding calculators which are not programmable and 2
Vide Notification No. GSR 789(E), dated 17-10-2000.
Information Technology Act, 2000 398 Self-Instructional Material NOTES
capable of
being used in conjunction with external files, which contain computer programmes, electronic instructions, input data, and output data,
that performs
logic, arithmetic, data storage and retrieval, communication control and other
functions.
Data [
Sec. 2(l)(o)]. It
means
a representation of information, knowledge, facts, concepts or instructions which are being prepared or have been prepared in a formalised manner, and is intended to be processed, is
being processed
or has been processed in a computer system or computer network, and may be in any form (including computer printouts, magnetic or optical storage media, punched cards, punched tapes) or stored internally in the memory of the computer.
Function [Sec. 2(l)(
u)].
In relation to a computer, it
includes logic, control, arithmetical process, deletion, storage and retrieval and communication or telecommunication from or within a
computer. 33.7
ATTRIBUTION, ACKNOWLEDGEMENT AND DESPATCH OF ELECTRONIC RECORDS Under this heading, the IT Act, 2000 contains provisions regarding — (a) when the transmission of an electronic record shall be attributed to the originator?; (b) would the addressee/receiver be bound to acknowledge the receipt of that electronic record?; and (c) how to determine the
time and place of despatch
and receipt of electronic record? 33.7.1
Attribution of Electronic Records (Sec. 11)
An electronic record shall be attributed to the originator, if it was sent— (
a)
by the originator himself; (b)
by a person who had the authority to act on behalf of the originator in respect of that electronic record; or (

c)
by an information system programmed by or on behalf of the originator to operate automatically.
Originator [Sec. 2(l)(za)]. It
means
a person who sends, generates, stores or transmits any electronic message or causes any electronic message to be sent, generated, stored or transmitted to any other person but does not include an intermediary.
Intermediary [Sec. 2(l)(w)].
Intermediary, with respect to any particular electronic message,
means any person who on behalf of another person receives, stores or
transmits
the
message or provides any service with respect to that message.
Addressee [Sec. 2(l)(b)]. It
means
a person who is intended by the originator to receive the electronic record but does not include any intermediary. 33.7.2 Acknowledgement of Receipt (Sec. 12) No agreement.
Where the originator
has not agreed with the addressee that the acknowledgement of receipt of electronic record be given in a particular form or by a particular method, an acknowledgement may be given by— (
a)
any communication by the addressee, automated or otherwise; or (b) any conduct of the addressee, sufficient to indicate to the originator that the electronic record has been received [
Sec. 12(1)].
Stipulation by the originator.
Where the originator has stipulated that the electronic record shall be binding only on receipt of an acknowledgement of such electronic record by him, then unless acknowledgement has been so received, the electronic record shall be deemed to have been
never sent by the originator [
Sec. 12(2)].
Information Technology Act, 2000 Self-Instructional Material 399 NOTES No stipulation
by the originator. Where the originator has not stipulated that the electronic record shall be binding only on receipt of such acknowledgement, and
the acknowledgement has not been received by the originator within the time specified or agreed or, if no time has been specified or agreed to within a reasonable time, then the originator may give notice to the addressee stating that no acknowledgement has been received by him and specifying a reasonable time by which the acknowledgement must be received by him
and
if no acknowledgement is received within the aforesaid time limit he may after giving notice to the addressee, treat the electronic record as though it has never been sent [Sec. 12(3)]. 33.7.3 Time and Place of Despatch and Receipt of Electronic Record (
Sec. 13) Save as
otherwise agreed to
between the originator and the addressee, the despatch of an electronic record occurs when it enters a computer resource outside the control of the originator [
Sec. 13(1)].
Save as otherwise agreed between the originator and the addressee, the time of receipt of an electronic record shall be determined as follows, namely: (a) if the addressee has designated a computer resource for the purpose of receiving electronic records— (i)
receipt occurs at the time when the electronic record enters the designated computer resource;
or (
ii)
if the electronic record is sent to a computer resource of the addressee that is not the
designated computer resource, receipt occurs at the time when the electronic record is retrieved by the addressee; (b) if the addresser has not designated a
computer resource along with specified timings, if any,
receipt occurs when the electronic record enters the computer resource of the addressee [
Sec. 13(2)]. Save as

otherwise agreed
to
between the originator and the addressee, an electronic record is deemed to be despatched at the place where the originator has his place of business, and is deemed to be received at the place where the addressee has his place of business [
Sec. 13(3)]. The provisions of subsection (2) shall
apply notwithstanding that the place where the computer resource is located may be different from the place where the electronic record is deemed to have been received
under subsection (3) [Sec. 13(4)].
For the purposes of this Section— (a) if the originator or the addressee has more than one place of business, the principal place of business, shall be the place of business; (b) if the originator or the addressee does not have a place of business, his usual place of residence shall be deemed to be the place of business; (c) "usual place of residence", in relation to a body corporate, means the place where it is registered [
Sec. 13(5)]. 33.8 SECURE ELECTRONIC RECORDS AND SECURE DIGITAL SIGNATURES
In view of the fact that the communicated electronic records and messages must be secure and reliable for giving boost to e-commerce, the IT Act, 2000 lays down the legal presumptions as to when the 'electronic record' and 'digital signature' are deemed secure.
Information Technology Act, 2000 400 Self-Instructional Material NOTES 33.8.1
Secure Electronic Record (Sec. 14)
Where any security procedure has been applied to an electronic record at a specific point of time, then such record shall be deemed to be a secure electronic record from such point of time to the time of verification. 33.8.2
Secure
Digital Signature (Sec. 15) If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed, was— (
a) unique to the subscriber affixing it; (b)
capable of identifying such subscriber; (c)
created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated, then such digital signature shall be deemed to be a
secure digital signature. 33.8.3 Security Procedure (Sec. 16)
The Central Government shall for the purposes of this Act prescribe the security procedure having regard to commercial circumstances prevailing at the time when the procedure was used, including— (
a)
the nature of the transaction; (b) the level of sophistication of the parties with reference to their technological capacity; (c) the volume of similar transactions engaged in by other parties; (
d)
the availability of alternatives offered to but rejected by any party; (e) the cost of alternative procedures; (f) the procedures in general use for similar types of transactions or
communications.
The Central Government has prescribed the "Information Technology Security Guidelines" in Schedule II of the "Information Technology (Certifying Authorities) Rules, 2000. 33.9 REGULATION OF CERTIFYING AUTHORITIES With a view to creating regulations for certification, the IT Act, 2000 provides for the appointment, functions, powers and duties of "Controller of Certifying Authorities" and other officers. The procedure for issuing a licence to a "Certifying Authority", as well as the procedure for suspension or revocation or renewal of the licence has also been laid down. The Act also provides for the functions and duties
of Certifying Authorities. 33.9.1 Appointment of Controller and other Officers (
Sec. 17) 1.
The Central Government may,
by notification in the Official Gazette,
appoint
a Con- troller of Certifying Authorities for the purposes of this Act and may also by the same or subsequent notification appoint such number of Deputy Controllers and Assistant Controllers as it deems fit. 2.
The Controller shall discharge his functions under this Act
subject to the general con- trol and directions of the Central Government. 3. The Deputy Controllers and Assistant Controllers shall perform the functions assigned to them by the Controller under the general superintendence and control of the
Con- troller.

Information Technology Act, 2000 Self-Instructional Material 401 NOTES 4.
The qualifications, experience and
terms and conditions of service of Controller, Deputy Controllers and Assistant Controllers
shall be such as may be prescribed by the Central Government. 5.
The Head Office and Branch Office of the
office
of the Controller shall be at such places as the Central Government may specify, and these may be established at such places as the Central Government may think fit. 6. There shall be a seal of the Office of the Controller. 33.9.2
Functions of Controller (
Sec. 18)
The Controller may perform all or any of the following functions,
namely: (
a)
exercising supervision over the activities of the Certifying Authorities; (b) certifying public keys of the Certifying Authorities; (
c) laying
down the standards to be maintained by the Certifying Authorities: (
d) specifying
the qualifications and experience which employees of the Certifying Authorities should possess; (
e)
specifying the conditions subject to which the Certifying Authorities shall conduct their business; (
f)
specifying the contents of written, printed or visual materials and advertisements that may be distributed or used
in respect of a Digital Signature Certificate and the public key; (g) specifying the form and content of a Digital Signature Certificate and
the key; (
h)
specifying the form and manner in which accounts shall be maintained by the Certifying Authorities; (i) specifying the terms and conditions subject to which auditors may be appointed and the remuneration to be paid to them; (j)
facilitating the establishment of any electronic system
by a Certifying Authority either solely or jointly with other Certifying Authorities and regulation of such systems; (k)
specifying
the manner in which the Certifying Authorities shall conduct their dealings with the subscribers; (l) resolving any conflict of interests between the Certifying Authorities and the subscribers; (
m) laying down the duties of the Certifying Authorities; (n) maintaining a database containing
the
disclosure record of every Certifying Authority
containing such particulars as may be specified by regulations which shall be accessible to public. 33.9.3
Recognition of Foreign Certifying Authorities (
Sec. 19)
Subject to such conditions and restrictions as may be specified by
regulations,
the Controller may with the previous approval of the Central Government, and by notification in the Official Gazette, recognise any foreign Certifying Authority as a Certifying Authority for the
purposes of this Act [Sec. 19(1)]. Where any Certifying Authority is recognised under subsection (1),
the Digital Signature Certificate issued by such Certifying Authority shall be valid for the purposes of
the Act [
Sec. 19(2)].
Information Technology Act, 2000 402 Self-Instructional Material NOTES Revocation of recognition.
The Controller may if he is satisfied that any Certifying Authority
has contravened any of the conditions and restrictions subject to which it was granted recognition
under subsection (1) he
may, for reasons to be recorded in writing, by notification in the Official Gazette, revoke such recognition [
Sec. 19(3)]. 33.9.4
Controller to Act as Repository (
Sec. 20) A 'repository' is an on-line database of Digital Signature Certificates and other related information useful for those who conduct their business operations through the medium of computer internet or e-commerce.

The Controller shall be the repository of all Digital Signature Certificates issued under this Act [
Sec. 20(1)]. To
ensure that the secrecy and security of the digital signatures are assured
the
Controller
shall— (a) make use of hardware, software and procedures that are secure from intrusion and misuse; (b)
observe
such
other standards as may be prescribed by the Central Government [Sec. 20(2)].
The Controller shall maintain a computerised database of all public keys in such a manner that such database and the public keys are available to any member of the public [
Sec. 20(3)]. 33.9.5 Grant of Licence to Certifying Authorities
to Issue Digital Signature Certificates (Sec. 21)
Any person may make an application, to the Controller, for a licence to issue Digital Signature Certificate,
provided he fulfils
such
requirements with respect to qualification, expertise, manpower, financial resources and other infrastructure facilities, which are necessary to issue Digital Signature Certificates as may be prescribed by the Central Government [Sec. 21(1)
(2)]. A licence granted under this Section shall— (
a)
be valid for such period as may be prescribed by the Central Government; (
b) not be transferable or heritable; (c) be
subject to
such terms and conditions as may be specified by the regulations [
Sec. 2-1(3)]. Application for licence (
Sec. 22).
Every application for issue of a licence shall be
in such form as may be prescribed by the Central Government.
The
application for issue of a licence shall be
accompanied by— (a) a certification practice statement; (b) a statement including the procedures with respect to identification of the applicant; (c) payment of such fees, not exceeding
twenty-five thousand rupees
as may be prescribed by the Central Government; (d) such other documents, as may be prescribed by the Central Government.
Certification practice statement [Sec. 2(l)(h)]. "It
means
a
statement issued by a Certifying Authority to specify the practices that it employs in issuing Digital Signature Certificates." This statement specifies a set of rules and requirements which are to be followed by a Certifying Authority (CA) in its operation and issuing certificates. Check Your Progress 1. What do you understand by the term e-governance? 2. What do you understand by the term digital signature?
Information Technology Act, 2000 Self-Instructional Material 403 NOTES
Procedure for grant or rejection of licence (Sec. 24). The Controller may, on receipt of an application
for a
licence to issue Digital Signature Certificate,
after considering the documents accompanying the application and such other factors, as he deems fit, grant the licence or reject the application. However, no application
shall
be rejected
under this Section
unless the applicant has been given a reasonable opportunity of
presenting his case. Renewal of licence (
Sec. 23).
An application for renewal of a licence shall be— (a) in such form; (b) accompanied by such fees, not exceeding
five thousand rupees,
as may be prescribed by the Central Government and shall be made not less than

forty-five
days before the date of expiry of the period of validity of the licence.
Suspension of licence (
Sec. 25). The Controller may,
if he is satisfied after making an inquiry, revoke the licence where
a Certifying Authority has,— (a) made a statement in, or in relation to,
the application for the issue or renewal of the licence, which is incorrect or false in material particulars; (b) failed to comply
with
the terms and conditions subject to which the licence was granted; (c) failed to maintain the standards specified by the Central Government; (
d) contravened any provisions of this Act, rule, regulation or order made thereunder. However, no
licence
shall be revoked unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed revocation [Sec. 25(1)]. The Controller may, if he has reasonable cause to believe that there is any ground for revoking
a licence under sub-section (1), by
order suspend such licence pending the completion of any inquiry ordered by him. However, no licence
shall
be suspended for a period exceeding ten days unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed suspension [Sec. 25(2)]. Further, no Certifying Authority whose
licence
has been suspended shall issue any Digital Signature Certificate during such suspension [
Sec. 25(3)].
Notice of suspension or revocation of licence (Sec. 26). Where the licence of the Certifying Authority
is suspended or revoked, the Controller shall publish notice of such suspension or revocation, as the case may be, in the database maintained by him.
Where one or more repositories are specified, the Controller shall publish notices of such suspension or revocation, as the case may be, in all such repositories.
However, the
database containing the
notice of such suspension or revocation, as the case may be,
shall be made available through a website which shall be accessible round the clock. 33.10
POWERS OF CONTROLLER The Controller of Certifying Authorities has the following powers: 1. Power to authorise, in writing, the Deputy or the Assistant Controller or any officer to exercise any of his powers (
Sec. 27). 2. Power to
take up for investigation any contravention of the Act or rules or regulations made thereunder.
He may authorise any officer also in this behalf [Sec. 28(1)]. 3. Power to exercise himself or through an authorised officer like powers which are
conferred on Income-tax Authorities under Chapter XIII of the Income-tax Act, 1961 [
Sec. 28(2)]. A few such powers are briefly stated below: (i)
Powers as are vested in the Court when trying a suit in respect of matters relating to inspection,
enforcing attendance of any person and examining him on oath, compelling the production of
books of account, etc.
Information Technology Act, 2000 404 Self-Instructional Material NOTES (ii) Power to enter and search any building, place, etc., where books of account, documents or valuables are believed to be kept, and seize them. (iii) Power to requisition books of account or assets from any officer possessing them. (iv) Power to call for information. (v) Power to inspect and take copies of any Register of Members or Debentureholders. (vi) Power to make enquiries. 4. Power to direct,
by order, a Certifying Authority or any employee of such Authority to take such measures or cease carrying on such activities as specified in the order, if those are necessary to ensure compliance with the provisions of
the Act, rules or any regulations made thereunder [Sec. 68(1)]. 5. Power to direct, by order, any agency of the Government to intercept any information transmitted through any “computer resource” (i.e., computer, computer system and computer network, etc.), if
it is necessary or expedient
in
the interest of the sovereignty or

integrity of India,
the
security of the State, friendly relations with foreign States
or public order
or
for preventing incitement to the commission of any cognizable offence [
Sec. 69(1)]. 33.10.1 Access to Computers and Data (Sec. 29) If
the Controller
has reasonable cause to suspect that any
contravention of the provisions of
this Act, rules or regulations made thereunder
has been committed,
the Controller or any other person authorised by him shall
have access to any computer system, any apparatus, data or any other material connected with such system, for the purpose of searching
or causing a search to be made for obtaining any information or data contained in or available to such computer system.
He may also,
by order, direct any person incharge of, or otherwise concerned with the operation
of, the computer system, data apparatus or material, to provide him with such reasonable technical and other assistance as he may consider necessary. 33.10.2
Certifying Authority to follow certain Procedures (
Sec. 30) The person to whom a licence has been granted by the Controller to issue Digital Signature Certificates is termed as a Certifying Authority [Sec. 2(l)(g)]. Every Certifying Authority shall follow certain procedures relating to security of system, in performance of its services, it is required, to, — (
a)
make use of hardware, software, and procedures that are secure from intrusion and misuse; (b) provide a reasonable level of reliability in its services which are reasonably suited to the performance of intended functions; (c) adhere to security procedures to ensure that the secrecy and privacy of the digital signatures are assured;
and (
d)
observe such other standards as may be specified by regulations. 33.11
DUTIES OF CERTIFYING AUTHORITY
The Certifying Authority
has the following duties: 1. To
ensure that every person employed or otherwise engaged by it complies, in the course of his employment or engagement, with the provisions of
the Act, rules, regulations and orders made thereunder (
Sec. 31).
Information Technology Act, 2000 Self-Instructional Material 405 NOTES 2. To
display its licence at a conspicuous place of the premises in which it carries on its business (
Sec. 32). 3. To surrender the licence to the Controller immediately after its suspension or revocation [Sec. 33(1)]. 4. To disclose in the manner specified by the regulations— (a) its Digital Signature Certificate which contains the public key corresponding to the private key used by
the
Certifying Authority to digitally sign another Digital
Signature Certificate; (b) any certification practice statement relevant thereto; (c) notice of the revocation or suspension of its Certifying Authority certificate, if any; and (d) any other fact that materially and adversely affects either the reliability of a Digital Signature Certificate, which that Authority has issued, or the Authority's ability to perform its services [
Sec. 34(1)]. 5. To make
reasonable efforts to notify any person who is likely to be affected by
the occurrence of any event which,
in the opinion of the Certifying Authority, may materially and adversely affect the integrity of its computer system or the conditions subject to which a Digital Signature Certificate was granted.
He may also
act in accordance with the procedure specified in its 'certification practice statement' to deal with such event or situation
[

Sec. 34(2)]. It may be noted that the Central Government has notified 3 the "Information Technology (Certifying Authorities) Rules, 2000" which may be referred with advantage. Schedule III of these Rules prescribes the "Security Guidelines for Certifying Authorities". 33.12 DIGITAL SIGNATURE CERTIFICATES The purpose of a digital signature certificate is to authenticate the identify of an individual. It ensures that the purported sender is infact the person who sent the message. It is signed digitally by the Certifying Authority. 33.12.1 Certifying Authority to Issue Digital Signature Certificate (Sec. 35)
Application.
Any person may make an application to the Certifying Authority for the issue of a Digital Signature Certificate
in such form
as may be prescribed by the Central Government.
The application shall be
accompanied: (
a)
by such fee not exceeding twenty-five thousand rupees
as may be prescribed by the Central Government.
However, different fees may be prescribed for different classes of applicants. (b)
by a 'certification practice statement' or where there is no such statement, a
statement containing such particulars, as may be specified by regulations.
Grant of certificate. On receipt of an application for the
issue of Digital Signature Certificate,
the Certifying Authority may, after consideration of the 'certification practice statement' or
the
other statement
referred above
and
after making such enquiries as it may deem fit, grant the Digital Signature Certificate or for reasons to be recorded in writing, reject the application.
However, no Digital Signature Certificate shall be granted unless the Certifying Authority is satisfied that— 3
Vide Notification No. GSR 789(E), dated 17-10-2000.
Information Technology Act, 2000 406 Self-Instructional Material NOTES (
a)
the applicant holds the private key corresponding to the public key to be listed in the Digital Signature Certificate; (
b) the applicant holds a private key, which is capable of creating a digital signature; (c) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the
applicant. 33.12.2
Representations upon issuance of Digital Signature Certificate (Sec. 36) While issuing a Digital Signature Certificate, the Certifying Authority certifies that the information contained in it is accurate and
that:— (
a)
it has complied with the provisions of this Act and the rules and regulations made thereunder; (b) it has published the Digital Signature Certificate or otherwise made it available to such person relying on it and the subscriber has accepted it;
(
c)
the subscriber holds the private key corresponding to the public key, listed in the Digital Signature Certificate; (
d) the subscriber'
s public key and private key constitute a functioning key pair;
and (e)
it has no knowledge of any material fact, which if it had been included in the Digital Signature Certificate would adversely affect the reliability of the representations made in clauses (a) to (d). 33.12.3 Suspension of Digital Signature Certificate (Sec. 37) The Certifying Authority which has issued a Digital Signature Certificate may suspend such Digital Signature Certificate,— (a) on receipt of a request to that effect from— (i) the subscriber listed in the Digital Signature Certificate; or (ii) any person duly authorised to act on behalf of that subscriber; (b) if it is of opinion that the Digital Signature Certificate should be suspended in public interest. A Digital Signature Certificate shall not be suspended for a period exceeding fifteen days unless
that subscriber
has been given an opportunity of being heard in the matter. Further,

on suspension of a Digital Signature Certificate under this Section, the Certifying Authority shall communicate the same to the subscriber. 33.12.4
Revocation of Digital Signature Certificate (Sec. 38) A Certifying Authority may revoke a Digital Signature Certificate issued by it— (a) where the subscriber or any other person authorised by him makes a request to that effect;
or (
b) upon the death of the subscriber; or (c) upon the dissolution of the firm or winding up of the company where the subscriber is a firm or a company.
The Certifying Authority may also
revoke a Digital Signature Certificate which has been issued by it at any time, if it is of opinion that—
Information Technology Act, 2000 Self-Instructional Material 407 NOTES (
a) a material fact represented in the Digital Signature Certificate is false or has been concealed; (b) a requirement for issuance of the Digital Signature Certificate was not satisfied; (c) the Certifying Authority's private key or security system was compromised in a manner materially affecting the Digital Signature Certificate's reliability; (d) the subscriber has been declared insolvent or dead or where a subscriber is a firm or a company,
which
has been dissolved, wound-up or otherwise ceased to exist. A Digital Signature Certificate shall not be revoked unless the subscriber has been given an opportunity
of being heard in the matter.
Further,
on revocation of a Digital Signature Certificate under this Section, the Certifying Authority shall communicate the same to the subscriber.
Notice of suspension or revocation (Sec. 39). Where a Digital Signature Certificate is suspended or revoked under Section 37 or Section 38, the Certifying Authority shall publish a notice of such suspension or revocation, as the case may be, in the repository specified in the Digital Signature Certificate for publication of such notice. Where one or more repositories are specified, the Certifying Authority shall publish notices of such suspension or revocation, as the case may be, in all such repositories. 33.13
DUTIES OF SUBSCRIBERS
The IT Act, 2000 lays down the following duties of the subscribers who have obtained the Digital Signature Certificate from some Certifying Authority: 1.
Generating Key Pair (Sec. 40). Where any Digital Signature Certificate, the public key of which corresponds to the private key of that subscriber which is to be listed in the Digital Signature Certificate, has been
accepted by a
subscriber,
then,
the subscriber shall generate the key pair by applying the security procedure. 2.
Acceptance of Digital Signature Certificate (
Sec. 41).
A subscriber shall be deemed to have accepted a Digital Signature Certificate if he publishes or authorises its publication: (a) to one or more persons; (b) in a repository, or
If he otherwise demonstrates his approval in any manner.
Subscriber representation.
By accepting a Digital Signature Certificate
the subscriber certifies to all who reasonably rely on the information contained therein that— (a) he
holds the private key corresponding to the public key listed in the Digital Signature Certificate
and is entitled to hold the same; (b) all his representations to the Certifying Authority and all material relevant information contained in the Certificate are true; (c) all information in the Certificate that is within his knowledge is true. 3. Control of Private Key (Sec. 42). Every subscriber shall exercise reasonable care to retain control of
the private key corresponding to the public key listed in his Digital Signature Certificate
and take all steps to prevent its disclosure
to a person not authorised to affix his digital signature.
If
the private key corresponding to the public key listed in the Digital Signature Certificate
has been compromised, then, the subscriber shall communicate
the same without any delay to the Certifying Authority in
the prescribed manner. Till so communicated, he shall be liable. Check Your Progress 3. Explain the law relating to authentication of electronic records. 4. What are the functions of the 'controller'? 5. What are the duties of the 'certifying authority'?

Information Technology Act, 2000 408 Self-Instructional Material NOTES 33.14 PENALTIES AND ADJUDICATION Inspite of security measures adopted by an owner of the computer, computer system and computer network, there are theft and intrusion. Legal protection has therefore been provided against the wrongdoers. Under the Act penalty is imposed by way of damages to be paid as compensation to the affected party for damage caused to any computer, computer network etc. by introduction of computer virus, unauthorised access and other types of mischief. 33.14.1 Penalty for Damage to Computer, Computer System, etc. (Sec. 43) If any person indulges in any of the following acts, without permission of the owner or any other person who is incharge of a computer, computer system or computer network, he shall be liable to pay damages by way of compensation not exceeding one crore rupees to the person so affected: (a) accesses or secures access to such computer, computer system or computer network; (b) downloads, copies or extracts any data, computer database or information from such computer, computer system or computer network including information or data held or stored in any removable storage medium; (c) introduces or causes to be introduced any computer contaminant or computer virus into any computer, computer system or computer network; (d) damages or causes to be damaged any computer, computer system or computer network, data, computer database or any other programmes residing in such computer, computer system or computer network; (e) disrupts or causes disruption of any computer, computer system or computer network; (f) denies or causes the denial of access to any person authorised to access any computer, computer system or computer network by any means; (g) provides any assistance to any person to facilitate access to a computer, computer system or computer network in contravention of the provisions of this Act, rules or regulations made thereunder; (h) charges the services availed of by a person to the account of another person by tampering with a manipulating any computer, computer system, or computer network. Explanation—For the purposes of this Section— (i) "computer contaminant"' means any set of computer instructions that are designed— (a) to modify, destroy, record, transmit data or programme residing within a computer, computer system or computer network; or (b) by any means to usurp the normal operation of the computer, computer system, or computer network; (ii) "computer database" means a representation of information, knowledge, facts, concepts or instructions in text, image, audio, video that are being prepared or have been prepared in a formalised manner or have been produced by a computer, computer system or computer network and are intended for use in a computer, computer system or computer network; Information Technology Act, 2000 Self-Instructional Material 409 NOTES (iii) "computer virus" means any computer instruction, information, data or programme that destroys, damages, degrades or adversely affects the performance of a computer resource or attaches itself to another computer resource and operates when a programme, data or instruction is executed or some other event takes place in that computer resource; (iv) "damage" means to destroy, alter, delete, add, modify or rearrange any computer resource by any means. 33.14.2 Penalty for Failure to Furnish Information, Return, etc. (Sec. 44) If any person who is required under this Act or any rules or regulations made thereunder to— (a) furnish any document, return or report to the Controller or the Certifying Authority fails to furnish the same, he shall be liable to a penalty not exceeding one lakh and fifty thousand rupees for each such failure; (b)

file any return or furnish any information, books or other documents within the time specified therefor in the regulations fails to file return or furnish the same within the time specified therefore in the regulations, he shall be liable to a penalty not exceeding
five thousand rupees
for every day during which such failure continues; (c) maintain books of account or records fails to maintain the same, he nail be liable to a penalty
not exceeding ten
thousand rupees for every day during which the failure continues. 33.14.3
Penalty Where No Specific Penalty is Provided Elsewhere in the Act (Sec. 45)
Whoever contravenes any rules or regulations made under this Act, for the contravention of which no penalty has been separately provided, shall be liable to pay a compensation not exceeding
twenty-five thousand rupees to the person affected by such contravention
or a penalty not exceeding twenty-five thousand rupees. 33.14.4 Adjudication — Appointment of Adjudicating Officer (Sec. 46)
For the purpose of adjudging whether any person has committed a contravention of any of the provisions of this Act or of any rule, regulation, direction or order made thereunder the Central Government shall
appoint any
officer not below the rank of a Director to the Government of India or an equivalent officer of a State Government to be an adjudicating officer for holding an inquiry in the manner prescribed by the Central Government.
However,
no person shall be appointed as an adjudicating officer unless he possesses such experience in the field of Information Technology and legal or judicial experience
as may be prescribed by the Central Government.
The adjudicating officer shall,
after giving the person referred to
above, give
a
reasonable opportunity for making representation in the matter and if, on such inquiry, he is satisfied that the person has committed the contravention,
he may
impose such penalty or award such compensation as he thinks fit in accordance with the provisions of that Section.
Where more than one adjudicating officers are
appointed, the Central Government shall specify by order the matters and places with respect to which such officers shall exercise their jurisdiction. Powers. Every adjudicating officer shall have the powers of a civil court which are conferred on the Cyber Appellate Tribunal
under subsection (2) of
Section 58,
and— (a) all proceedings before it
shall be deemed to be judicial proceedings within the meaning of Sections 193 and 228 of the Indian Penal Code, 1860; Information Technology Act, 2000 410 Self-Instructional Material NOTES (
b)
shall be deemed to be civil court for the purposes of Sections 345 and 346 of the Code of Criminal Procedure, 1973.
Factors to be taken into account by the Adjudicating Officer (Sec. 47). While adjudging the quantum of compensation, the adjudicating officer shall have due regard to the following factors, namely: (
a)
the amount of gain of unfair advantage, wherever quantifiable, made as a result of the default; (b) the amount of loss caused to any person as a result of the default; (c) the repetitive nature of the default. 33.15
THE CYBER REGULATIONS APPELLATE TRIBUNAL
Here the IT Act, 2000 deals with the establishment of
one or more Appellate Tribunals to be known as Cyber Regulations Appellate Tribunal
or Cyber Appellate Tribunal to exercise jurisdiction, powers and authority as conferred under the Act. 33.15.1
Establishment of Cyber Appellate Tribunal (Sec. 48)
The Central Government shall, by notification, establish one or more appellate tribunals to be known as the Cyber Regulations Appellate Tribunal.
It
shall also specify, in the
notification

the matters and places in relation to which the
Cyber Appellate Tribunal may exercise jurisdiction.
Composition of Cyber Appellate Tribunal (
Sec. 49).
A Cyber Appellate Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer of the Cyber Appellate Tribunal) to be appointed, by notification, by the Central Government.
Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings (Sec. 55).
No order of the Central Government appointing any person as the Presiding Officer of a Cyber Appellate Tribunal shall be called in question in any manner and no act or proceeding before
a Cyber
Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Cyber Appellate Tribunal.
Staff of the Cyber Appellate Tribunal (Sec. 56). The Central Government shall provide the Cyber Appellate Tribunal with such officers and employees as that Government may think fit. The officers and employees of the Cyber Appellate Tribunal shall discharge their functions under general superintendence of the Presiding Officer.
The salaries
and allowances
and other conditions of service of the officers and employees
of the Cyber Appellate Tribunal
shall be such as may be prescribed
by the
Central
Government.
Qualifications
for appointment as Presiding Officer of the Cyber Appellate Tribunal (Sec. 50).
A person shall not be qualified for appointment as the Presiding Officer of
a Cyber Appellate Tribunal
unless he— (a)
is, or
has
been, or is qualified to be, a Judge
of
a High Court;
or (b)
is or has been a member of the Indian Legal Service and is holding or has held a post in Grade I of the Service for at least three years. Term of Office (Sec. 51). The Presiding Officer
of a Cyber Appellate Tribunal
shall hold office for a term of five years from the date on which he enters upon his office
or until he attains the age of sixty-five years, whichever is earlier.
Salary, allowances and other terms
and conditions of service of Presiding Officer (Sec. 52).
The salary and allowances payable to, and the other terms and conditions of service
Information Technology Act, 2000 Self-Instructional Material 411 NOTES
including pension, gratuity and other retirement benefits of, the Presiding Officer of a Cyber Appellate Tribunal shall be such as may be prescribed. Further,
the salary and allowances and the other terms and conditions of service of the
Presiding Officer shall not be varied to his disadvantage after appointment. Filling up of vacancies (Sec. 53). If, for reason other than temporary absence, any vacancy occurs in the office of the Presiding Officer
of a Cyber Appellate Tribunal,
then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Cyber Appellate Tribunal from the stage at which the vacancy is filled. Resignation [Sec. 54(1)]. The Presiding Officer of Cyber Appellate Tribunal may,
be
notice in writing under his hand addressed to the Central Government, resign his office. However, he shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is

the earliest. Removal [Sec. 54(2)(3)]. The Presiding Officer of a Cyber Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the Supreme Court in which the Presiding Officer concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges. The Central Government may, be rules, regulate the procedure for the investigation of misbehaviour or incapacity of the aforesaid Presiding Officer. 33.15.2

Appeal to Cyber Regulations Appellate Tribunal (Sec. 57) Any person aggrieved by an order made by Controller or an adjudicating officer under this Act may prefer an appeal to a Cyber Appellate Tribunal having jurisdiction in the matter. However, no appeal shall lie from an order made by an adjudicating officer with the consent of the parties. Period allowed for appeal. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Controller or the adjudicating officer is received by the person aggrieved and it shall be in such form and be accompanied by such fee as may be prescribed. However, the Cyber Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

Order by Cyber Appellate Tribunal.

On receipt of an appeal, the Cyber Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against. The appeal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal. The Cyber Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Controller or adjudicating officer. The appellant may either appear in person or authorise one or more legal practitioners or any of its officers to present his or its case before the Cyber Appellate Tribunal (Sec. 59). 33.15.3

Powers of the Cyber Appellate Tribunal (Sec. 58)

The Cyber Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908. It shall, however, be guided by the principles of natural justice, provisions of the Act and rules made thereunder. Natural justice means to act in good faith, fairly, justly and impartially and never arbitrarily. It shall have powers to regulate its own procedure including the place at which it shall have its sittings.

Information Technology Act, 2000 412 Self-Instructional Material NOTES

The Cyber Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely: (a) summoning and enforcing

the attendance of any person and examining him on oath; (b) requiring the discovery and production of documents or other electronic records; (c) receiving evidence on affidavits; (d) issuing commissions for the examination of witnesses or documents; (e) reviewing its decisions; (f) dismissing an application for default or deciding it ex parte, (g) any other matter which may be prescribed.

Every proceeding before the Cyber Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196 of the Indian Penal Code and the Cyber Appellate Tribunal shall be deemed to be a civil court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

The Central Government has notified 4 the "Cyber Regulations Appellate Tribunal (Procedure) Rules, 2000." 33.15.4 Civil Court not to have Jurisdiction (Sec. 61) The Adjudicating Officer and the Cyber Appellate Tribunal have exclusive jurisdiction to decide specific issues for which they have been empowered. Section 61 provides that: (a) No court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an adjudicating officer appointed under this Act or the Cyber Appellate Tribunal constituted under this Act is empowered by or under this Act to determine; and (b) No injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Injunction is a specific order of the court directing the defendant to refrain from doing certain act. 33.15.5 Appeal to High Court (Sec. 62)

Any person aggrieved by any decision or order of the Cyber Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Cyber Appellate Tribunal to him on any question of fact or law arising out of such order. However, the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days. 33.15.6 Compounding of Contraventions (Sec. 63) Any contravention under the Act may, either before or after the institution of adjudication proceedings, be compounded by the Controller or such other officer as may be specially authorised by him in this behalf or by the adjudicating officer, as the case may be, subject to such conditions he may impose. However, the compounded sum shall not, in any case, exceed the maximum amount of the penalty which may be imposed under this Act for the contravention so compounded. 4 Vide Notification No. GSR 791(E), dated 17-10-2000.

Information Technology Act, 2000 Self-Instructional Material 413 NOTES The above provision shall not apply to a person who commits the same or similar contravention within a period of three years from the date on which the first contravention committed by him, was compounded.

Explanation—For the purposes of this Section, any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention. Where any contravention has been compounded, no proceeding or further proceeding, as the case may be, shall be taken against the person guilty of such contravention in respect of the contravention so compounded. 33.15.7 Recovery of Penalty (Sec. 64)

A penalty imposed under this Act, if it is not paid, shall be recovered as an arrear of land revenue and the licence or the Digital Signature Certificate, as the case may be, shall be suspended till the penalty is paid. 33.16

OFFENCES
The Information Technology Act provides civil and criminal penalties for the violation of its provisions. Sections 43 to 47 dealing with civil penalty have already been discussed under the heading "Penalties and Adjudication". Sections 65 to 76 dealing with criminal penalty are discussed hereunder. In all cases severe penalty is provided which is criminal in nature, i.e., either imprisonment for the offence or imposition of fine or both. 33.16.1 Tampering with Computer Source Documents (Sec. 65) If any
person
knowingly or
intentionally conceals, destroys or alters or intentionally or knowingly causes another to conceal, destroy or alter any computer source code used for a computer, computer programme, computer system or computer network, when the computer source code is required to be kept or maintained by law for
the time being in force,
he
shall be punishable with imprisonment up to three years, or with fine up to
two lakh rupees,
or with both.
Explanation—
For the purposes of this Section, "computer source code" means the listing of programmes, computer commands, design and layout and programme analysis of computer resource in any form. 33.16.2
Hacking with Computer System (
Sec. 66) Whoever
with the intent to cause or knowing that he is likely to cause wrongful loss or
damage to the public or any person destroys or deletes or alters any information residing in a computer resource or diminishes its value or utility or affects it injuriously by any means, commits hacking. Whoever commits hacking shall be punished with imprisonment up
to three years, or with fine upto two lakh rupees, or with both. 33.16.3
Publishing of Information which is
Obscene in Electronic Form (Sec. 67) Whoever publishes or transmits or causes to be published in the electronic form, any material which is lascivious or appeals to
the
prurient interest or if its effect is such as to
tend to deprave and corrupt persons who are likely, having regard to all relevant circumstances,
to read, see or hear the matter contained or embodied in it,
shall be punished. On first conviction
he shall be punishable with imprisonment up
to five years and with fine up to one lakh rupees. In the event of
a second or subsequent conviction
he shall be punishable with imprisonment up to ten years and also with fine up to two lakh rupees.
Information Technology Act, 2000 414 Self-Instructional Material NOTES It may be noted that it is only the publishing or transmitting of obscenity which is an offence, and not its possession. 33.16.4 Securing Unauthorised Access to Protected System (Sec. 70) The Government, may, be notification in the Official Gazette declare that any computer, computer system or computer network to be a protected system. It may also, by order in writing, authorise persons to have access to it.
Any person who secures or attempts to secure unauthorised
access to a protected system
shall be punished with imprisonment which may extend to ten years and shall also be liable to fine. 33.16.5
Penalty for Misrepresentation (Sec. 71)
Whoever makes any misrepresentation to, or suppresses any material fact from, the
Con- troller
or the Certifying Authority for obtaining any licence or Digital Signature Certificate, as the case may be,
shall be punished with imprisonment for a term which may extend to two years, or with fine
which
may extend to
one lakh rupees, or with both. 33.16.6
Penalty for Breach of Confidentiality and Privacy (
Sec. 72)
If

any person
who, in pursuance of any of the powers conferred under this Act, rules or regulations made thereunder,
has secured access to any electronic record, book, register, correspondence, information, document or other material without the consent of the person concerned discloses
such electronic record, book, register, correspondence, information, document or other
material to any other person,
he
shall be punished with imprisonment for a term which may extend to two years, or with fine
which
may extend to
one lakh rupees, or with both.
Thus, Section 72 prohibits unauthorised disclosure of the contents of electronic record. 33.16.7
Penalty for Publishing Digital Signature Certificate False in Certain Particulars (Sec. 73)
No person shall publish
a Digital
Signature Certificate or otherwise make it available to any other person with the knowledge that— (a) it has not been issued by the Certifying Authority; or (b) it has not been accepted by the subscriber; or (c) the certificate has been revoked or suspended. However, if the
publication is for the purpose of verifying a digital signature created prior to such suspension or revocation,
this rule will not apply.
Any
person, who contravenes the above
provisions,
shall be punished with imprisonment for a term which may extend to two years, or with fine
which
may extend to
one lakh rupees, or with both. 33.16.8
Publication for
Fraudulent Purpose (Sec. 74)
Whoever knowingly creates, publishes or otherwise makes available a Digital
Signature Certificate for any fraudulent or unlawful purpose
shall be punished with imprisonment for a term which may extend to two years, or with fine
which
may extend to
one lakh rupees, or with both. 33.16.9
Act to Apply for Offence or Contravention Committed Outside India (
Sec. 75)
The provisions of this Act shall apply also to any offence or contravention committed outside India by any person irrespective of his nationality,
if the
act or conduct constituting
Information Technology Act, 2000 Self-Instructional Material 415 NOTES
the offence or contravention involves a computer; computer system or computer network located in India. 33.16.10
Confiscation (
Sec. 76) Section 76 provides for confiscation of
any computer, computer system, floppies, compact disks, tape drives or any other accessories related thereto, in respect of which
there is contravention of any provision of this Act.
However,
where it is established to the satisfaction of the court adjudicating the confiscation that the person who is in possession, power or control
of
these articles in not responsible for the contravention,
the court may, instead of making an order for confiscation, make such
other order as it may think fit. 33.16.11 Penalties and Confiscation not to Interfere with other Punishments (Sec. 77) Any penalty imposed or confiscation made under this Act shall not interfere with other punishments provided under any other law for the time being in force. 33.16.12 Power to Investigate Offences (Sec. 78) A

police officer not below the rank of Deputy Superintendent of Police
is empowered to investigate any offence under the
Act. 33.16.13 Network Service Providers not to be Liable in Certain Cases (Sec. 79)
For the removal of doubts, it is hereby declared that
no person providing any service as a network service provider shall be liable under this Act, rules or regulations made thereunder for any third party information or data made available by him if he proves that the offence or contravention was committed
without his knowledge or that he had exercised all due diligence to prevent the commission of
such offence
or contravention. Explanation—For the purposes of this Section,— (a) "network service provider" means an intermediary; (b) "
third party information" means any information dealt with by a network service povider in his capacity as an intermediary. 33.16.14
Offences by Companies (Sec. 85)
Where a person committing
a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder
is
a company, every person who, at the time the contravention was committed, was incharge of, and was responsible to, the company for the conduct of business of the company as well as the company, shall be guilty of
the contravention
and
shall be liable to be proceeded against and punished accordingly,
unless
he
proves that
the contravention took place without his knowledge or that he exercised all due diligence to prevent
such contravention.
If
it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such person shall also
be deemed to be guilty of the contravention
and shall be liable to be proceeded against and punished accordingly.
Explanation—For the purposes of this Section,— (i) "company" means any body corporate and includes a firm or other association of individuals; and (ii) "
director" in relation to a firm, means a partner in the firm.
Check Your Progress 6. What do you mean by hacking with computer system? 7. The IT Act provides civil and criminal penalties for the violation of its provisions. Elucidate.
Information Technology Act, 2000 416 Self-Instructional Material NOTES 33.16.15
Constitution of Advisory Committee (Sec. 88) The Central Government shall, as soon as may be after the commencement of this Act, constitute a Committee called the Cyber Regulations Advisory Committee.
It
shall consist of a Chairperson
and such number of other
official and non-official members representing
the interests principally affected or having special knowledge of the subject-matter as the Central Government may deem fit.
There shall be paid to the
non-official members of such Committee such travelling and other allowances
as
the Central Government may fix. The Cyber Regulations Advisory Committee shall advise— (a) the Central Government either generally as regards any rules or for any other purpose connected with
the
Act; (b) the Controller in framing the regulations under this Act. The
Central Government has notified the constitution of "Cyber Regulations Advisory Committee" consisting of 21 members including the Chairperson vide Notification No. GSR 790 (E), dated 17th October, 2000. 33.16.16 Power of Controller to make Regulations (Sec. 89) The Controller may, after consultation with the Cyber Regulations Advisory Committee and with the previous approval

of the Central Government, by notification in the Official Gazette,
make regulations consistent with the Act and the rules made thereunder to carry out the purposes of
the Act. In particular
such regulations may provide for all or any of the following matters, namely: (a) the
particulars relating to maintenance of database containing the disclosure record of every Certifying Authority under Section 18(m); (b) the conditions and restrictions subject to which the Controller may recognise any foreign Certifying Authority under Section 19(1); (c) the terms and conditions subject to which a licence may be granted under Section 21 (3)(c); (d) other standards to be observed by a Certifying Authority under Section 30(d); (e) the manner in which the Certifying Authority shall disclose the matters specified in Section 34(1); (f) the particulars of statement which shall accompany an application under Section 35(3); (g) the manner by which the subscriber communicates the compromise of private key to the Certifying Authority under Section 42(2). 33.17 TEST QUESTIONS 1. What do you understand by the term Information Technology? Explain the rationale behind the Information Technology Act, 2000. 2. Explain the terms "e-commerce" and "e-governance" with reference to Information Technology Act, 2000. 3. What are the objectives of Cyber Laws? Explain. 4. Define the following terms as used in the Information Technology Act, 2000: (i) Digital signature; (ii) Asymmetric crypto system; (iii) Electronic record; (iv) Private key an Public key; (v) Computer network; (vi) Originator; (vii) Computer database; (viii) Computer virus.
Information Technology Act, 2000 Self-Instructional Material 417 NOTES 5. How is "
Controller of Certifying Authorities" appointed? What are his functions under the Information Technology Act, 2000. 6. Discuss the powers of "Controller of Certifying Authorities" under the Information Technology Act, 2000. 7.
Discuss the duties of "Certifying Authority" under the Information Technology Act, 2000. 8. Discuss the provisions of Information Technology Act, 2000 relating to "Digital Signature Certificate". 9. Enumerate the activities relating to computer, computer network etc., which are sub- ject to sanction and penalised, if indulged without the permission of the owner or the person-in-charge. 10. How is "Cyber Appellate Tribunal" established? What are its powers under the Information Technology Act, 2000? Discuss. 11. Discuss the provisions of Information Technology Act, 2000 relating to appointment, term of office, salary, resignation and removal of the Presiding Officer of the Cyber Appellate Tribunal.
The Company Self-Instructional Material 419 NOTES UNIT 34 THE COMPANY Structure 34.0 Introduction 34.1 Unit Objectives 34.2 Companies Act and its Administration 34.3 Definition of Company and its Characteristics 34.4 Characteristics of Company 34.5 Incorporation of Company 34.6 Test Questions 34.0 INTRODUCTION The evolution of Joint Stock Company form of business organisation was a historical necessity. The sole proprietorship and partnership firms with limited capital, unlimited liability, limited managerial skill and other drawbacks could not prove effective to meet the challenges posed by economies of large scale production and introduction of advanced technologies. Therefore the businessmen was forced to think in terms of bigger form of business organisation. As a result, the present form of joint stock companies emerged which is capable of mobilising large amount of capital with the provision of limited liability and efficient and specialised management. The "company" was found most suitable form of organisation for large scale enterprises requiring heavy investment and also for enterprises involving heavy risks. In this unit, we shall study the meaning and nature of a company, illegal associations, and procedure of incorporation of a company. The Act constituting the Company Law in India and its administration has also been discussed in very brief. 34.1 UNIT OBJECTIVES ? Know the definition and essential characteristics of a company. ? Understand the law regarding illegal associations. ? Know the procedure of incorporation of a company. 34.2 COMPANIES ACT AND ITS ADMINISTRATION The Companies Act, 1956 constitutes the Company Law in India. It contains elaborate provisions relating to the formation,
powers and responsibilities of the directors and managers, raising of capital, holding
of company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and winding up of companies. The Act contains 658 Sections and XV Schedules. The Companies Act, 1956 has been amended for about two dozen times so far. The recent in the series are the Companies (Amendment) Act, 2002 and the Companies (Second Amendment) Act, 2002. The Companies (Amendment) Act, 2002 provides for setting-up and regulation of cooperatives as companies under the Companies Act, 1956 to be called "Producer Companies". The Amending Act came into force on 6th February, 2003. The Companies (Second Amendment) Act, 2002 was notified in the Gazette of India dated 14th January, 2003. But this amending Act has not yet been enforced by the Government. The

The Company 420 Self-Instructional Material NOTES amending Act proposes to establish a 'National Company Law Tribunal' providing it with powers presently being exercised by the Company Law Board (CLB), Board of Industrial and Financial Reconstruction (BIFR) and High Courts. The amending Act also provides for dissolution of Company Law Board (CLB) and BIFR, as well as repeal of Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). Administration. The Companies Act, 1956 is administered by the Central Government through the 'Ministry of Company Affairs', Company Law Board and the Registrars of Companies. The Company Law Board is to exercise and discharge most of the powers of the Central Government under the Companies Act, and also such other powers as may be conferred on it by the Companies Act. It is empowered to look after the day-to-day administration of the Companies Act. The Company Law Board has set up four regional offices with head quarters at Mumbai, Kolkata, Chennai and Noida (Gautam Budh Nagar), headed by 'Regional Directors'. There is a Registrar of Companies for each State of India. He is appointed by the Central Government functioning generally at the capital of each State. He is vested with the primary duty of registering companies floated in his State and ensuring that such companies comply with statutory requirements under the Companies Act. The office of the Registrar of Companies (ROC) is a public office where companies are required to file documents and returns according to the provisions of Law and the public is authorised to inspect the same on payment of a prescribed fee. The Central Government exercise control over the Registrars of Companies through the respective Regional Directors who happen to be senior officers of the Company Law Board. 34.3 DEFINITION OF COMPANY Section 3(l)(i) and (ii)
of
the Companies Act define a

An 'existing company' means a company formed and registered under any of the former Companies Acts". The above definition does not reveal the distinctive characteristics of a company. Perhaps the clearest description
of a company is given by Lord Justice Lindley—"By
a company is meant
an association
of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit
and loss (
as the case may be)
arising
therefrom.
The common stock so contributed is denoted in money and is the capital of the
company.
The persons who contribute it, or to whom it belongs, are members. The proportion of capital
to which
each member is entitled is his share. Shares are
always transferable although the right to transfer them is often more or less restricted."
A more comprehensive legal definition of a company giving its main essentials, has been given by Haney: "A company is an incorporated association, which
is an artificial person created by law, having a separate entity, with a perpetual succession and
a common seal."
A company, thus,
may be defined as
an incorporated association, which
is an artificial
legal
person, having a separate legal entity, with a perpetual succession, a common seal,
a common capital comprised of transferable shares and
carrying limited liability. 34.4 CHARACTERISTICS An examination of the above definitions reveals the following essential characteristics of a company: 1. Incorporated association. A company must necessarily be incorporated or registered under the prevalent Companies Act. Registration creates a joint stock company and it is

The Company Self-Instructional Material 421 NOTES compulsory 1 for all associations or partnerships, having a membership of more than ten in banking and more than twenty in any other trading activity, formed for carrying on a business with the object of earning profits. 2. Artificial legal person. A company is an artificial legal person in the sense that on the one hand,
it is created by a process other than natural birth
and does not possess the physical attributes of a natural person, and on the other hand, it is clothed with many of the rights of a natural person. It is invisible, immortal (law alone can dissolve it)
and exists only in the eyes of law. It has no body, no
soul, no conscience, neither it is subject to the imbecilities of the body. It is because of these physical disabilities that a company is called an artificial person. But it cannot be treated as a fictitious entity because it really exists. As a rule, a company may acquire and dispose of property, it may enter into contracts through the agency of natural persons, it may be fined for the contravention of the provisions of the Companies Act. Thus for, most legal
purposes a company is a legal person just like a natural person, who has
rights and duties at law. In short, it may be said, therefore, that a company being an artificial legal person can do everything like a natural person, except of course that, it cannot take oath, cannot appear in its own person in the court (must be represented by counsel), cannot be sent to jail, cannot practise a learned profession like law or medicine, nor can it marry or divorce. 3. Separate legal entity. A company is a legal person having a juristic personality entirely distinct from and independent of the individual persons who are for the time being its members (Kathiawar Industries Ltd. vs. C.G. of Evacuee Property 2). It has the right to own and transfer the title to property in any way it likes.
No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or in its winding up (
Mrs B.F. Gazdar vs. The Commissioner of Income Tax) 3 .
It can sue and be sued in its own name
by its members as well as outsiders. Creditors of the company are creditors of the company alone and they cannot directly proceed against the members personally. A company is not merely the sum total of its component members, but it is something superadded to them. In mathematical language it may be defined as n + 1th person, where n stands for the total number of members and the 1th person for the company itself. Even if a shareholder owns virtually the whole of its shares, the company is a separate legal entity in the eyes of law as distinguished from such a shareholder. This principle was judicially recognized by the House of Lords in the famous case of Salomon vs. Salomon & Co. Ltd. 4 In this case, Mr Salomon, who carried on a prosperous business as a leather merchant,
sold his business for the sum of £30,000 to 'Salomon & Co. Ltd.' which consisted of Salomon himself, his wife
and
daughter and his four sons. The purchase consideration was paid by the company by allotment of 20,000
fully paid £1 shares and £10,000 in debentures conferring a floating charge
over all the company's assets, to Mr. Salomon. One share of £l each was subscribed for in cash by the remaining six members of his family. Salomon was the managing director of the company and as he held virtually the whole of its stock, he had absolute control over the company. Only a year later, the company became insolvent and winding up commenced. On winding up the statement of affairs was roughly
like this: Assets £6,000; Liabilities: Salomon as debentureholder—£10,000 and unsecured creditors £7,000. Thus, its assets were running short of its liabilities by £11,000. The unsecured creditors claimed priority over the debentureholder (Mr Salomon) on the ground that
a person cannot owe to himself and that Salomon and the company were one and the same person. They further contended that the company was a mere "alias" or agent for Salomon, 1 For details refer to the heading: 'Illegal Associations' later in this Unit. 2 A.I.R. (1967), Punjab, 337. 3 A.I.R., Bombay (1955), S.C. 74. 4 (1897), A.C. 22.
The Company 422 Self-Instructional Material NOTES the business was solely his, conducted solely for him and by him and the company was a mere sham and fraud, hence Salomon was liable to indemnify the company against its trading debts.
But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the company's assets must be applied in payment of the debentures first in priority
to unsecured creditors.
Lord Macnaghten observed in this case: "The company
is at law a different person altogether from the subscribers to the Memorandum;
and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers, as members liable, in any shape or form, except
to the extent and in the manner provided by the Act."

Not a citizen. Although a company is a legal person having nationality in accordance with the country of its incorporation and a domicile in accordance with the place or state of its incorporation or registration, it is not a citizen (State Trading Corporation of India Ltd. vs. Commercial Tax Officer). 5 A company cannot, therefore, claim the protection of those fundamental rights which are expressly guaranteed to citizens only, e.g., the right of franchise. But still they are sufficiently protected under the Constitution. For instance, their freedom of trade or commerce cannot be curtailed, there can be no compulsory acquisition of their property, and no unjust discrimination in any matter whatsoever can be done against them. The company has the right to challenge a law if the law happens to violate fundamental rights of citizens (Prithivi Cotton Mills vs. Broach Borough Municipality). 6 4. Perpetual existence. A company is a stable form of business organisation.
Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s)
or director(s).
The provision for transferability of shares in case any shareholdsr wishes to drop out, as also for transmission of shares to the successor(s) of the deceased in case any shareholder dies, helps to preserve the perpetual existence of a company.
Law
creates it and law alone can dissolve it. Members may come and go but the company can go on forever. "During the war all the members of one private company, while in general meeting, were killed
by a
bomb. But the company survived; not even a hydrogen bomb could have destroyed
it. 7
The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership. 5. Common seal. As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for
itself. It acts through natural persons who are called its directors.
But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of
a common seal, with
the name of the company engraved on it, as a substitute for its signature.
Any document bearing the common seal of the company
will be legally binding on the company. A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document. If the Articles are silent, the provisions of Table A (the model set of articles appended to the Companies Act) will apply. As per Regulation 84 of Table A, the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorised by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose, and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence. Under its common seal a company may, in writing, appoint any person as its attorney to execute deeds on its behalf. 5 S.C.J. 605 (1963). 6 A.I.R. 1968, Gujarat, 124. 7 Gower, L.C.B. The Principles of Modern Company Law, 4th ed. (1979), footnote p. 105.
 6. Limited liability.
The liability of the members for
the debts of the company is limited to the
amount unpaid on their shares

howsoever heavy losses the company might have suffered. For example, if a shareholder buys 100 shares of Rs 10 each and pays Rs 5 on each share, he has paid Rs 500 and can be made no pay another Rs 500, but he cannot be made to pay more than Rs 1,000 in all. No shareholder can be called upon to pay more than the nominal or face value of shares held by him, in case of a company with limited liability. (Later we shall see that the Act also provides for the creation of a company 'limited by guarantee' and a company with 'unlimited liability', but companies with 'limited liability' are most popular.) Thus, by virtue of this characteristic the personal property of the shareholder cannot be seized for the debts of the company, if he holds a fully paid up share. 7. Transferability of shares. The shares of a public company are freely transferable and members can dispose of their shares whenever they like without seeking any permission from the company or the other members. In a private company, however, some restriction on the right to transfer is essential in its articles as per Section 3(l)(iii) of the Act, but absolute restriction on the right of the members to transfer shares contained in the articles shall be void. It may, however, be noted here that a company possesses the above mentioned characteristics by virtue of its incorporation or registration under the Companies Act. Although a partnership—the main alternative to the company as a form of business organisation, may also be registered under the Indian Partnership Act, 1932, yet it does not possess any of these characteristics. 34.5 ILLEGAL ASSOCIATIONS After having discussed the meaning and characteristics, etc., of a company, there arises a question: Is it discretionary for an 'association of persons' having any number, formed for the purpose of carrying on a business for gain, either to get itself registered under the Companies Act or to act as a partnership or unregistered company? The
answer to this question is provided by
Section 11 of the Act which provides that
no company, association or partnership consisting of more than 20 persons (10
in the case of banking business) be formed to carry on any business for gain unless it is registered under the Companies Act or any other Indian Law. It will be noted that an association of persons consisting of more persons than specified by Section 11, need not necessarily be registered under the Companies Act for being a legal body of persons. Such an association of persons will be perfectly legal even if it is registered under any other Indian Law. For example, Chit Fund Mutual Help Societies are to be registered under Madras Chit Fund Act, 1961, and the Balussery Benefit Chit Fund Pvt. Ltd., 1/24 Asaf Ali Road, New Delhi, which have been registered under Madras Chit Fund Act as extended to National Capital Territory of Delhi, is a legal company. A partnership consisting of more than the aforesaid number of persons, unless so registered, will be illegal association having no legal existence although none of the objects for which it may have been formed is illegal
within the meaning of Section 23 of the Indian Contract Act, 1872.
So far as associations consisting of less than the number prescribed as above are concerned, they have the option whether to get themselves registered or not. If not registered, they will be regarded as perfectly legal associations but the liability of their members will always be unlimited. This Section does not apply to the case of a single Joint Hindu family business, whatever may be the number of its members (Shyamlal Roy vs. Madhusudan Roy). 8 It is to be emphasised that there must be a business having for its object the acquisition of gain for the application of this Section. Associations, which carry on business but whose object is not the acquisition of 'gain' for its members need not be registered under the Act. Check Your Progress 1. Define a company. 2. Explain the concept of 'separate legal entity' in relation to a company. 8 (1959), A.I.R. Cal. 380.
The Company 424 Self-Instructional Material NOTES Thus, Section 11 does not apply to literary, scientific or charitable associations and as such they are not compulsorily registrable. Again, if there is gain to members of the association without carrying on a business by virtue of 'pooling agreements' to eliminate competition, then also the association does not fall within the purview of this Section and need not be compulsorily registered under the Companies Act (New Mofussil Co. Ltd. vs. Rustomji). 9 Rules of counting number of persons. Every person, human, legal or otherwise, who holds an independent position in law and is capable of entering into contracts, will count as one person in the constitution of a company for the purpose of counting number of persons under Section 11. Accordingly a company (being a separate entity in law) and a Joint Hindu family managed by a karta (being regarded as separate entity in Hindu Law) count as one person, irrespective of varying number of individual members. Further, where two or more joint families form a partnership, in computing the number of persons, a joint family shall not count as one person but all adults of both the joint families shall be counted. The object of this provision is to curb the formation of large unregistered association of persons. A partnership firm has no separate entity in law and therefore, partners will count as separate members of the company. Two or more persons holding a share jointly are treated as a single member. A person who holds shares both in his own name and on behalf of a minor, also counts as one person. Consequences of non-registration. The consequences of non-registration of an association which falls within the terms of Section 11 are very serious indeed to its members. Such an association is not recognised at law and is treated as an illegal association. The effects of non-registration are as follows: 1. No legal existence. Such an association cannot enter into any binding contracts. Neither the association nor members in their personal capacity can sue any outsider who has dealt with it. So also one member cannot sue another member in respect of any matter connected with the association. Further,

such an association cannot be sued by a member or an outsider (
of course individual members can be sued), for it cannot contract any debt or enter into any contract. Again, such an association cannot be dissolved through the court because there is nothing to dissolve, the association being absolutely unrecognised at law (Meva Ram vs. Rain Gopal). 10 2. Unlimited personal liability of members. Sub-section (4) of Section 11 provides that every member of such an association will be personally liable for all liabilities incurred in such business, and can, therefore, be sued by an outsider. 3. Fine. Sub-section (5) of Section 11 provides that every member of such illegal association will be punishable with fine which may extend to Rs 10,000. The only relief open to a member of illegal association is to claim a refund of his original subscription, provided the money has not already been used up by the illegal association in its business (Greenberg vs. Cooperstein). 11 Such an illegal association, however, is liable to income-tax on profits earned by it (Gopalji Co. vs. Commr. of Income-tax). 12 It must further be noted that an illegal association remains illegal inspite of subsequent reduction in the number of its members to below 20, till it gets registered (Madanlal vs. Jankiprashad), 13 and that subsequent registration will not alter the position with regard to past acts (Gujarat Trading Co. vs. Tricumji). 14 9 38 Bom. L.R. 408. 10 (1926), 48 All. 735. 11 (1926), 1 Ch. 667. 12 (1931), Lah. 76. 13 49, All. 319. 14 Bom. H.C.R. (O.C.) 45.

The Company Self-Instructional Material 425 NOTES Penalty for Improper Use of Words "Limited" and "Private Limited" (Sec. 631) If any person or persons trade or carry on business under any name of which the word "Limited" or the words "Private Limited"
is or are the last word or words, that person or each of these persons shall, unless duly incorporated as
public or private company, as the case may
be, punishable with fine which may extend to Rs 500 for every day upon which
that name has been used. Besides, such person(s) shall be personally liable to an unlimited extent for all the debts incurred in the business. 34.6 INCORPORATION OF COMPANY A company is brought into existence by a legal process called incorporation. This is effected by registration with the Registrar of Companies. After completing the promotional work and before getting the proposed company actually registered the promoter takes the following preparatory steps: (i) To
ascertain from the Registrar of Companies whether the name by which the new company is to be started is available or not; (
ii) To get a Letter of Intent (to be converted later on into an Industrial Licence) under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act; (iii) To fix up underwriters, brokers, bankers, solicitors, auditors and signatories to the memorandum; (iv) To get Memorandum and Articles of Association prepared and printed. After taking the above mentioned preliminary steps, the promoter makes an application to
the Registrar of Companies
of
the State in which
the registered office of the company is to be situated,
for registration
of the company. The application must be
accompanied by the following documents: (1) Memorandum of association
duly stamped, signed and witnessed [
Sec. 33(1)(a)). (2) Articles of association properly stamped, duly signed by the signatories of the Memorandum and witnessed. The filing of Articles is optional in the case of a public company with limited liability, which may adopt 'Table A', the model set of Articles, in its entirety. But where a public limited company adopts 'Table A' the fact must be specified on the Memorandum 'Registered without articles' which will mean automatic adoption of 'Table A'. For all other companies filing of separate Articles is essential [Sec. 33(1)(b)]. (3)
The agreement, if any, which the company proposes to enter into with any individual for appointment as
its managing or whole-time director or manager [
Sec. 33(1)(c)]. (4) A written consent of the directors to act in that capacity, duly signed by each director, along with a written undertaking by them to take the necessary qualification shares, if any, as provided in the Articles [Sec. 266(1)]. The document is, however, not to be filed in the case of: (i)
a company without share capital; (ii) a private company; and (iii) a company which was a private company
prior to its becoming a public company [Sec. 266(5)]. (5) The notice of address of the registered office of the company. It may, however, be filed within 30 days of incorporation (Sec. 146). (6) A statutory declaration stating that all the legal requirements of the Act precedent to incorporation have been complied with. It must be signed by an advocate of the Supreme Court or of a High Court, or by an attorney or a pleader entitled to appear before a High Court, or by a secretary, or a chartered accountant, in whole-time practice
in India,
who is

engaged in the formation of the company or by
a person named
in the Articles
as a director,
managing director, manager or secretary of the company [
Sec. 33(2)].
The Company 426 Self-Instructional Material NOTES Alongwith the above documents necessary filing fees and registration fees at the prescribed rates are also to be paid. Schedule X, given at the end of the Companies Act, prescribes the rates of filing fees and registration fees. The Registrar will scrutinize these documents and if they are in order, he will register the company and will issue a certificate of incorporation (the company's "birth certificate"). On obtaining this certificate the company becomes a body corporate, with perpetual succession and a common seal [Sec. 34(2)]. The Registrar of Companies will allocate a Corporate Identity Number (CIN) to each company registered on or after 1st November, 2000. 15 Further, the Government [Department of Company Affairs' (DCA)] has decided that all companies registered under the Companies Act, 1956 prior to 1st November, 2000 will be allotted a Corporate Identity Number (CIN) within a year upto April 2002 in a phased manner. The DCA has directed all Registrar of Companies (ROCs) to act accordingly. 16 Conclusiveness of certificate of incorporation. Section 35 states that the certificate, once issued, is conclusive evidence of the fact that the company has been duly registered. In other words, once a certificate of incorporation has been granted no one can question the regularity of the incorporation. In the famous Peel's 17 Case Lord Cairns observed "... when
once the certificate of incorporation is given nothing is to be inquired into as to the regularity of the prior proceedings." Accordingly, even though the conditions of registration prescribed by the Act might not have been duly complied with prior to registration, e.g., the signatories to the memorandum be all infants or the signatures to the memorandum come out to be forged or the memorandum be found to be materially altered after signatures 18 or there were not seven subscribers to the memorandum, once the certificate of incorporation is issued, the court cannot go behind it and the existence of the company cannot be questioned. The logic of this provision is that once the company is held out to the world as a company ready to contract engagements, then it would be most disastrous if, years after, any person was allowed to show that it was not properly registered. It may, however, be noted that if a company having illegal objects has been registered, the illegal objects do not become legal by issue of the certificate. But the certificate would be all the same conclusive and the legal personality of the company cannot be extinguished by cancellation of the certificate of incorporation (Bowman vs. Secular Society Ltd.). 19 The remedy, in such a case, would be 'to wind up' the company. 34.7 TEST QUESTIONS 1. "An incorporated company is a totally different person or thing or entity from its members—the individuals comprising it." Explain and illustrate. 2. Answer the following problems : (a) A husband and wife who were the only two members of a Private Company died in an accident. Does the company also come to an end ? [Hint. No. The company will continue as usual because it has a perpetual existence. The legal heirs of the deceased members will become members of the company by transmission of shares.] 15 General Circular No. 12/2000 dated 25-10-2000 issued by the Department of Company Affairs. 16 PIB Press Release dated 17-4-2001. 17 (1867) 2 Ch. App. 674. 18 Peel's case Supra. 19 (1971) A.C. 406. Check Your Progress 3. Explain the penalty for improper use of the word 'Limited'. 4. What are the documents re- quired to be filed with the Registrar for the incorpora- tion of company?
The Company Self-Instructional Material 427 NOTES (b) A, a trader, carries on business under the name of 'A & Co. Ltd.' without being incorporated as a company with limited liability. Discuss the consequences of the act of A. [Hint. A, is liable to a fine up to Rs. 500/- per day for the period during which the word Ltd., has been improperly used, under Section 631 of the Act. Besides, A is personally liable to an unlimited extent for all the debts incurred in the business.] 3. (a) "A company is a legal entity quite distinct from its members." explain. (b) What is an illegal association? What are its consequences? 4. (a) Discuss the notion of corporate personality in the light of the decision given in Salomon vs Saloman & Co. Ltd. (b) During a
war all the members of a private company, while in general meeting, are killed by a bomb. Does the company cease to exist because all the members die? State reasons. [Hint. No, the company does not cease to exist because a company has perpetual existence.
Its life does not depend upon the death of any or all member(s). Law creates it and law alone can dissolve it.] 5.
A shareholder of a company has no insurable interest in its property. Explain.
Kinds of Companies Self-Instructional Material 429 NOTES UNIT 35 KINDS OF COMPANIES Structure 35.0 Introduction 35.1 Unit Objectives 35.2

Test Questions 35.0 INTRODUCTION A company is defined as a voluntary association of persons formed for the purpose of doing business, having a distinct name and limited liability. Companies, whether public or private, are an indispensable part of an economy. They are the modes through which a country grows and expands world wide. In India, the Companies Act, 1956, is the most important piece of legislation that empowers the Central government to regulate the formation, financing, functioning and winding up of companies. The Act contains the mechanism regarding organisational, financial, managerial and all the relevant aspects of a company. 35.1 UNIT OBJECTIVES ? Understand the kinds of companies ? Understand the exemptions and privileges enjoyed by private companies. ? Understand how a private company may be converted into public company. 35.2 KINDS OF COMPANIES ACCORDING TO THE MODE OF INCORPORATION A company may be incorporated either by a special Act of legislature or under the Companies Act and accordingly a company may be : (1) statutory company, or (2) incorporated company. 1. Statutory company. It is incorporated by a special Act passed either by the Central or State legislature.
Companies intending to carry on some business of national importance are formed in this way. Examples of such companies are :
Reserve Bank of India, State Bank of India, Life Insurance Corporation, Food Corporation of India,
Unit Trust of India, etc. The powers which are to be exercised by such companies are defined by the Acts constituting them and therefore, they are not required to have a memorandum of association (a document which defines the limitation of the powers of a company), as also to use the word 'Limited' as part of their names. The audit of such companies is conducted under the supervision and control of the Auditor General of India. Although each statutory company is governed by the provisions of its special Act,
the provisions of the Companies Act, 1956 also apply to them, in so far as the said provisions
are not inconsistent with the provisions of the
special Acts under which these companies are formed (
Sec. 616).
Kinds of Companies 430 Self-Instructional Material NOTES 2. Incorporated or registered company. A company registered under the Companies Act is known as 'Incorporated' or 'Registered' company. All existing companies in India, except the statutory companies, have been formed in this way and are governed by the provisions of the Companies Act, 1956. It may, however, be noted that Insurance, Banking and Electric Supply companies though incorporated under the Companies Act are also governed for most of their operative matters by provisions of their special Acts, viz., the Insurance Act, 1938, the Banking Regulation Act, 1949, and the Electricity Supply Act, 1948, and the provisions of the Companies Act will be applicable to these companies only to such extent as these are not inconsistent with those contained in the special Acts governing them (Sec. 616). Registered companies can further be classified in two ways: (i) on the basis of number of members, and (ii)

On the basis of
the number of members a registered company may be: (1) private company or (2) public company. 1. Private company. According to Section 3(l)(
iii), a "private
company" means a company which
has a minimum paid up capital of Rs one
lakh or such higher paid up capital as may be prescribed,
and by its articles
of association: (a) restricts the right of
the members to transfer shares,

or were in the employment of the company; (
c)
prohibits any invitation to the public to subscribe for any
shares in, or debentures of, the company; and (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.
The significance of the words if any used in Sub-clause (a) above may be borne in mind. As a result of these words, the articles of association of a private company having no share capital shall have to place restrictions specified in the aforesaid Sub-clauses (b), (c) and (d) only. In other words, in the case of a private company having no share capital, articles of association need not contain restriction regarding the right of the members to transfer shares. For the purpose of counting the number of members in compliance of Sub-clause (b) of the above definition, the Section further lays down that: (i) members
who have been formerly in the employment of the company shall not be counted provided they were members while in that
employment and have continued
to be members after the employment ceased;
and (
ii)
where two or more persons hold one or more shares
of the
company jointly, they shall be treated as a single member.
It is worth mentioning that the Companies (Amendment) Act, 2000 has for the first time prescribed capital adequacy norm for incorporation of companies so that only genuine companies with serious business intentions come into existence. It may be noted that a 'licensed company' 1 registered under Section 25 has been exempted from complying with the requirement of minimum paid up capital, as aforesaid [Sec. 3(6)]. 1 For details refer to the side-heading: 'Licensed Company' discussed later in this unit.
Kinds of Companies Self-Instructional Material 431 NOTES
The
minimum number of members required to form a private company is
two.
Such a company must add the word "Private" in its name. A private company enjoys some exemptions and privileges (i.e., some of the provisions of the Companies Act do not apply to such a company) which will be discussed later in this chapter. 2.
Public company. As per Section 3(1)(iv),
a "public company" means
a company which: (a) is not a private company; (b)
has a minimum paid up capital of
Rs five
lakh or such higher paid up capital, as may be prescribed; (
c)
is
a private company which is a subsidiary 2 of
a company which
is not a private company,
i.e., which is a subsidiary of a public company.
Elaborating Clause (a) of the above definition, a 'public company' is one, which: (i) does not
have any restriction on the transfer of shares, if any: (ii) does not limit the maximum number of members, (iii) can invite public for the subscription of its shares and debentures (of course it is under no obligation to invite public for this purpose if it is confident of obtaining the required capital privately); and (iv) can invite or accept deposits from the public.
The Companies (Amendment) Act, 2000 has added Clauses (b) and (c) stated above in the definition of a 'public company'. Thus, all new public companies incorporated on or after the commencement of the Amendment Act (i.e., 13th December, 2000), must have the minimum prescribed paid up capital of Rs five lakh. Further, a public company now includes

a ‘private company which is a subsidiary of a company which
is not a private company’.
As a result of this provision,
a private company which is a subsidiary of public company
shall
become public company on and from the commencement of the Amendment Act, 2000. In other words, with amended definition of a public company, reference to the expression—‘
a private company which is a subsidiary of public company’ shall
become redundant and such a company shall now be treated as a full fledged public company. Consequently, such a company will cease to enjoy the exemptions and privileges hitherto available to it under the Companies Act. It has been further provided that a ‘licensed company’ 3 registered under Section 25 shall not be required to have minimum paid up capital as stated above [Sec. 3 (6)].
The minimum number of members required to form a public company is seven. 35.4

80% **MATCHING BLOCK 34/38** W

KINDS OF REGISTERED COMPANIES ON THE 35.3 BASIS OF LIABILITY OF MEMBERS On the basis of liability of members,

the Companies Act makes provision for the registration of three types of companies, namely: 1. Companies limited by shares, or 2. Companies limited by guarantee, or 3. Unlimited companies. Each of these types may be a ‘public company’ or a ‘private company’ (Sec. 12). 2 For details refer to the side-heading— “Holding Company and Subsidiary Company” discussed later in the present unit. 3 For details refer to the side-heading: ‘Licensed Company’ discussed later in this unit.
Kinds of Companies 432 Self-Instructional Material NOTES 1.
Companies limited by shares. A company having the liability of its members limited by the memorandum to the amount, if any, unpaid on
the
shares respectively held by them
is termed “a company limited by shares” [
Sec. 12(2)(a)]. Such a company is popularly called as limited liability company.
The
liability can be enforced at any time during the existence and also during the winding up of
the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. Most of the companies in India are of this type and it is with companies of this class that we are mainly concerned. 2. Companies limited by guarantee. A company limited by guarantee may be defined as “
a company having the liability of its members limited by
its memorandum
to such amount as the
members may respectively thereby
undertake

84% **MATCHING BLOCK 35/38** W

to contribute to the assets of the company in the event of its being wound up” [Sec. 12(2)(b)). The

amount
guaranteed by each member cannot be demanded until the company is wound up, hence it is in the nature of a ‘reserve capital’. It is to be observed that in this type of companies
the liability of the members can only be implemented after the commencement of winding up of the company, whereas in the case of companies limited by shares the liability, if any,
can be enforced at any time during the existence as well as during winding up
of
the company. Such companies may or may not have share capital.

But they are formed generally without share capital for non-trading purposes, e.g., for the promotion of commerce, art, science, culture, sports, etc., because if they are formed for trading purposes, they must, in practice, possess a share capital for carrying on business, and the registration of a guarantee company with a share capital would be in no way better than registration in the ordinary way as a company limited by shares. The Chambers of Commerce, trade associations and sports clubs are usually guarantee companies because neither they require huge capital nor aim at making profit.
The articles of association of such a company
must state the number of members with which the company is to be registered. 3.
Unlimited companies.
A company having no limit on the liability of its members is an unlimited company [
Sec. 12(2)(c)]. Thus the liability of members in this type of companies is unlimited, i.e., it may extend to the personal property of the members. Like partnership every member is liable to contribute, in proportion to his interest in the company, towards the amount required for payment in full of the total liabilities of the company, and if one is unable to contribute anything then the additional deficiency is to be shared among the remaining members in proportion to their capital in the company. But it is different from an ordinary partnership in one important respect, i.e., creditors of such a company cannot sue members directly and they can only resort to the winding up of the company on default, the reason is that being a registered company it has a separate entity in law. It must be noted, however, that here also the liability of a member is enforceable only at the time of winding up. COMPANIES Registered Cos. Statutory Cos. Cos. Ltd. by Shares Cos. Ltd. by Guarantee Unlimited Cos. Private Cos. Public Cos. Cos. having share capital Cos. not having share capital Cos. having S. capital Cos. not having S. capital Private Cos. Public Cos. Private Cos. Public Cos. Private Cos. Public Cos. Private Cos. Public Cos.
Kinds of Companies Self-Instructional Material 433 NOTES Such a
company may or may not have share capital. The articles of association of an unlimited company
must
state the number of members with which the company is to be registered
and, if the
company has
a
share capital, the amount of share capital with which the company is to be registered [
Sec. 27(1)]. As the capital, if any, is stated in the articles and not in the memorandum, it may be varied—increased or reduced—by passing a special resolution,
without the sanction of the court (Re Borough, etc., Building Society). 4 Again, an unlimited company is free from the restriction imposed by Section 77 and can purchase its own shares. Such companies are, however, rare these days. Diagrammatically different kinds of companies may be shown as follows: 35.5 OTHER KINDS OF COMPANIES Some other types of companies which are referred to, under the Companies Act, are as follows: 1. Licensed Companies or Companies not for Profit. Section 25 relates to licensed companies. Such companies are also registered under the Companies Act like any other company but before they are registered a licence may be obtained from the Central Government. Any association formed for promoting commerce, art, science, religion, charity or any other useful object and which does not intend to apply its profits, if any, for payment of any dividend to its members but instead to apply its income in promoting its objects can obtain a licence from the Government and can get itself registered as a company with limited liability. On registration it enjoys certain exemptions and privileges as compared to an ordinary limited company. Such companies may exclude the words 'limited' or 'private limited' from their names. They are registered without paying any stamp duty on their memorandum and articles. These companies are also exempted from complying with the provisions of Sections 147, 160(l)(aa), 166(2), 171(1), 209(4)(a), 257, 264(1), 285, 287, 299, 301 and 302(2) of the Companies Act either wholly or in part. The licence may at any time be revoked by the Central Government, if the fundamental conditions of the licence are contravened. Such companies may be public or private companies and may or may not have share capital. In case they have a share capital, they are exempted from complying with the requirement of minimum paid up capital of Rs one lakh for a private company or Rs five lakh for a public company [Sec. 3(6)]. It is worth noting that a partnership firm may be a member in a Licensed company in its firm name and it is only on the dissolution of the firm that its membership shall cease [Sec. 25(4)]. 2. One-man Company or Family Company. Where one-man holds practically the whole of the share capital of a company and takes a few more dummy members (usually family members) simply to meet, the statutory requirement of the
minimum number of persons (6 more persons
in case of a public company and one other person in case of a private company)
such a company is known as "one-man company". Such a company is perfectly in order in the eyes of law and is regarded to have a separate entity, as distinct from the majority shareholder (Salomon vs. Salomon & Co. Ltd.). 5 3. Foreign Company. A

foreign company means a company incorporated outside India but having a place of business in India [
Sec. 59(1)]. Within 30 days of the establishment of the business in India, a foreign company has to furnish to the Registrar, the following documents as per Section 592: 1. A certified copy of the Charter, Stature, Memorandum and Articles of the company, containing the constitution of the company. If the instrument is not in English language, a certified translation thereof. Check Your Progress 1. Classify companies on the basis of number of members. 2. What do you understand by companies limited by shares. 4 (1893), 2 Ch. 242. 5 (1897), A.C. 22.
Kinds of Companies 434 Self-Instructional Material NOTES 2.
The full address of the Registered or Principal Office of the
company. 3. A list of directors and secretary of the company giving name in full, usual residential address, nationality of origin, his business and particulars of other directorships held by him. 4.
The names and addresses of any person or persons resident in India, authorised to accept service of legal process and notices
on behalf of the company. 5.
The full address of that office of the company in India which is to be deemed as its principal place of business in India. When any change occurs in the above particulars the Registrar must be notified accordingly within the prescribed time (Sec. 593). Obligation regarding accounts. The obligations of a foreign company in respect of accounts are almost the same as those of a company registered under the Indian Companies Act. Section 594 provides that every foreign company, unless exempted by the Central Government, is required to file with the Registrar every year three copies of its Balance Sheet and Profit and Loss A/c and other documents, required under the Act. Along with these documents, it must also send to the Registrar three copies of a list in the prescribed form of all the places of its business in India [Sec. 594(3)]. Other obligations (Sec. 595). Every foreign company shall: (i) state the name of the country of its incorporation in every prospectus inviting subscriptions in India for its shares or debentures. It may be noted, however, that a foreign company 6 may issue a prospectus even if it has no place of business in India (Sec. 603); (ii) conspicuously exhibit on the outside of every office or place of business, its name and the country of incorporation in English and in the regional language; (iii) give the name of the company and the country of incorporation in English language in all business letters, bill heads and letter paper and in all notices and other official publications of the company; and (iv) state in every prospectus and in all official publications and exhibit outside every office or place of business, whether the liability of the members is limited. Office where documents to be delivered (Sec. 597). Any document which any foreign company is required to deliver to the Registrar of companies shall be delivered to the Registrar having jurisdiction over New Delhi and also
to
the Registrar of the State in which the principal place of business of the company is situated.
If any foreign company ceases to have a place of business in India, it must forthwith give notice of the fact to the Registrars referred to above, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrars shall cease. Penalties. If any foreign company fails to comply
with any
of the foregoing provisions,
the company and every officer or agent
of the company, who is in default, shall be punishable with fine
extending upto Rs 10,000
and in
the case of continuing offence with an additional
fine which may extend to Rs 1,000 for every day during which
the default continues (
Sec. 598). Further, any such defiant foreign company shall not be entitled to enforce any contract by way of a suit or set-off or counter-claim though it will be liable to be sued in respect of any contract it may have entered into (Sec. 599). Application of other provisions of the Companies Act. The provisions of Sections 124 to 145 relating to the registration of charges will apply to foreign companies in respect of charges on property created in India. The provisions of Section 118 relating to the rights of members and debentureholders to have a copy of the 'trust deed' for securing any issue of 6 Here the expression 'foreign company' has been used in literal sense, namely, a company incorporated outside India.

Kinds of Companies Self-Instructional Material 435 NOTES debentures of the company will also apply to foreign companies. Further, Section 209 shall also be applicable io foreign companies to the extent of requiring them to keep at their principal place of business in India the books of account with respect to moneys received and expended, sales and purchases made, and assets and liabilities in relation to their business in India (Sec. 600). The following Sections of the Act are also applicable to foreign companies: (i) The provisions of Section 159 relating to the filing of Annual Return with the Registrar shall, subject to such modifications or adaptations as may be made therein by the rules made under this Act, apply to a foreign company [Sec. 600(3)(b)(i)]. (ii) The provisions of Section 209A (inspection of books of account, etc.), Section 233A (power of Central Government to direct special audit in certain cases), Section 233B (audit of cost accounts in certain cases), and Sections 234 to 246 (power of Registrar to call for information or explanation and investigation of affairs of company by Central Government) shall, so far as may be, apply only to the Indian business of a foreign company, as they apply to a company incorporated in India [Sec. 600(3)(b)(ii)]. (iii) In respect of foreign companies, in which fifty per cent or more of the paid-up share capital (whether equity or preference or partly equity and partly preference) is held by Indian citizens and/or companies incorporated in India, such other provisions of the Act as may be notified by the Central Government with regard to business carried on by them in India, will become applicable to such foreign companies as they apply to a company incorporated in India [Sec. 591(2)]. 4. Government Company. A
Government company is defined in Section 617
as "
any
company in which not less than 51 per cent
of paid-up share capital is
held by the Central Government or
by
any State Government 7 or
Governments or partly by
the
Central Government and partly by one or more State Governments
and includes a company which is a
subsidiary of a government company
as thus defined." The special provisions of the Companies Act relating to Government companies are as follows: 1. As regards audit. (a) The auditor of a Government company shall be appointed or reappointed by
the Comptroller and Auditor General of India. The Comptroller and Auditor General of India
will have the power to direct the company's auditor relating to the manner of audit and the performance of his duties. He shall also have the power to conduct a supplementary test audit of the company's accounts by persons appointed by him. (b) The auditor is required to submit a copy of his audit report to the Comptroller and Auditor General, who shall have the right to comment upon the report. Any such comments shall be placed before the annual general meeting of the company along with the audit report [Sec. 619] 2. As regards annual reports. (a) Where the Central Government is a member of a Government company, the Central Government shall prepare an annual report on the working and affairs of the company within three months of its annual general meeting before which the audit report is placed. The annual report is to be laid before both Houses of Parliament together with a copy of the audit report and any comments thereupon, made by the Comptroller and Auditor General of India [Sec. 619A(1)]. (b) Where in addition to the Central Government, any State Government is also a member of a Government company, that State Government shall place a copy of the annual report (prepared by Central Government) together with a copy of the audit report and the 7 Under Article 299 of the Constitution of India, all contracts for and on behalf of the Government of India (Central Government) are required to be in the name of the President of India and all contracts for and on behalf of any State Government are required to be in the name of the Governor of the State.
Kinds of Companies 436 Self-Instructional Material NOTES comments (referred to earlier) before the House or both Houses of the State Legislature [Sec. 619A(2)]. (c) Where the Central Government is not a member of a Government company, every State Government which is a member shall cause an annual report on the working and affairs of the company lo be prepared within the same time (as referred to above), and then soon after lay it before the House or both Houses of the State Legislature with a copy of the audit report and comments thereupon [Sec. 619A(3)]. 3. As regards the application of the Companies Act. A Government company is to be registered under the Companies Act. It may be incorporated as a 'public' or 'private' company.
The Central Government may, however, by notification in the Official Gazette, direct that any of the
provisions of this Act
shall not apply to any

Government company or shall apply only with such exceptions, modifications and adaptations, as may be specified in the notification. The notification shall be effective to the extent to which it is approved by Parliament (Sec. 620). Subject to such notification, such companies are governed by the Companies Act like any other limited company without any discrimination. The Central Government has issued notifications (published in the Gazette of India, dated 11 February and 4 March, 1978) granting exemptions to government companies from the application of certain Sections of the Companies Act. For example, they have been exempted from complying with the provisions of Sections 198, 259, 268, 269, 309, 310, 311, 387 and 388 relating to the appointment of Managing or Whole time Directors and payment of remuneration to them. Similarly, Sections 255, 256 and 257 pertaining to appointment and retirement of directors shall not apply to such Government companies which are wholly owned by the Central or/and State Government(s). In a bid to streamline the functioning of Government companies and to cut down delays, the Central Government has again issued five notifications (published in The Gazette of India, dated 16-7-85) granting exemption to Government companies from the application of the following Sections of the Companies Act: (i) Sections 165, 187D. 294, 294AA(2) and (3). (ii) Section 108 in respect of shares held by nominees of Government. It has further been notified that Sections 149(2A), 205A, 205B, 263, 264, 265, 266, 307, 308, 316, 317 and 386 of the Companies Act shall not apply to Government companies wholly owned by Central or/and State Government(s). A government company, no doubt, has certain special features but it should not be placed on the same footing as a State or Government. It basically remains a company in the ordinary sense, having a legal entity of its own, separate from that of its shareholders whoever they may be. It makes no difference whether the entirety of the capital is subscribed by the Government or Government holds only 51 per cent of the share capital. In no case a Government company is identified with State and its employees do not become government servants, holders of civil posts under the Union or State Governments (S.K. Debnath vs. Mining and Allied Machinery Corporation). 8 Examples of popular Government companies are: Heavy Engineering Corporation Ltd., Hindustan Machine Tools Ltd., State Trading Corporation of India Ltd., and Indian Drugs and Pharmaceuticals Ltd. 5. Holding Company and Subsidiary Company. Where one company controls the management of another company the former is called the 'Holding
Company' and the latter over which the control is exercised is termed as a "Subsidiary Company'. The
Act defines these terms as follows:
Holding company. "A company shall be deemed to be the holding company of another, if that other is its subsidiary" [Sec. 4(4)]. 8 (1968), 1 Comp. L.J. 214.
Kinds of Companies Self-Instructional Material 437 NOTES Subsidiary company.
A company shall be deemed to be a subsidiary of another. 9 (
a) if that other company controls the majority composition of its Board of Directors with the sole object of controlling its management; or (b) if that other company holds more than half in nominal value of its equity share capital; or (c) in the ease of a private company in respect whereof the preference shareholders and equity shareholders may enjoy similar voting rights, if that other company is itself a private company and holds more than half of its total voting power; or (d) if it is a subsidiary of any other company which is that other company's subsidiary. For example: if company B is a subsidiary of company A and company C is a subsi diary of company B, company C will become a subsidiary of company A

by virtue of this Clause. If company D is a subsidiary of company C, company D will be a subsidiary of company B and consequently also of company A; and so on. Clarification of Clause (a) above. For the purposes of Clause (a) above, the composition of a company's Board of Directors is deemed to be controlled by another company, if that other company, by the exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of directorships [Sec. 4(2)]. Control over the composition of the subsidiary's Board is almost invariably derived from the voting rights enjoyed by the holding company by virtue of shares in the subsidiary held by it, but it could also arise from the provisions of the subsidiary's memorandum or articles, or from a contract with the subsidiary which empowers the holding company to appoint directors to the subsidiary's Board (Oriental Industrial Investment Corporation Ltd. vs. Union of India and Others). 10 It may further be noted that Clause (a) above is more relevant in the case of a company limited with guarantee or an unlimited company without share capital. The relationship of holding company and subsidiary company may also exist where there is no share capital. In such a case there will be no question of a holding company, holding more than fifty per cent of shares in a subsidiary. The holding company controls the Board of Directors of the subsidiary by means of voting power other than the holding of a majority of equity shares. The above definitions, thus, indicate that there is no such thing as a holding company as of itself by constitution, and that there can be no holding company except where there are one or more subsidiaries. The usual form to create the holding and subsidiary company relationship is a substantial investment (more than fifty per cent) in the equity share capital of another company. Further, it may also be noted that 'holding of shares' or 'power to appoint majority of directors' of the following nature shall not be taken into consideration while determining the relationship of holding and subsidiary companies: (1) where the shares are held or the power is exercised by the company in a fiduciary capacity, e.g., as a trustee; or (2) where the shares are held or the power is exercisable by a lending company merely as security for a transaction entered into in the ordinary course of the business; or (3) where the shares are held or the power is exercisable by virtue of the provisions of any debentures or debenture trust deed for securing any issue of such debentures (sometimes debentureholders have a right to appoint directors as a special privilege in order to feel secure). From the above provisions it must be clearly understood that in order to call a company a "holding company", it must hold the 'majority equity capital' or must possess the 'power to appoint majority of directors' with the sole object of controlling the management of 9 Section 4(1), read with Section 90(2) and (3). 10 (1981), 51 Comp. Cas. 487.

Kinds of Companies 438 Self-Instructional Material NOTES another company. If the object is otherwise—either is a security for a loan or in a fiduciary capacity or as pure and simple investment, it is not to be called a holding company. The Act contains some special provisions relating to holding and subsidiary companies. For example,

every holding company is required to attach to its annual accounts, copies of the Balance Sheet, Profit and Loss Account, Directors' Report and Auditors' Report, etc., in respect of each subsidiary company

as per the requirements of Sections 212 to 214, so that

a true and fair view of the state of affairs of the

group as a whole (holding company together with its subsidiary companies) may be presented to a shareholder, a creditor and potential investor of that

company. Again,

a private company which is subsidiary of a public company

shall be

treated as a full fledged public company on and from the commencement of the Companies (Amendment) Act, 2000 (i e., 13th December, 2000), and shall be made subject to all the provisions of the Companies Act which apply to public companies. Further, Section 77 restricts a subsidiary company from purchasing shares of its holding company. Rationale behind the concept of 'Holding and Subsidiary Company'. The rationale behind the introduction of the concept of 'holding and subsidiary company' may be explained as follows. The public companies used to hold majority of share capital of private companies. Initially whatever might have been the objective behind such a practice, but it generally led to the improper use of public money by virtue of greater freedom bestowed upon private companies under the Act. Therefore, with a view to having a more effective control over the private companies managed and controlled by the public companies this concept was introduced. Through the introduction of this concept private companies controlled by public companies were styled as the subsidiaries of the latter and were made subject to almost the same discipline as was applicable to public companies. For further tightening the control over the private company which is a subsidiary of public company, the Companies (Amendment) Act, 2000, has included such a private company within the definition of a public company. Consequently, with effect from the commencement of the Amendment Act, 2000, the moment a private company becomes a subsidiary of a public company, it shall be regulated exactly like a public company.

The existing private companies which are subsidiaries of public companies shall also be covered by the amended provisions. 35.6 EXEMPTIONS AND PRIVILEGES OF PRIVATE 35.4 COMPANIES The exemptions and privileges 11 enjoyed by a private company, as provided in the Act, are as follows: 1. Only two persons (instead of seven required for a public company) may form themselves into a private company (Sec. 12). 2. It can commence business immediately on incorporation as it has not to wait to obtain a certificate for the commencement of business [Sec. 149(7)]. 3. It is allowed to work with only two directors while at least three are required in case of a public company [Sec. 252(2)]. 4. At the time of getting the company incorporated with the Registrar of Companies, directors are not required to file with the Registrar their consent in writing to act in that capacity and their undertaking to take up qualification shares, if any [Sec. 266(5)]. 5. It need not prepare and file 'prospectus' or 'statement in lieu of prospectus' with the Registrar [Sec. 70(3)]. 11 These may also be called "advantages" of private companies as compared to public companies.

Kinds of Companies Self-Instructional Material 439 NOTES 6. It can proceed to allot shares without having to wait for any such thing as 'minimum subscription' (Sec. 69). 7. It is also exempted from the requirements of holding statutory meeting and filing statutory report. A public company must hold such a meeting after one month and before six months from the date of obtaining the certificate to commence business in order to acquaint the shareholders, about the details of company's working till that day (Sec. 165). 8. Right of pre-emption does not apply to such a private company. Under Section 81, a public company, in certain cases proposing to increase its subscribed capital by allotment of further shares, must offer them to existing equity shareholders prorata in the first instance. But this Section does not apply to a private company, which is, therefore, free to allot new issues to outsiders [Sec. 81(3)]. 9. It enjoys considerable freedom with regard to its directors, managing director or manager. It is not required to comply with those provisions and restrictions relating to the agencies of management which are applicable to public companies. For example: (i) All its directors can be permanent life directors and the requirement of retirement by rotation does not apply (Sec. 255). (ii) All its directors can be appointed en bloc by a single resolution (Sec. 255). (iii) Number of directors can be increased beyond the limit fixed in the articles of association without Central Government sanction (Sec. 259). (iv) Directors are not required to file with the Registrar, within 30 days of their first appointment, their consent in writing to act as such director [Sec. 264(3)]. (v) An interested director may participate in the Board's proceedings and exercise his vote (Sec. 300). (vi) Central Government's approval is not required either for appointment of, or reappointment of a managing director or wholetime director of the company (Secs. 268 and 269). (vii) It may, by its Articles of association, provide special disqualifications for appointment of directors (Sec. 274). (viii) No restriction on the number of companies to be managed by a director 'fifteen in case of public companies) or by a managing director (two companies in case of public companies) or by a manager (two companies in case of public companies) apply to such a company (Secs. 275, 316 and 386). (ix) Again, the restriction on period of appointment of a managing director/manager (five years in case of public company) does not apply to a private company (Sec. 317). (x) No restrictions on loans to directors apply to such a company (Sec. 295). (xi) No restrictions are imposed, as to the selling of whole or part of the undertaking, on the powers of Board of Directors (Sec. 293). (xii) No restriction on the payment of remuneration to directors, managing directors, etc. apply to such a company while overall maximum remuneration is fixed at 11 per cent of annual net profits for managerial personnel in case of a public company (Sec. 198). (xiii) Provision as to the Company Law Board's powers to prevent change in the Board of Directors likely to affect company prejudicially, does not apply to a private company (Sec. 409). Check Your Progress 3. What are the special features of Government companies ? 4. Describe briefly privileges enjoyed by a private company. 5. When is a company deemed to be a subsidiary of another company?

Kinds of Companies 440 Self-Instructional Material NOTES 10. Life director appointed by a private company on or before 1st April, 1952, cannot be removed by the company in general meeting. While any director, other than appointed by Central Government, can be removed by the company in a general meeting in case of a public company (Sec. 284). 11. The restrictions on inter-corporate loans and investments do not apply to such a private company (Sec. 372A). 12. It can keep its affairs secret. Although it has been made obligatory upon every private company to file three copies of Balance Sheet and three copies of Profit and Loss Account with the Registrar, within 30 days of the Annual General Meeting, copy of Profit and Loss Account shall not be open for inspection to a non-member (Sec. 220). 13. The provisions of Sections 171 to 186 relating to general meetings, manner of taking vote, etc., must be followed by a public company, but a private company can make its own regulations by its Articles in this respect (Sec. 170). 14. Quorum required for the general meeting of shareholders in case of a private company is two persons personally present, unless provided otherwise in the Articles, while in the case of a public company, it is five persons personally present (Sec. 174(1)]. 15. It need not keep an index of members (Sec. 151). 35.7 DISTINCTION BETWEEN A PRIVATE AND PUBLIC COMPANY The important points of distinction between a private company and a public company are as follows: 1. Minimum paid up capital. A private company must have a minimum paid up capital of Rs one lakh whereas a public company must have a minimum paid up capital of Rs five lakh. 2. Minimum number of members. The minimum number of persons required to form a private company is two. It is seven persons in case of a public company. 3. Maximum number of members.

The maximum number of members of a private company must not exceed fifty excluding members who are or were in the employment of the company. But no such maximum limit is fixed
in the case of a public company. 4. Minimum number of directors.
A private company must have at least two directors
whereas a public company
is required to have at least three directors. 5. Transfer of shares.
In a private company the right to transfer shares is restricted by
the Articles of Association and the transfer of shares requires, the prior permission of the Board of Directors. But in the case of public company a shareholder can transfer his shares freely without restriction. 6. Public subscription. A private company by its Articles of Association
prohibits any invitation to the public to subscribe for any
shares in, or debentures of, the company.
A public company can invite, public for the subscription of its shares and debentures. 7. Acceptance of public deposits. A private company, by its Articles of Association, pro- hibits any invitation or acceptance of deposits from the public. A public company can invite or accept deposits from the public. 8.
Commencement of business. A private company can commence its business
immediately after getting the Certificate of Incorporation.
A public company can commence its business only after getting the Certificate of Commencement of Business. 9.
Issue of prospectus. A private company need not prepare and file a 'prospectus' or 'statement in lieu of prospectus' with the Registrar. A public company must prepare and file with the Registrar a 'prospectus' or 'statement in lieu of prospectus'.
Kinds of Companies Self-Instructional Material 441 NOTES 10. Allotment of shares. A private company can proceed to allot shares without having to wait for any such thing as 'minimum subscription'. But a public company inviting public to subscribe shares cannot allot shares without raising 'minimum subscription'. 11. Statutory meeting. A private company is not required to hold a statutory meeting, whereas a public company must hold such a meeting after one month and before six months from the date of obtaining the Certificate to Commence Business. 12. Provisions regarding directors. A private company enjoys considerable freedom as regards its directors, managing director or manager. It is not required to comply with those provisions and restrictions relating to the managerial personnel which are applicable to public companies. For example, unlike a public company, a private company is not required to obtain Central Governments approval for appointment or reappointment of a managing director or whole-time director. 13. Managerial remuneration. There is no restriction on the payment of remuneration to directors, managing directors, etc., in the case of a private company, while overall maximum managerial remuneration is fixed at 11 per cent of annual net profits in case of a public company. 14. Index of members. A private company need not keep an index of members whereas a public company must keep such an index if its number of members exceeds fifty. 35.8 CONVERSION
OF COMPANIES Conversion of a Private Company into a Public Company. A private company
may either automatically become a public company or can be deliberately convened into a public company. Automatic conversion by default. Automatic conversion of a private company into a public company takes place by operation of law where a private company makes a default in complying with the essential
statutory requirements as laid down in Section 3(l)(iii) of the Act (i.e., if
its membership exceeds fifty, it permits free transfer of shares, invites public to subscribe to its shares or debentures, or invites or accepts deposits from the public), it becomes a public company automatically. The Company Law Board, however, may relieve the company from being treated as a public company, on such terms and conditions as it thinks just and equitable, if it is of opinion that the default was due to inadvertence or accident or some other sufficient cause, on an application of the company or any interested person (Sec. 43). It is to be noted that a private company which becomes a public company automatically by virtue of the above provision need not comply with any legal formality prescribed in the case of deliberate conversion. Again, inspite of the conversion, such a company may retain the characteristics of a private company, i.e., it can have restrictions as to transfer of shares, membership and public subscription, etc. It can continue to have only two members and two directors. Deliberate conversion. A private company may, at any time, pass a special resolution deleting from its Articles the four compulsory restrictions as to membership, transfer of shares, public subscription and acceptance of public deposits, and then from the date of alteration it becomes a public company. Within 30 days of passing the resolution referred to above, a copy of special resolution, a copy of altered Articles, together with a copy of '
prospectus' or a 'statement in lieu of prospectus' must be filed with the Registrar.
The 'prospectus' filed must state the matters and set out the reports specified in "Schedule II" of the Act. In case the company decides to file a 'statement in lieu of prospectus', it must be in the "form" and contain particulars set out in "Schedule IV" to the Companies Act (Sec. 44). Check Your Progress 6. How will you convert a private company into a public company and vice- versa?

Kinds of Companies 442 Self-Instructional Material NOTES For becoming a public company, the company will have to increase the number of its members to at least seven and that of its directors to at least three, if already their number was fewer than the aforesaid statutory minimum required in that connection for a public company. Further, the company will also have to enhance its paid up capital to at least Rs 5 lakh, if its existing paid up capital was less than the above stated statutory minimum requirement for a public company. Upon becoming a public company, the word 'Private' will be deleted from the name of the company.

Conversion of a Public Company into a Private Company: A public company may be converted into a private company without resorting to winding up of the company. For doing so, a special resolution will be passed to alter the Articles so as to incorporate the four restrictions imposed upon a private company under Section 3(1)(iii), and a copy of the same shall be filed with the Registrar of Companies within 30 days of passing the resolution. The company will also reduce the number of its members in accordance with the legal requirement for a private company, if the existing number is more than that. After this sanction of the Central Government must be obtained, for no alteration made in the Articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government [Proviso to Sec. 31(1)]. If the Government approves the changes in the Articles of Association the company becomes a private company from the date of the order of approval. Within 30 days of the receipt of the approval from the Central Government, a copy of altered Articles together with a copy of Government's letter of approval must be filed with the Registrar [Sec. 31(2A)]. After the conversion of the company from public to private it will have to add the word "private" in its name. 35.9 TEST QUESTIONS 1. Write notes on: (a) Company Limited by Guarantee. (b) Unlimited Companies. (c) Licensed Companies. (d) One man Company. 2. What is a Foreign Company? Is it necessary for it to comply with the provisions of the Companies Act? Is so, to what extent? 3. What is a Government Company? What are its special features? How far is it governed by the Companies Act, 1956? 4. (a) Define a 'Private Company'. How does it differ from a public company? (b) Describe the restrictions on a private company. 5. Define a 'Private Company'. What privileges and exemptions are granted to a private company? 6. An existing private limited company has decided to convert itself into a public limited company. Enumerate in detail the procedure to be adopted for this. 7. Define a public company and explain the procedure for converting (i) a private company into a public company, and (ii) a public company into a private company.

Memorandum of Association and Articles of Association Self-Instructional Material 443 NOTES UNIT 36 MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION Structure 36.0 Introduction 36.1 Unit Objectives 36.2

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Definition and Importance 36.3 Contents of Memorandum 36.4 Alteration of Memorandum 36.5 The Doctrine of Ultra Vires 36.6 The Obligation to Register Articles 36.7 Contents of Articles 36.8 Alteration of Articles 36.9 Limitations Regarding Alteration of Articles 36.10 Binding Force of Memorandum and Articles 36.11 The Doctrine of Indoor Management 36.12 Exceptions to the Doctrine of Indoor Management 36.13

Test Questions 36.0 INTRODUCTION The memorandum of association of a company is its principal document. "It is a document of great importance in relation to the proposed company". 1

No company can be registered without a memorandum of association and that is why it is sometimes called a life giving document. Articles of Association is another document of paramount significance in the life of a company. It contains regulations for the internal administration of a company's affairs. Articles of Association may well be compared with the "Partnership Deed" in a partnership. They prescribe rules and bye-laws for the general management of the company and for the attainment of its objects as given in its memorandum. 36.1 UNIT OBJECTIVES ? Understand the importance of memorandum of association. ? Be familiar with the clauses of memorandum. ? Know the procedure of alteration of different clauses of memorandum. ? Understand the doctrine of ultra-vires and effects of ultra-vires transactions. ? Understand the significance of 'articles of association'. ? Be familiar with the contents of 'articles of association'. ? Know the provisions regarding alteration of articles. ? Understand the legal effects of the memorandum and articles. 1 Palmer's Company Law, 20th ed., 1959, p. 56.

Memorandum of Association and Articles of Association 444 Self-Instructional Material NOTES 2 (1875) L.R. 7, H.L. 653. ? Understand the doctrine of indoor management. ? Be clear about the exceptions to doctrine of 'indoor management'. 36.2 DEFINITION AND IMPORTANCE Under Section 2(28)

of the Act “Memorandum means the
memorandum of association of a company as originally framed or as altered
from time to time
in pursuance of any previous company laws or
of this Act.”
This definition
does not throw any light on the scope, use and importance of the memorandum in a company. We shall, therefore, examine some better definitions given by judges. Lord Cairns in the leading case of Ashbury Railway
Carriage Co. vs Riche 2 observed that “
The
memorandum of association of a company is its charter and defines the
limitation of the powers of a company.” “
The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated.”
Lord Macmillan, “
The purpose of the memorandum
is to enable the shareholders, creditors and those who deal with the company, to know
what is its permitted range of enterprise.” Importance. The definitions given above clearly indicate the scope and the importance of the document. In fact

company has a share capital or not, whether it is limited by guarantee or otherwise, and defines the scope of activities within which the company can function. It is this document which delimits the capacity to contract of the company. A company cannot undertake operations that are not mentioned in its memorandum. Any act of the company outside the scope of activities as laid down in the memorandum is said to be ultra vires and not binding on it. Further, the memorandum of association is the constitution of the company in its relation to the outside world. It is a public document and persons dealing with the company may ask for its copies on payment of a nominal charge. Every person who deals with the company is presumed to have sufficient knowledge of its contents (as it is open to public inspection) and anybody dealing with the company shall be bound by its provisions and cannot bind the company for ultra vires acts. It is perhaps for this reason that no company is allowed to tamper with its contents without the sanction of the Central Government or the Company Law Board or the Court of Law. The Act prescribes complicated procedure to be followed by a company intending to alter any of its provisions and that is why this document is regarded as an unalterable charter of a company. As per Section, 15 it should
be printed, divided into paragraphs numbered consecutively, signed by each subscriber
duly attested by a witness (not being a subscriber himself). 36.3 CONTENTS OF MEMORANDUM Section 13 sets out the contents of the Memorandum. The document must
contain the following clauses: (1) the name clause, (2) the registered office clause, (3) the objects clause, (4) the liability clause, (5) the capital clause, and (6) the association clause
or subscription clause. We shall now consider each of these clauses in detail. 1. The name clause. Under this clause the corporate name of the company is stated. Any suitable name can be chosen by a company, subject, however, to the following restrictions: (a) In the case of companies limited by shares or limited by guarantee the word “Limited” or “Private Limited” must be the last word in the name of every public or private company
Memorandum of Association and Articles of Association Self-Instructional Material 445 NOTES respectively. There is, however, one exception to this rule as provided in Section 25 of the Act, which permits charitable companies 3 formed to promote commerce, art, science, religion, etc., (prohibiting the payment of dividends and applying all the profits to the promotion of their objects) under a licence granted by the Central Government, to register with limited liability, but without the word “limited” as part of its name. In the case of unlimited companies, only the name is to be given. It should be noted that the inclusion of the word “company” is not essential in the proposed name of the company. (b) As per Section 20, the name chosen must not be undesirable in the opinion of the Central Government. The Act does not state what names shall be considered undesirable and as such gives very wide discretion to the Central Government. Ordinarily a name is considered undesirable and therefore not allowed if it is either: (i)
too identical or similar to the name of another existing

company or firm (whether registered or unregistered) so as to lead to confusion (British Vacuum Cleaner Co. vs. New Vacuum Cleaner Co. Ltd., 1907). The reason for this rule is that the reputation of a company may be injured, if a new company adopts an allied name; or (ii) misleading, e.g., suggesting that the company is connected with a government department or any municipality or other local authority, or that it is an association of a particular type, e.g., "Cooperative Society", "Building Society", when this is not the case. If, however, through inadvertence or otherwise, a company is registered by an almost identical name, the court will grant an injunction restraining it from using the name. An injunction will not be granted, however, to prevent the use of purely descriptive word with a definite meaning and in common use. Thus, in Aerators Ltd. vs. Tollitt, 4 the plaintiff was not granted an injunction restraining the defendant from using the name of Automatic Aerators Ltd., because both companies were manufacturers of apparatus for the instantaneous automatic aeration of liquids under distinct patents. Once the name is chosen and the company is registered in that name, Section 147 requires that it, along with the address of registered office, must appear on the outside of every office or place of business (though inside the building) of the company in a conspicuous manner in one of the local languages and on all cheques, bills, letters, notices and other official, publications, etc., of the company. 2. The registered office clause. The second clause of
the memorandum
must mention
the
name
of the State in which
the registered office of the company is to be situated [
Sec. 13(l)(b)]. This is required in order to fix the domicile of the company, i.e., the place of its registration. Domicile must be distinguished from residence. While domicile is the place of its registration, residence is the place of its management and control, i.e., where the Board of Directors meets (Damiler Co. Ltd. vs. Continental Tyre Rubber Co.) 5 . Although the actual
address of the registered office of the company is not required to
be stated in the memorandum, every company must have specified premises in a town fixed as its registered office either from the day on which it begins to carry on business or as from the 30th day after the date of its incorporation, whichever is earlier (Sec. 146(1)]. Notice of the situation of the registered office and of every change therein is to be given to the Registrar for record within 30 days of incorporation or date of change, as the case may be [Sec. 146(2)]. Usually, the notice of the situation of registered office is filed at the same time as the memorandum. 3 Companies of this kind have been fully discussed in preceding Unit, under the heading, 'Licensed Companies'. 4 (1902) 2 Ch. 319. 5 (1916), 2 A.C. 307.

 The importance of the registered office is that it is the address of the company where all communications and notices are to be sent and where register of members, register of debentureholders, register of charges, minutes books of general meetings, etc., are kept. 3. The objects clause. It is the most important clause of the memorandum because it sets out the objects or vires of the company. A company is not legally entitled to do any business other than that specified in its objects clause. This rule is meant to protect first, the members, who can at once know the purpose for which their money is to be employed and can be sure that their money is not going to be risked in an unknown activity or project and secondly, the public at large, who deal with the company, can at once know the extent of company's powers and whether a particular transaction which is to be entered into with them is ultra vires the company or not. Moreover, the fact that the company's capital cannot be spent on any project outside the objects clause of the company gives a feeling of security to the creditors. Although the subscribers to the memorandum are free to choose the objects of the proposed company, the following points should be kept in mind while drafting the objects clause of a company: (i) The objects of the company must not be illegal, e.g., to carry on the business of lottery. (ii) They must not be against the provisions of the Companies Act, such as buying its own shares (Sec. 77), declaring dividend out of capital, etc. (iii) They must not be against public policy, e.g., to carry on trade with an enemy country. (iv) They must be stated clearly and definitely. An ambiguous statement like "company may take up any work which it deems profitable" is meaningless. (v) They must be quite elaborate also. Not only the main objects, but the subsidiary or incidental objects too should be stated because it is very difficult to alter them. The narrower the objects expressed in the memorandum, the less is the subscriber's risk, but the wider such objects the greater is the security of those who transact business with the company. It is, therefore, of utmost importance that the objects clause be drafted with the greatest care. The objects clause of a company must be divided into two sub-clauses: (a) The main objects. Under this sub-clause the main
objects to be pursued by the company on its incorporation

and objects incidental or ancillary to the attainment of the main objects must be stated. (b) Other objects. Under this sub-clause other objects of the company not included in the above clause must be stated [Sec. l3(l)(d)]. In the case of 'non-trading companies' the objects clause should also mention the names of those States to whose territories the objects of a company will extend. The main objects shall be pursued by the company immediately on its incorporation. But if a company wishes to start a business included in other objects, it shall have to obtain either the authority of a special resolution or an ordinary resolution and Central Government's sanction. In addition to the above, the secretary or a director must file with the Registrar, a declaration that the requirement as to resolution, etc., has been complied with. It must, however, be observed that by virtue of this provision additional protection has been provided to the shareholders of the company because now the management cannot risk the capital of the company in entirely new projects, without giving any notice to them, under the pretext of pursuing objects subsidiary or incidental to the main objects. Implied powers. Further, apart from the powers expressly provided in the objects clause, a trading company has also certain implied powers. These are: (i) to borrow money; (ii) to
Memorandum of Association and Articles of Association Self-Instructional Material 447 NOTES 6 Press release issued by SEBI on 11-6-1999. Check Your Progress 1. Memorandum of association of a company is its principal document. Elucidate. 2. Describe the contents of memorandum. act by agents; (iii) to compromise disputes; and (iv) to mortgage or sell land. In general it may be said that a company authorised by its objects clause to carry on the business of making and selling cotton textiles would possess implied powers for the purpose of carrying on that business, to purchase or take on lease premises for factories, warehouses, offices and shops, to engage employees, to borrow money and so on; because all these matters are fairly incidental (naturally attached) to the carrying out of the company's main objects. 4. The liability clause. This clause states
that
the liability of members is limited to the amount, if any, unpaid on their shares.
If the memorandum so provides, the liability of the directors may be unlimited (Sec. 322). If it is proposed to register the company limited by guarantee, this clause will state
the amount which every member
undertakes

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to contribute to the assets of the company in the event of its winding up.

A company registered with unlimited liability need not give this clause in its memorandum of association. 5. The capital clause. Every limited company (whether limited by shares or whether limited by guarantee), having a share capital must state
the amount of its
share capital with which the company is proposed to be registered and the
division thereof into shares of a fixed
denomination, in this clause. It is usually expressed as follows: "
The share capital of the company is Rs 10,00,000 divided into 1,00,000 shares of Rs 10 each."
This capital
is variously described as "registered", "authorised" or "nominal" capital and the stamp duty is payable on this amount. There is no legal limit to the amount of share capital. It may be any amount running into crores of rupees but the denomination of each share should be Rs 10 or 100 in case of equity shares and Rs 100 in case of preference shares. However, the companies whose equity shares are dematerialised (i.e., cease to exist in physical form and corresponding credit is given in the form of book entry in the records of the Depository) shall have the freedom to issue equity shares in any denomination which should not be less than rupee one. 6 The amount of authorised capital should be sufficiently high so that further issue of shares may easily be done to finance the expanding business. It is optional for a company to state the divisions of the authorised capital into different classes of shares, if any, and the rights of various classes of shareholders in this clause. Usually such details are described in the articles of the company. Note that an unlimited company having a share capital, is not required to have the capital clause in its memorandum.
In the case of such a company Section 27(1) provides that
the amount of share capital with which the company is to be registered
must be stated in the articles
of association of the company. 6. The association or subscription clause. Under this clause we have the "declaration of association", which is made by the signatories of the memorandum under their signatures duly attested by witness, that they desire to be formed into a company and

that they agree to the purchase of qualification shares, if any. Each subscriber must take at least one share. The statement reads as follows: "
We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance
to the
Memorandum of Association and we agree to take the number of
shares in the capital of the company
shown against our names."
There must be
at least
seven signatories
in case of a public company and at least two in case of a private company.
The
subscribers usually act as first directors of the company. In the case of a company which is limited by guarantee or is having unlimited liability, and which has no share capital, the legal provision regarding the purchase of at least one share by each subscriber does not apply. Above mentioned clauses are referred to as the compulsory clauses of the memorandum as per Section 13. Other provisions relating to Managing Director or Manager, etc., may also be given in the memorandum but they can be altered in the same manner as the Articles of the company [Sec. 16(3)].
Memorandum of Association and Articles of Association 448 Self-Instructional Material NOTES 36.4 ALTERATION OF MEMORANDUM As per Section 16 "a company shall not alter the conditions contained in its memorandum., except in the cases, in the mode, and to the extent, for which express provision is made in the Companies Act". As such alteration in any compulsory clause of the memorandum is possible only by strictly following the procedure laid down in the Act. We shall now see the procedure and extent of alteration of different clauses of memorandum as given in the Companies Act. 1. Alteration
of name clause. A company may, by passing
a "special resolution" 7 and with the approval of Central Government in writing,
change its name. But no approval
of Central Government is needed
where the only change in the name is the addition thereto or the
deletion therefrom, the word "private"
consequent
on the conversion of a public company into a private company
or vice versa (
Sec. 21). If through inadvertance or otherwise, a company's name is wrongly
registered by a name which, in the opinion of the Central Government, is
identical with the name of another existing company or is undesirable,
the name of the new company may be changed by passing an "ordinary resolution" 8 and obtaining the approval of Central Government
in writing.
In such case, the Central Government can also within 12 months of first registration or registration under a changed name, direct the company to change its name. If a direction is issued, the
company must change its name within three months, from the date of direction, unless, the
time is extended, in the above manner (Sec. 22). Within 30 days of passing the resolution, a copy of the same shall be filed with the Registrar. Also, a copy of the Central Government's order of approval shall be filed with the Registrar within three months of the order.
The Registrar shall
enter the new name on the "Register" in place of the former name and shall issue a fresh incorporation certificate with the new name.
It is only after this that the change becomes effective and the company can use the new name (Sec. 23). 2. Alteration of registered office clause. A company may change its registered office within the same city by passing a Board's resolution only to that effect. A notice is, however, to be given to the Registrar within 30 days of the change. If
a company wants to shift
its registered office from one city to another
city within the same State,

it must pass a special resolution authorising the change and file its copy with the Registrar within 30 days. A notice of address of new location of the office must be given to the Registrar within 30 days of the shifting of the office [Sec. 146(2)]. Regional Director's approval for shifting of Registered Office within the same State in certain cases. Section 17A has been added by the Companies (Amendment) Act, 2000, to provide that shifting of the registered office by a company
from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies
within the same State shall, in addition to passing a special resolution under Section 146, also require confirmation of the Regional Director.
For this purpose an application shall be made in the prescribed form 9
seeking approval for the shifting of the registered office. The Regional Director shall communicate confirmation or otherwise, after giving necessary opportunity of being heard to the parties, within four weeks. A certified copy of the said confirmation order together with a printed copy of the memorandum as altered
is required to be filed within two months with the Registrar of Companies who shall issue the certificate of 7 "Special resolution" requires 21 days notice and may be passed by three-fourth majority of votes of members present in person or by proxy, those remaining neutrals being ignored. 8 "Ordinary resolution" requires 21 days notice and may be passed by bare majority of votes of members present in person or by proxy, those remaining neutrals being ignored. 9 "Form IAD" has been prescribed vide Rule 4BBA of the Companies (C.G.'s) General Rules and Forms (Third Amendment) Rules, 2001, w.e.f. 31-1-2001.
Memorandum of Association and Articles of Association Self-Instructional Material 449 NOTES registration within one month from the date of receipt of the certified copy of the Order. Thereafter the Registrar shall make necessary changes in the "Register" and transfer the records
to the Registrar of Companies under whose jurisdiction registered office is proposed to be shifted.
In the meanwhile, the registered office is shifted to its new location and notice of new address shall be given to the new Registrar within 30 days of shifting the office. Regarding newly added Section 17A discussed above, it is pertinent to note the following: (i) At present, the provisions of this Section will have applicability only to companies situated in the State of Tamil Nadu and State of Maharashtra which have more than one office of the Registrar of Companies. There are two offices of the Registrar of Companies in Tamil Nadu—one at Chennai and the other at Coimbatore. There are two offices of the Registrar of Companies in Maharashtra—one at Mumbai and the other at Pune. (ii) The provisions of this Section have been made effective from 1st March 2001. The types of changes in the situation of the registered office, as mentioned above, do not involve alteration of memorandum because the Act requires only the mentioning of
the
name
of
the State in which
the registered office of the company is to be situated
under the '
Registered Office
Clause' of the memorandum. Therefore, it is only
the change of registered office from one State to another which involves alteration of the memorandum; and
perhaps it is for this reason that a lengthy procedure has been prescribed under the Companies Act for effecting such a change.
Change of registered office from one State to another State
is possible only when such a change enables the company to meet out any of the purposes enumerated in Section 17(1) 10 of the Act. In addition to this requirement, the following procedure is to be followed for effecting the change: First, a special resolution must be passed by the company and a copy thereof should be filed with the Registrar within 30 days. Secondly, the sanction of the Company Law Board is to be obtained. Before confirming the alteration the Company Law Board satisfies itself that sufficient notice has been given to the creditors and other persons, whose interest may be affected by the alteration, and they have given their consent, and that every such creditor who objects to it has either been paid in full or his debt has been fully secured. The Company Law Board also causes notice of the proposed change to be served on the Registrar so that he may appear before the Board and state his objections or suggestions, if any, with regard to the change. The Company Law Board may then issue the confirmation order on such terms and conditions as it thinks fit. Thirdly, a certified copy of the Company Law Board's confirmation order together
with a printed copy of the altered memorandum must be filed with the

Registrars of both the States within three months of the order. The Registrar of each State must register the same and certify the registration within one month from the date of the filing of such documents. Further, the Registrar of the present State will send all the records and documents relating to the company to the Registrar of the other State in due course. Fourthly, certificates of registration of the 'transfer' from both the Registrars are obtained, and Lastly, the Registered Office is shifted to its new location in the other State and notice of the new address is given to the Registrar within 30 days of the shifting of the office. 3. Alteration of objects clause. Section 17(1) of the Companies Act states that the objects clause and the registered office clause (in case transfer is contemplated from one State to another) can be altered only if the change enables the company: 10 For details of Section 17(1) see the next sub-heading—'Alteration of objects clause'.

Memorandum of Association and Articles of Association 450 Self-Instructional Material NOTES 11 This Section does not apply to a private

company. (i) to carry on its business more economically or more efficiently; (ii) to attain its main purpose by new or improved means; (iii) to enlarge or change its local area of operations; (iv) to carry on some business which

can be suitably combined with the present business of the company; (v) to restrict or abandon any of its objects specified in the memorandum; (vi) to amalgamate the company with any other company; (vii)

to sell or dispose of the whole or any part of the undertaking of the company.

If any of the above purposes can be achieved, a company may alter its objects clause by passing a special resolution only [Sec. 17(2)]. A copy of special resolution authorising the alteration together

with

a printed

copy of the memorandum as altered must be filed with the Registrar

within thirty days of passing

the resolution. The

Registrar shall register the same and issue a certificate of registration within one month. The alteration will be effective only on getting this certificate of registration (Secs. 17, 18 and 19). It is worth mentioning here that prior to the passing of the Companies (Amendment) Act, 1996, companies were also required to seek the approval of the Company Law Board for alteration of the Objects Clause. This requirement has now been dispensed with. The change is a welcome measure as it reduces the time frame for implementing expansion and diversification of business operations. It is important to note that if a company proposes to alter the objects clause of its memorandum to take up an entirely new business activity (which is neither incidental or ancillary to its main objects nor included in its 'other objects') by insertion of new objects, it would be necessary, in addition to adopting the procedure stated above, to pass another special resolution at the same general meeting, according approval to the commencement of new business [Sec. 149(2A)(i)]. 11 A copy of the second special resolution

is also to

be filed with the Registrar within thirty days of

passing of the resolution. 4.

Alteration of liability clause. Liability of shareholders of a limited company, or a company limited by guarantee, cannot be made unlimited unless the same is expressly agreed to by each and every member concerned (Sec. 38). The liability of Directors, Managing Director or Manager can be made unlimited by passing a special resolution, if the Articles so permit and if the officer concerned has accorded his consent to the liability becoming unlimited (Sec. 323). The change becomes effective from the date of passing the resolution. Information to Registrar must, however, be sent together with relevant papers within thirty days of passing the special resolution. Shareholders of unlimited liability company can make their liability limited by passing a special resolution and obtaining the Court's sanction.

A copy of special resolution must be filed within thirty days of its passing and a copy of the

Court's confirmation order must be filed within three months of the order with the Registrar. Alteration is effective from the date of registration by the Registrar. 5. Alteration

of capital clause. According to Section 94,

a company limited by shares or

a company limited by guarantee

and having a share capital

can alter the capital clause of its memorandum, in any of the following ways: (a) It may increase its authorised share capital. It is to be noted that further issue of unissued shares within the authorised capital is governed by Section 81 of the Act and shall not alter the memorandum. The Board of Directors, if so authorised by the Articles, may increase the issued capital within the limit of authorised capital, by passing a board's resolution.

Memorandum of Association and Articles of Association Self-Instructional Material 451 NOTES (b) It may consolidate or sub-divide the whole or any part of its existing shares into shares of larger or smaller denominations. (c) It may convert its fully paid-up shares into "stock" or vice versa. (d) It may cancel its unissued shares, i.e., shares which have not been subscribed for by any person, and diminish the amount of its authorised
share capital by the amount of the shares so cancelled.
It is to be remembered that diminition of authorised share capital by cancellation of unissued shares does not amount to reduction of share capital, for the cancelled shares have never been issued to anyone. The object of such cancelling may be to get rid of an unissued class of shares carrying inconvenient rights. A company can make any of these alterations by simply passing an ordinary resolution, provided it is authorised by its Articles to do so. If the Articles do not provide for it, then firstly Articles must be changed by passing a special resolution. Within thirty days of the date of passing the resolution, notice must be given to the Registrar together with a copy of resolution and altered memorandum, who will then register the altered memorandum. It is from the date of passing the ordinary resolution that the change becomes effective. It is worth noting that there is no necessity of passing a resolution for alteration of authorised capital where it stands increased by reason of: (a) an order made by the Central Government for conversion of any loans or debentures into shares of the company; or (b) an order made by the Central Government on the application of any "public financial institution" which proposes to convert any debentures or loans with conversion clauses into shares of the company [Sec. 94A(1) and (2)]. It may be pointed out that this Section does not absolve the company from giving notice of the increase of capital to the Registrar of Companies. Such a notice has to be given in the form of a return in the prescribed form within thirty days from the date of receipt of Government's order and the Registrar shall then make the necessary alterations in the memorandum of the company [Sec. 94A(3)]. Note: It may be recalled that an unlimited company having a share capital is not required to have the Capital Clause in its memorandum. In the case of such a company, Section 27(1) provides that the amount of 'Registered Share Capital' must be stated in the 'articles' of the company. Alteration of capital clause, therefore, does not involve alteration of memorandum in the case of companies with unlimited liability and having a share capital. In the end, it may be noted that where an alteration is made in the memorandum of a company, every copy of the memorandum subsequently issued must be in accordance with the alteration. For non-compliance with this requirement,
the company and
every officer
of the
company who is in default, shall be punishable with fine which may extend to
Rs. 100
for each
copy so issued (Sec. 40). 36.5 THE DOCTRINE OF ULTRA VIRES The doctrine of Ultra Vires implies that those transactions or acts of a company which are outside the ambit of its objects clause (i.e., which are ultra vires its memorandum) are deemed to be ultra vires or beyond the powers of the company. Consequently, all such transactions which are ultra vires the memorandum of association shall be wholly null and void so far as the company is concerned and can never be subsequently ratified and validated, even though all the shareholders consent or purport to ratify such transactions. It is to be observed that the law has not attributed to companies a general capacity to contract. Although a company is a legal entity it has not been equated to a natural person in this respect. It has capacity to do only those things which it is empowered to do by the 'objects clause' of its memorandum of association.

Memorandum of Association and Articles of Association 452 Self-Instructional Material NOTES 12 (1875), L.R. 7 H.L. 653. 13 A.I.R., (1963), S.C. 1185. The application of the Doctrine of Ultra Vires was first explained by the House of Lords in the leading case Ashbury Railway Carriage & Iron Co. Ltd. vs. Riche. 12 In that case the company's objects, as stated in the memorandum, were : (a) to make and sell, and lend on hire railway carriages and wagons, and all kinds of railway plants, fittings, machinery and rolling stock; (b) to carry on the business of mechanical engineers and general contractors; (c) to purchase, lease, work and sell mines, minerals, land and buildings, and (d) to purchase and sell as merchants, timber, coal, metals, or others materials and to buy and sell any such materials on commission or as agents. The directors entered into a contract with Riche, for financing the construction of a railway line in a foreign country and the company subsequently purported to ratify the act of the directors by passing a special resolution at a general meeting. The company, however, repudiated the contract. Riche thereupon sued the company for breach of contract. The House of Lords held that the contract, being of a nature not included in the company's objects, was void as being ultra vires not only of the directors but of the whole company, and could not be made valid by ratification on the part of the shareholders, and therefore the company was not liable to be sued for breach. In the case of A. Lakshmanaswami Mudaliar vs. L.I.C. 13 the Supreme Court of India has affirmed that an ultra vires contract remains ultra vires even if all the shareholders agree to ratify it. It is to be noted, however, that if the act instead of being ultra vires the company is ultra vires the directors only (e.g., directors extend time for the repayment of any debt due by a director without the consent of the shareholders in general meeting while, as per Section 293, they have no authority to do so), the whole body of shareholders can ratify it and make it binding upon the company by passing an ordinary resolution. Also, if an act is ultra vires the articles (e.g., allowing a higher rate of interest on calls received in advance than what is provided in the articles), the company can alter the articles by passing a special resolution so as to make the same intra vires (within the powers) the articles with retrospective effect. The company is allowed to ratify acts which are ultra vires the directors or ultra vires the articles because here it, in fact, possessed the 'capacity to contract'. It is, therefore, very important to remember that the doctrine of ultra vires comes into force in relation to acts ultra vires the company. Rationale behind the "Doctrine". We have observed earlier that a company is capable of doing only such acts as are allowed by the objects clause of its memorandum of association. The rationale of this restriction on the company's powers lies in the fact that a company, being an artificial person, is devoid of conscience and intelligence and therefore, cannot look after its own interests. Moreover, the restriction also aims at protecting the interests of the shareholders and the creditors of the company by ensuring that the funds of the company would not be dissipated in unauthorised activities. It is these facts to which the 'Doctrine of Ultra Vires" owes its existence. Besides, the Indian Contract Act also lends support to this "Doctrine". While prescribing the essentials of valid contract it expressly lays down that incapacity to contract of one or both of the parties to a contract makes the contract void. Hence, if a company enters into a contract for which it is not competent, the contract shall be deemed to be null and void. Effects of Ultra Vires Transactions. Howsoever cautiously the directors might act, ultra vires acts are likely to do done. The position of the company in the case of ultra vires acts is similar to the case of a
minor.
According to the Indian Contract Act '
an agreement by a minor is
absolutely void
and inoperative as against him
but he can derive benefit under it.'
Thus, some of the noteworthy consequences of ultra vires acts are as follows: 1. Personal liability of directors. The funds of a company, under the Act, can only be applied in carrying out its authorised objects. Accordingly, if a director
of a company

Self-Instructional Material 453 NOTES 14 (1873), L.R., 8CP 427. 15 (1903), A.C. 114. 16 Cf. Avtar Singh, Company Law, p. 44 (1982 ed.). makes an ultra vires payment (payment for an object outside the memorandum of association), he can be compelled to refund the money to the company. Of-course, the director could get indemnity as against the payee if it is proved that the payee was in know of the fact that the payment to him was ultra vires. Directors will also be personally liable to anyone who suffers a loss because of "breach of warranty of authority" on their part. The directors are agents of the company and as such they are expected to act within the limits of the company's powers. If they induce, however innocently, an outsider to contract with the company in a matter in which the company does not have power to act, they will be personally liable to the plaintiff for his loss, because an agent is personally liable to third parties when he exceeds his authority. In Weeks vs. Propert 14 : A railway company invited applications for a loan on debentures, although it had already exhausted its limits as laid down in the memorandum. On seeing the advertisement the plaintiff offered a loan of £500 which was duly accepted by the directors. The loan being ultra vires was held to be void and not binding upon the company but the directors were held personally liable because by inserting the advertisement, they had warranted that they had the power to borrow which they did not, in fact, possess and as such their warranty of authority was broken. It must, however, be observed that the directors can be made personally liabile if their act amounts to an implied misrepresentation of facts and not of law. Thus, where the memorandum does not authorise to borrow at all, it is a question of law which every lender is supposed to know. Hence if a lender lends money to such a company, he can neither make company liable nor the directors The reason being that the lender, is supposed to know the company's powers, and if the contract is not consistent therewith, he takes the risk. However, such a lender is entitled to certain remedies which are discussed below under point no. 3—ultra vires contracts. Thus briefly stated, it may be said that directors can always be held personally liable by the company for acts done by them ultra vires the memorandum of association, while the third party can make them personally liable only where they act ultra vires the memorandum in breach of their warranty of authority amounting to an implied misrepresentation of facts. Similarly, where the directors act ultra vires their powers or ultra vires the articles and the company does not subsequently ratify the contract, they shall be personally liable to the other party to the contract for the breach of an implied warranty of their authority (Starkey vs. Bank of England 15). If, however, they have become personally liable to third parties on ultra vires transactions they will have no right to be indemnified by the company against this liability, of course, they have the usual rights of contribution inter se. 2. Ultra vires acquired property. If a company's money has been spent in purchasing some ultra vires property, the company's right over that property must be held secure. For, that asset, though wrongly acquired, represents the corporate capital. "Property legally and by formal transfer or conveyance transferred to a corporation is in law duly vested in such corporation; even though the corporation was not empowered to acquire such property." 16 As observed earlier, the position of the company in the case of ultra vires acquired property is similar to the case of a minor. 3. Ultra vires contracts.

A contract which is ultra vires the company is wholly void and of no legal effect.

As a result any one entering into an ultra vires contract cannot make the company liable for his claim. For example, if the object given in the memorandum is to manufacture shoes, and the company starts another business admittedly ultra vires, say, manufacture of cloth, any person having a claim for the supply of the raw materials, to the Memorandum of Association and Articles of Association 454 Self-Instructional Material NOTES 17 (1953) Ch. 131. 18 Adapted from S.M. Shah, Lectures on Company Law, p. 37 (1975 ed). 19 58 Bom. L.R. 1056. 20 (1914) A.C. 398. 21 19 Ch. D. 64. cloth manufacturing unit cannot make the company liable. The decision in Re Jon Beauforte (London) Ltd., 17 provides a similar illustration : A company formed for the purpose of carrying on business as 'costumiers and gown makers' decided to change to the manufacture of 'veneered panels' which was admittedly ultra vires. The company entered into contracts for the construction of a factory, for the purchase of veneers, and for the purchase of coke but failed to make a success of its new enterprise and went into liquidation shortly afterwards. It was held that none of the three suppliers could prove for their debts in the company's liquidation. The reason for this rule is that every one dealing with a company is supposed to know its objects and if he acts carelessly, he takes the risk.

The following two points must, however, be noted in this connection 18 : (a)

If money or property obtained under an ultra vires contract has been used to pay intra vires debts of the company, then by the principle of subrogation the creditor can, to that extent, stand in the shoes of those creditors who have been paid off, but he cannot claim any securities held by such creditors for their debts (Deonarayan Prashad vs. The Bank of Baroda Ltd. 19). (b) If the property handed over to the company or the money lent to the company, by virtue of an ultra vires contract, exists in specie or if it can be traced in specie, or if it has been expanded in purchasing some particular assets, the person handing it over can get it back (Sinclair vs. Brougham 20),

and obtain an injunction restraining the company from parting with it, provided he intervenes before the money is spent or the identity of the property is lost

or the property passes into the hands of a bona fide purchaser for value. 4. Ultra vires lending. A person borrowing money from the company under a contract which is ultra vires, can be sued by the company to recover the amount so lent. In Re Coltman 21 Brett. L.J. observed: "The only objection to this loan is that it was made without authority. But it does not seem to me that the borrower can set up as a defence to an action that the person who lent him the money and to whom he had made a promise to repay that money, had no authority to lend him that money.....The promise to pay back the money which you have borrowed is not illegal.....The only objection is, that those who made the contract with the debtor had no authority to make it, and that is an objection which he cannot take." 5. Ultra vires torts. A company cannot be made liable for torts committed by its officers in connection with a business which is entirely outside its objects. It can be made liable in torts only if these are committed in the course of intra vires activities by its servants or officers within the course of their employment. Thus the "Doctrine of Ultra Vires" aims at protecting the shareholders' and creditors' money in general, by implicitly prohibiting the use of corporate capital beyond the permissible range of corporate activity, yet it may give rise to occasional injustice to an outsider who may be entrapped in contracts which are void ab initio and therefore may be deprived of his money or claim. 36.6 THE OBLIGATION TO REGISTER ARTICLES Section 26 states that a public company limited by shares may register Articles, while a company limited by guarantee or an unlimited company or a private company limited by Check Your Progress 3. What do you understand by alteration of capital clause? What is the procedure for alteration of capital clause? 4. Explain the doctrine of ultra-vires.

Memorandum of Association and Articles of Association Self-Instructional Material 455 NOTES shares must register Articles along with the memorandum at the time of registration. In other words, it is optional for a public company limited by shares to register Articles, whereas other types of companies are required to do so compulsorily. There arises a question as to what happens if a public company limited by shares does not register any Articles. The answer to this question is provided by Section 28(2) which states that if a public company limited by shares does not register any Articles, Table A (the model set of 99 Articles given at the end of the Companies Act) shall automatically apply to such a company. Even if such a company registers Articles of its own, "Table A" will still apply automatically on all such points on which the said Articles are silent, unless its regulations have expressly been excluded by the company in its Articles. Most companies find it best to register a special set of Articles. Companies, other than a public limited company, have to register Articles compulsorily because they cannot adopt "Table A" in its entirety but in their case also the regulations of "Table A" will, so far as they are applicable, apply automatically on all such points on which their own Articles are silent, unless their own Articles expressly exclude those regulations. Form and signature of Articles. The Articles of Association of every company must be (a) printed, (b)
divided into paragraphs, numbered consecutively, and (c) signed by each subscriber to the Memorandum, who shall add his address, description and occupation,
if any,
in the
presence of at least one witness who will attest the
signature and shall likewise add his address, description and occupation,
if any (Sec. 30). 36.7 CONTENTS OF ARTICLES Articles usually contain rules and bye-laws on matters like: 1. The extent to which "Table A" is applicable. 2. Different classes of shares and their rights. 3. Procedure of making an issue of share capital and allotment thereof. 4. Procedure of issuing share certificates. 5. Lien on shares. 6. Forfeiture of shares and the procedure of their re-issue. 7. Procedure for transfer and transmission of shares. 8. The time lag in between calls on shares. . 9. Conversion of shares into stock. 10. Payment of commission on shares and debentures to underwriters. 11. Rules for adoption of preliminary contracts, if any. 12. Reorganisation and consolidation of share capital. 13. Alteration of share capital. 14. Borrowing powers of directors. 15. Procedure for convening, holding and conducting different kinds of general meetings. 16. Voting rights of members, proxies and polls. 17. Payment of dividends and creation of reserves. 18. Appointment, powers, duties, qualifications, remuneration etc., of directors. 19. Use of the Common Seal of the company. 20. Keeping of books of accounts and their audit. 21. Appointment and remuneration etc., of auditors. 22. Capitalisation of profits.

Memorandum of Association and Articles of Association 456 Self-Instructional Material NOTES 23. Board meetings and proceedings thereof. 24. Rules as to resolutions. 25. Appointment, powers, duties, qualifications, remuneration etc., of managing director, manager and secretary, if any. 26. Arbitration provision, if any. 27. Provision for such powers which cannot be exercised without the authority of Articles, for example, the issue of redeemable preference shares; issuing share warrants to bearer; refusing to register the transfer of shares; reducing share capital of the company. 28. Winding up. In addition to the above matters, the Articles
of an unlimited company should
state the number of members with which the company is to be registered
and
if

it has
a
share capital, the amount of share capital with which it is to be registered [
Sec. 27(1)].
In the case of a company limited by guarantee,
the
Articles
must
state the number of members with which the company is to be registered [
Sec. 27(2)]. The
Articles of a private company having a share capital must contain the four restrictions as given by Section 3(l)(iii) under Sub-clauses (a), (b), (c) and (d), namely: (a) restriction on the right of members to transfer shares; (b) limitation of the number of its members to fifty, excluding members who are or were in the employment of the company; joint-holders of shares to be treated as single member; (c) prohibition of
any invitation to the public to subscribe for any shares in, or debentures of, the company; and (
d) prohibition of acceptance of deposits from the public. In the case of a private company not having a share capital, the Articles must contain provisions relating to the matters specified in the above-mentioned Sub-clauses (b), (c) and (d) only [Sec. 27(3)]. It must, however, be remembered that Articles should not contain anything which is against the law of the land, the Companies Act, the public policy and is ultra vires the memorandum. Any such Clauses shall be inoperative and void. 36.8 ALTERATION OF ARTICLES The articles, being the internal regulations of the company, can be freely altered by the company. The right to alter or add to the Articles is expressly conferred by Section 31 which states that a company may alter its Articles, as often as required, by passing a special resolution only. A copy of special resolution authorising the alteration together
with a printed
copy of the altered Articles must be filed with the Registrar
within 30 days of passing
the said resolution. The alteration will be effective from the date of registration by the Registrar. It is to be observed that the power to alter Articles is a statutory power and cannot be negatived in any way. A company cannot deprive itself of this statutory right either by inserting a clause in the Articles or by a contract with any one (Andrews vs. Gas Meter Co.). 22 Further, Articles an be realtered by passing a special resolution and they can also be altered with a retrospective effect (Allen vs. The Gold Reefs of West Africa Ltd.). 23 This freedom of the company to alter its Articles is, however, subject to certain limitations. 22 (1897) 1 Chapter 361. 23 (1990) 1 Chapter 656. Also see All India Railwaymen's Benefit Fund vs. Bareshwar Nath I.L.R. (1945) Nag. 599. Check Your Progress 5. What are the usual contents of articles of association? 6. Describe the procedure for alteration of articles.
Memorandum of Association and Articles of Association Self-Instructional Material 457 NOTES 24 (1900) 1 Ch. 656. 36.9 LIMITATIONS REGARDING ALTERATION OF 37.5 ARTICLES 1.
The alteration must not be inconsistent with the provisions of the Companies Act
or any other statute (Sec. 31). Thus a company cannot alter its Articles so as to exclude or limit the rights of its shareholders to present a petition for the winding up of the company, because this right is conferred by Section 439. To cite another example, the alteration cannot be made so as to increase the liability of any member without his written consent, for, it shall be contrary to Section 38 of the Act. However, it is possible that the
Articles may impose on the company conditions stricter than those provided under the law,
for example, they may provide that a resolution should be passed by a special majority when the Act requires it to be passed by an ordinary majority. Similarly, the Articles may provide that all the directors would be liable to retire by rotation when the Act provides that in the case of a private company all the directors can be permanent and in the case of a public company one-third of the total number of directors can be permanent. 2. The alteration must not be inconsistent with he conditions contained in the memorandum (Sec. 31). The Articles are subject to the memorandum and so must not override the memorandum. As such they cannot be altered so as to give powers which are not given by the memorandum. 3. The alteration must not be inconsistent with the alteration ordered by the Company Law Board. In the exercise of its powers to remedy "oppression" and "mismanagement" under Sections 397 and 398, the Company Law Board has power to alter a company's memorandum and Articles in any way it thinks fit. When the Company Law Board has amended the memorandum or Articles, the company can make no alteration which is inconsistent with the Company Law Board order without the leave of the Company Law Board (Sec. 404). 4. Approval of the Central Government must also obtained in certain cases. For example, in the following cases alteration made in the Articles shall be valid and operative only if such alteration has also been approved by the Central Government: (a) If alteration results in
the conversion of a public company into a private company (

Sec. 31). (b) In the case of a public company, if alteration relates to any provision regarding the appointment or reappointment of a managing or whole-time director or of a director not liable to retire by rotation, and the proposed alteration is not in accordance with the conditions specified in Schedule XIII in that regard (Sec. 268 read with Schedule XIII). (c) In the case of a public company, if alteration results in an increase of remuneration to a director including a managing or whole-time director beyond the limits prescribed in Schedule XIII (Sec. 310 read with Schedule XIII). Where the alteration has been approved by the Government, a printed copy of the Articles as altered shall be filed by the company with the Registrar within one month of the date of receipt of order of approval. 5. The alteration must not deprive any person of his rights under a contract. Alteration should not destroy and of the rights possessed by any person by virtue of a contract. In Allen vs The Gold Reefs of West Africa Ltd., 24 Lord Lindley observed, "....Thus a person appointed in accordance with the provisions of the Articles as director on a fixed remuneration of Rs 2,000 p.m. under an independent contract of service, cannot be made to accept a lesser amount by altering the Articles." It is to be observed, however, that in case a person

 accepts the appointment purely on the terms of the Articles, the alteration shall be valid and binding upon such a person. For example, in C. Chettiar vs. Krishna Aiyanger's 25 case, the Articles provided Rs 250 p.m. as pay for the company's secretary. The post was accepted by the plaintiff and in the specific agreement with him the Articles were referred to show the terms of the contract. Later on the company changed the Articles so as to reduce the secretary's pay to Rs 25 p.m. The alteration was held valid and operative. It was stated that any one accepting an appointment purely on the terms of the articles takes the risk of those terms being altered. 6. The alteration must not constitute a fraud on the minority. Alteration would be liable to be impeached if the effect of it were to defraud or oppress the minority. The principle was laid down in the case of Menier vs. Hooper's Telegraph Works. 26 In this case the majority of the members of Company A, were also members of Company B. At a meeting of Company A, they passed a resolution to compromise an action against Company B in a manner alleged to be favourable to Company B but unfavourable to Company A. On an action by the minority of Company A, the resolution was held invalid and the compromise was set aside. The Court observed, "It would be a shocking thing if that could be done, because the majority have put something into their pockets at the expense of the minority". Similarly, the Court will certainly intervene if the majority pass a resolution sanctioning a sale of the company's property to themselves at an undervalue. 7.

The

alteration must be bona fide for the benefit of the company as a whole. Alteration shall not

be valid if it

has been made for the benefit of an aggressive or fraudulent majority. Thus, in Brown vs. British Abrasive Wheel Co. 27 certain shareholders held 98 per cent of the company's shares. The company passed a special resolution that a shareholder, upon the request of the holders of 90 per cent of the issued shares, shall be bound to sell and transfer his shares to the nominee of such holders at a fair value. It was held that the alteration was not for the benefit of the company as a whole but for the benefit of the majority and an injunction was granted restraining the company from carrying out of resolution. On the other hand, alteration made bona fide in

the interests of the company shall be valid even if it is likely to affect adversely the

personal interests of some of the members of the company. Thus, in Sidebottom vs. Kershaw, Leese & Co. 28 the Court upheld an alteration of the Articles of a private company, which authorised the directors to order any shareholder, carrying on a competitive trade to that of the company, to transfer his shares at a fair value to the person nominated by the directors, on the ground that the alteration was for the benefit of the company as a whole, individual hardship being irrelevant. The distinction between these two cases must, however, be noted. Whereas in the former case the alteration was clearly for the benefit of an aggressive majority, in the latter it was not, because under the given circumstances it would likewise have operated against the majority. 36.10 BINDING FORCE OF MEMORANDUM AND 37.6 ARTICLES Regarding the binding force or legal effect of the memorandum and articles, Section 36 of the Act provides that, "subject to the provisions of the

Act,

the memorandum and articles shall,

when registered, bind the company and the members

thereof

to the same extent

as if they respectively had been signed

by the

company and

by each member,

and contained covenants (agreements) on its and his part to observe all the provisions of memorandum and of the articles." It follows from the language of the Section that the memorandom and 25 I.L.R. 33 Mad. 36. 26 (1874) 9 Ch. App. 350. 27 (1919) 1 Ch. 290. 28 (1920) 1 Ch. 154.

Memorandum of Association and Articles of Association Self-Instructional Material 459 NOTES articles bind the company to its members, the members to the company, the members to each other in an exceptional case, but they do not bind the company or its members to outsiders. For the sake of clarity we shall now see the legal effect of this provision (i.e., Sec. 36) under the following heads in some details : 1. Company is bound to its members. The articles and memorandum constitute a contract binding the company to its members in their capacity as members, and as such a company is bound to comply with the provisions of these documents. As a result each member can restrain the company from committing a breach of the articles or/and memorandum which would affect his rights as a member, by bringing an injunction against it (Re Peveril Gold Mines Ltd.). 29 Thus, an individual member can enforce his membership rights such as his right to vote or his right to recover dividend which has been declared or his right to receive notice of any general meeting, etc., in pursuance to the articles, if he is denied any of these rights by the company (Pender vs. Lushington) 30 . In Johnson vs. Lyttle's Iron Agency 31 , a forfeiture of shares, irregularly effected by the company, was set aside at the instance of the aggrieved member as the company did not comply with the provisions of the articles. It must be noted that these documents bind the company to members and vice versa

in respect of their membership rights only and not contractual rights of other kinds.

Even a member enjoying certain rights in capacity other than a member cannot enforce them against the company. Thus, where the articles provided that the company should purchase certain property belonging to a member, there was held to be no contract between the company and the member to that effect (Re Tavarone Mining Co.). 32 2. Each member is bound to the company. Members are bound to the company to observe and follow the provisions of the memorandum and articles, just as if every one of them had contracted to conform to them. All money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company (Sec. 36). "Articles constitute a contract between each member and the company" (Welton vs. Saffery 33). It follows, therefore, that

a company can sue its members for the enforcement of

its articles as well as for restraining their breach. Thus, if the articles provide to refer any dispute between the company and its member to arbitration, the court will stay an action by the member, in such a dispute on an application made by the company. For the sake of another illustration the facts of Boreland Trustees vs. Steel Brothers & Co. Ltd., 34 may be seen. The articles of the defendant company provided that the shares of any member who became bankrupt should be sold to certain other persons at a certain price to be fixed by the directors. B became bankrupt. His trustee in bankruptcy claimed that he was not bound by the articles and he could dispose of the shares as he liked. It was held that he was bound by the terms of the articles and could not claim the shares against the company. But this binding force on members is only in respect of their rights and obligations as members. In Beattie vs. Beattie 35 , the articles provided that a dispute arising between the company and any member would be referred to arbitration. A director, who was also a member of the company, was sued for wrongs done in his capacity as director. It was held that the arbitration clause was not applicable lo this dispute because it did not relate to the rights of director as member but as director. 3. Each member is bound to other members in exceptional case only. Articles or/and memorandum do not create an express agreement between the members of the company 29 (1889), 1 Ch. 122. 30 (1877), 6 Ch. D. 70. 31 (1877), 5 Ch. 687. 32 (1873), 8 Ch. App. 956. 33 (1897), A.C. 299, 315. 34 (1901), 1 Ch. 279. 35 (1938), Ch. 708.

Memorandum of Association and Articles of Association 460 Self-Instructional Material NOTES inter-se, because in usual course a member is not allowed to sue another member directly for any wrong done to the company or to recover money alleged to be due to the company. The action must be brought by the company itself or if it is in liquidation, by the liquidator (Burland vs. Earle 36). If a shareholder defaults in making payment of a call made, only the company may sue him because if other members are allowed to sue him, there may be thousands of suits (if the number of members is that large) filed against him, which shall be absurd. The only exception, where articles form a contract between individual members qua members and where an individual member in his personal capacity, may sue other member or members directly without joining the company as a party to the action, is when the persons against whom relief is sought control the majority of shares and will not allow an action to be brought in the name of the company and the acts complained of, are either fraudulent or ultra vires (The Dhakeshwari Cotton Mills Ltd. vs. Nilkamal 37). 4. Neither the company nor the members are bound to outsiders. The articles and memorandum create no contract with outsiders, that is, vendors, solicitors, secretary, etc. A member is also an outsider if the matter in question is not connected with his membership rights and obligations. An outsider cannot take advantage of these documents to found a claim thereon against the company or its members, even though his name may have been mentioned in the articles, for, such a person is not a party to the contract constituted by the articles and memorandum. Thus, for instance, where the articles provided for remuneration to be paid to promoters, it was held that the promoters had no right of action against the company (Re Rotherham Alum & Co. 38). Similarly in the case of Eley vs. Positive Government Life Assurance Co. Ltd. 39 : The articles provided that Eley should be the company's solicitor for life. Eley was employed by the company and he also purchased certain shares of the company. But the specific contract with him did not contain the term that he shall be the company's solicitor for life. After sometime the company dismissed him. He then sued the company
for damages for breach of contract. It was held that
be had no cause of action, because the articles did not constitute any contract between the company and himself. It may be noted that outsiders may acquire rights under the articles and can enforce them against the company if articles have been referred to show the terms of the contract in the specific agreement between the outsider and the company. Thus, where the directors were appointed under a specific contract referring to therein the provisions of the articles in that regard which provided a remuneration of Rs. 5,000 p.m. to a director, the terms of the articles become a part of the contract which the directors could enforce against the company (Re New British Iron Co. 40). Constructive Notice of Memorandum and Articles. After registration memorandum and articles become "public documents" and it is taken for granted that every one who deals with the company is in the know of these documents (Mahony vs. East Holyford Mining Co. 41). This is called the "Constructive Notice of Memorandum and Articles" or the "Doctrine of Constructive Notice." The legal effect of this doctrine is that if a person deals with a company in a manner which is inconsistent with the provisions contained in its memorandum or articles (i.e., enters into a transaction which is beyond the powers of the company as set out in those documents), he must be deemed to have dealt with the company at his own risk and cost and shall have to bear the consequences thereof. For 36 (1902), A.C. 83. 37 (1937), A.I.R. Cal. 645. 38 (1883), 25 D. 103. 39 (1876), 1 Ex. D. 88. 40 (1898), 1 Ch. 324. 41 (1875), 7 H.L. 869. Check Your Progress 7. Discuss the limitations regarding alteration of articles. 8. Discuss the binding force of the memorandum and Articles.

Memorandum of Association and Articles of Association Self-Instructional Material 461 NOTES example, if the articles provide that a bill of exchange must be signed by two directors, a person who has a bill signed by only one director cannot claim payment upon such bill. 36.11 THE DOCTRINE OF INDOOR MANAGEMENT As observed above, the "Doctrine of Constructive Notice" will estop a person dealing with a company from pleading ignorance of the provisions contained in its memorandum or articles. But where these documents prescribe some condition or procedure to be fulfilled or adopted before a transaction is entered into, a perusal of these public documents will give no indication whether the required condition or procedure has been complied with. Also, the outsider cannot be deemed lo have constructive notice of any procedural failure which he has no means of discovering. It is for this reason that the courts have allowed an exception to the "doctrine of constructive notice" and have enunciated a rule for the protection of persons dealing with companies. The rule is that persons dealing with the company in good faith have a right to assume that the internal requirements prescribed in public documents have been observed. They are not bound to enquire into the regularity of the internal proceedings. Thus, where the articles give power to borrow with the sanction of an ordinary resolution of a general meeting, a lender need not enquire whether the general meeting was convened on proper notice, or whether a proper quorum was present at the meeting, or whether the necessary resolution was properly passed thereat. He is entitled to assume that what has been done, has been regularly done by the company and can hold the company liable even if the internal formalities are found, not to have been completed. This rule is known as the "Doctrine of Indoor Management. " The genesis of the doctrine of indoor management could be traced back to the year 1856, when the decision in the famous case of Royal British Bank vs. Turquand 42 was delivered. In that case, the plaintiff lent money to a company on the security of a bond signed by two directors given under the seal of the company. The company's deed of settlement (the equivalent of modern articles of association) permitted borrowing by directors in that way only when authorised by an ordinary resolution of a general meeting. The company alleged that no such resolution had been passed, and, therefore, the loan was taken without its authority. The Court held that the company was bound by the contract since the plaintiff was entitled
to assume that the necessary resolution must have been passed. The
observation made by V. Haldane in the case of Pacific Coast Coal Mines Ltd. vs. Arbuthnot 43 is worth noting in this connection: "A person can be presumed to know the constitution of the company, but not what may or may not have taken place within the doors that are closed to him." The facts of County of Gloucester Bank vs. Rudry Merthyr & Co., 44 case provide another good illustration on the point. In that case a person was issued a mortgage deed to which the seal of the company had been affixed at a Board meeting at which no quorum was present. It was held that mortgage deed was valid because the mortgagee had no means of knowing the internal irregularity in the management. Briefly stated the "doctrine of indoor management" lays down that 'persons dealing with the company are only required to see that the proposed dealings are apparently regular and consistent with the memorandum and articles. They need not enquire into the regularity of the internal proceedings of the company. They are entitled to presume that the directors are acting lawfully in what they do, and can hold the company liable even if the internal formalities are found not to have been completed.' The doctrine is of great importance in the world of commerce, because in its absence the general plight of the persons dealing 42 (1856), 6E. & B. 327. 43 (1917), A.C. 607. 44 (1895), 1 Ch. 629.
Memorandum of Association and Articles of Association 462 Self-Instructional Material NOTES with companies would have been miserable, for, the company, very often, could have escaped liability by denying the authority of the officials to act on its behalf. 36.12 EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT In the following cases protection under this doctrine cannot be claimed: 1. Knowledge of irregularity. A person who has actual or constructive notice (i.e., be presumed to know in the given circumstances) of the internal irregularity cannot obviously claim the protection of this rule. Thus in Howard vs. Patent Ivory Co. 45 , the directors, under the articles, had no authority to borrow more than £ 1,000 without the sanction of a resolution of the company in general meeting. Without such consent they borrowed £ 3,500 from themselves and took debentures. It was held, that as they had notice of the internal irregularity, their debentures were good only to the extent
of £ 1,000. 2. Negligence on the part of the outsiders. If the circumstances are so suspicious as to invite further enquiry and the

outsider had not made proper enquiries which would have revealed the irregularities, he would not be entitled to the protection of the "doctrine of indoor management." For example, if an officer acts outside his apparent authority, the outsider cannot claim the protection of this rule under the pretext that be presumed that the relevant power might have been delegated to the officer, as per the articles. In such a case be must make further enquiries otherwise he is taking the risk. A clear illustration is the case of Anand Bihari Lal vs. Dinshaw & Co., 46 where the plaintiff accepted a transfer of company's property from its accountant, the transfer was held void. The plaintiff should have insisted on seeing the 'power of attorney' executed in favour of the accountant by the company before accepting the transfer, as the transaction is apparently beyond the scope of an accountant's authority. Even the unusual magnitude of the transaction may put a person dealing with a company upon enquiry as to its being authorised (Houghton & Co. vs. Nothard Law & Wills 47). 3. Forgery. The rule is of no avail where the outsider is found to have relied upon a document which is a forged one, for, a forgery is a nullity (i.e., void ab initio). Thus, in Ruben vs. Great Fingall Ltd. 48 the secretary of the company forged the signatures of two of the directors, as required under the articles, on a share certificate and issued the same to the plaintiff. The company refused to accept him as a shareholder. The plaintiff pleaded that whether the signatures were genuine or forged was a part of internal management and, therefore, the company should be estopped from denying genuineness of the document. But it was held that the plaintiff was not a shareholder and the certificate was a nullity because this doctrine only applies to irregularities which otherwise might affect a genuine transaction and it cannot apply to a forgery which is void ab-initio. It must, however, be observed that although
a company is not liable for forgeries committed by its
officers, yet it
may be held 49 liable for fraudulent acts of its officers acting under their ostensible authority on its behalf.
Thus, where 50 director or a manager of a company with ostensible authority under the memorandum and articles of the company, practises a fraud upon the company by not placing the money borrowed by him on a hundi or a bill of exchange in the coffer of the company, the company is bound to honour the hundi or the bill of exchange, as the case may be, and cannot defeat a bona fide creditor's claim for 45 (1888), 38, Ch. D. 156. 46 (1942), A.I.R. Oudh. 417. 47 (1928), A.C. 1. 48 (1906), A.C. 439. 49 Cf. Lectures on Company Law by S.M. Shah, p. 55 (1975 ed.). 50 Ibid. Check Your Progress 9. Explain the doctrine of indoor management. 10. What is 'Table A' and when is it adopted?
Memorandum of Association and Articles of Association Self-Instructional Material 463 NOTES recovery of the money on the ground of fraud of its own officers (Shri Kishan vs. Mondal Bros. & Co. 51). Distinction between Memorandum and Articles. The fundamental points of distinction between these two important documents are as follows: 1. The memorandum
contains the fundamental conditions upon which alone the company is allowed to be incorporated. It defines and limits the objects of the company beyond which the actions of the company
cannot go. The articles are the internal regulations of the company and are subsidiary to the memorandum. 2. The memorandum is subordinate to the Act only, while the articles are not only subordinate to the Act but also to the memorandum. 3. The memorandum must compulsorily be filed with the Registrar by all types of companies at the time of incorporation while a public company limited by shares need not file a separate set of articles at the time of incorporation as it may choose to adopt 'Table A'— the model set of articles. 4.
The memorandum defines the relation between the company and the outsiders, i.e., creditors, buyers, sellers, debtors and members, etc. Articles govern internal relationship between the company and the members and
generally have nothing to do with the outsiders. 5. The memorandum cannot be easily altered while articles are easily alterable by passing a special resolution only. 6. Acts done by a company
ultra vires the memorandum are void and cannot be ratified by the shareholders. But
acts done by a company ultra vires the articles but intra vires the memorandum are simply irregular and not void and can be ratified subsequently by the shareholders. 7. Outsiders have no remedy against the company for contracts entered into ultra vires the memorandum, while they can enforce contract against the company even if it is ultra vires the articles, i.e., where some formality relating to internal regulation like passing of the required resolution, might have not been performed, provided they act carefully and had no notice of the irregularity. 36.13 TEST QUESTIONS 1. What are the contents of Memorandum of Association? 2. "A company shall not alter the conditions contained in its Memorandum except in the cases, in the mode and to the extent, for which express provision is made in the Act". Amplify. 3. (a) "Memorandum of Association is a fundamental and unalterable charter of a company". Comment. (b) Set out the steps to be followed by a company which desires to alter the registered office clause of its Memorandum of Association. 4. (a) What is meant by Memorandum of Association? (b) Explain clearly the contents of Memorandum of Association. (c) What is the importance of the said document? 5. Explain the doctrine of ultra vires in relation to companies and describe the liability of a company and its agents for ultra vires acts. 51 (1967), A.I.R. Cal. 75.

Memorandum of Association and Articles of Association 464 Self-Instructional Material NOTES 6. What are the usual contents of Articles of Association? Explain the significance of 'Table A'. Should a company have a special set of articles? 7. How far do the Articles of Association bind (a) members to the company (b) members inter se, (c) the company to the members, and (d) the company to the outsiders. 8. (a) What do you know about the binding effect of the Articles of Association? Indicate the limitations on the power of a company to alter its Articles of Association. (b) The Secretary of a company issued a share certificate in favour of 'A', which apparently complied with the company's Articles as it purported to be signed by two Directors and the Secretary and it had the company's seal affixed to it. In fact, the Secretary had forged the signatures of the Directors and affixed the seal without authority. Is the certificate binding on the company? [Hint. No. Forgery is a nullity. Company cannot be held liable for the forgery committed by its officers. (Ruben vs. Great Fingall Ltd.)] 9. How far do you agree with the statement that the power to alter the articles conferred by the Companies Act is very wide yet it is subject to a large number of limitations? Elucidate. 10. Explain the 'doctrine of indoor management.' Are there any exceptions to this doctrine? Discuss.

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Contract of Sale of Goods: Definition and Essentials of a Contract of Sale; Kinds of Goods; The Price; Document of Title to Goods

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Definition of Consumer [Sec. 2(1) (D)] Filing of Complaint: Who can File a Complaint [Sec. 2(1) (B) and Sec 12(1)]; Grounds on which a Complaint can be Made [Sec. 2(1) (C)] Trade Practices: Unfair Trade Practice; Restrictive Trade Practice Redressal of Complaints: Consumer Protection Councils; Consumer Disputes Redressal Agencies; District Forum; State Commission; National Commission; Powers of the Consumer Forums

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Arbitrator; Appointment of Arbitrators; Effect of Death or Insolvency of a Party to Arbitration; Removal of Arbitrator; Jurisdiction of Arbitral Tribunals; Powers of Arbitrators; Duties of Arbitrators

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Equal Treatment of Parties; Rules of Procedure for Arbitration; Place and Commencement of Arbitration; Arbitration Procedure; Arbitral Award; Form and Contents of Arbitral Award; Costs of Arbitration and Deposits; Correction and Interpretation of Award; Additional Award

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Electronic Governance Attribution, Acknowledegment and Despatch of Electronic Records Secure Electronic Records and Secure Digital Signatures Certifying Authorities: Regulation of Certifying Authorities; Powers of Controller; Duties of Certifying Authority; Digital Signature Certificates Duties of Subscribers Offences Penalties and Adjudication; The Cyber Regulations Appellate Tribunal COMPANY LAW-I The Company:

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Kinds of Companies: Kinds of Companies according to the Mode of Kinds of Registered Companies on the Basis of Number of Members; Kinds of Registered Companies on the Basis of Liability of Members; Other Kinds of Companies; Exemptions and Privileges of Private Companies; Distinction between a Private and Public Company; Conversion of Companies

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of Association: Definition and Importance; Contents of Memoradum; Alteration of Memorandum; The Doctrine of Ultra Vires

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The Indian Contract Act, 1872; Definition of Contract; Essential Elements of a Valid Contract; Types of Contracts

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Who Can Demand Performance?; By Whom Contracts must be Performed?; Performance of Joint Promises; Assignment of Contracts; Order of Performance of Reciprocal Promises; Time and Place for Performance; Appropriation of Payments; Contracts which Need not be Performed

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Definition and Essentials of a Contract of Sale; Kinds of Goods; The Price; Document of Title to Goods

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contract of sale of goods? Discuss the essential characteristics of a contract of sale of goods. 2. Define the

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Delivery 19.3 Rules as to Delivery of Goods 19.4 Acceptance of Delivery by Buyer 19.5

Delivery; Rules as to Delivery of Goods; Acceptance of Delivery by Buyer

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22/38	SUBMITTED TEXT	41 WORDS	80%	MATCHING TEXT	41 WORDS

Definition of Consumer 27.3 Who can File a Complaint 27.4 Grounds on which a Complaint can be Made 27.5 Unfair Trade Practice 27.6 Restrictive Trade Practice 27.7 Consumer Protection Councils 27.8 Consumer Disputes Redressal Agencies 27.9 District Forum 27.10 State Commission 27.11 National Commission 27.12 Powers of the Consumer Forums 27.13

Definition of Consumer [Sec. 2(1) (D)] Filing of Complaint: Who can File a Complaint [Sec. 2(1) (B) and Sec 12(1)]; Grounds on which a Complaint can be Made [Sec. 2(1) (C)] Trade Practices: Unfair Trade Practice; Restrictive Trade Practice Redressal of Complaints: Consumer Protection Councils; Consumer Disputes Redressal Agencies; District Forum; State Commission; National Commission; Powers of the Consumer Forums

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23/38	SUBMITTED TEXT	9 WORDS	100%	MATCHING TEXT	9 WORDS

GROUNDS ON WHICH A COMPLAINT CAN BE MADE [SEC. 2(1)(C)]

Grounds on which a Complaint can be Made [Sec. 2(1)(C)]

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24/38	SUBMITTED TEXT	28 WORDS	100%	MATCHING TEXT	28 WORDS

Arbitrator 29.3 Appointment of Arbitrators 29.4 Effect of Death or Insolvency of a Party to Arbitration 29.5 Removal of Arbitrator 29.6 Jurisdiction of Arbitral Tribunals 29.7 Powers of Arbitrators 29.8 Duties of Arbitrators 29.9

Arbitrator; Appointment of Arbitrators; Effect of Death or Insolvency of a Party to Arbitration; Removal of Arbitrator; Jurisdiction of Arbitral Tribunals; Powers of Arbitrators; Duties of Arbitrators

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25/38	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

the number of arbitrators, the arbitral tribunal shall consist of a sole arbitrator. (

the number of arbitrators, the arbitral tribunal shall consist of a sole arbitrator.

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26/38	SUBMITTED TEXT	9 WORDS	100%	MATCHING TEXT	9 WORDS

EFFECT OF DEATH OR INSOLVENCY OF A PARTY TO ARBITRATION

Effect of Death or Insolvency of a Party to Arbitration;

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27/38	SUBMITTED TEXT	37 WORDS	100%	MATCHING TEXT	37 WORDS

Equal Treatment of Parties 30.3 Rules of Procedure for Arbitration 30.4 Place and Commencement of Arbitration 30.5 Arbitration Procedure 30.6 Arbitral Award 30.7 Form and Contents of Arbitral Award 30.8 Costs of Arbitration and Deposits 30.9 Correction and Interpretation of Award 30.10 Additional Award 30.11

Equal Treatment of Parties; Rules of Procedure for Arbitration; Place and Commencement of Arbitration; Arbitration Procedure; Arbitral Award; Form and Contents of Arbitral Award; Costs of Arbitration and Deposits; Correction and Interpretation of Award; Additional Award

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28/38	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

the parties, the arbitral proceedings in respect of a particular dispute

the parties, the arbitral proceedings in respect of a particular dispute

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29/38	SUBMITTED TEXT	42 WORDS	96%	MATCHING TEXT	42 WORDS

Electronic Governance 33.7 Attribution, Acknowledegment and Despatch of Electronic Records 33.8 Secure Electronic Records and Secure Digital Signatures 33.9 Regulation of Certifying Authorities 33.10 Powers of Controller 33.11 Duties of Certifying Authority 33.12 Digital Signature Certificates 33.13 Duties of Subscribers 33.14 Penalties and Adjudication 33.15 The Cyber Regulations Appellate Tribunal 33.16

Electronic Governance Attribution, Acknowledegment and Despatch of Electronic Records Secure Electronic Records and Secure Digital Signatures Certifying Authorities: Regulation of Certifying Authorities; Powers of Controller; Duties of Certifying Authority; Digital Signature Certificates Duties of Subscribers Offences Penalties and Adjudication; The Cyber Regulations Appellate Tribunal

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30/38	SUBMITTED TEXT	14 WORDS	88%	MATCHING TEXT	14 WORDS

company as "a company formed and registered under this Act or an existing company.

Company means a company formed and registered under this Act or an existing company".

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31/38	SUBMITTED TEXT	52 WORDS	100%	MATCHING TEXT	52 WORDS

Kinds of Companies according to the Mode of Incorporation 35.3 Kinds of Registered Companies on The Basis of Number of Members 35.4 Kinds of Registered Companies on The Basis of Liability of Members 34.5 Other kinds of Companies 35.6 Exemptions and Privileges of Private Companies 35.7 Distinction Between a Private and Public Company 35.8 Conversion of Companies 35.9

Kinds of Companies according to the Mode of Kinds of Registered Companies on the Basis of Number of Members; Kinds of Registered Companies on the Basis of Liability of Members; Other Kinds of Companies; Exemptions and Privileges of Private Companies; Distinction between a Private and Public Company; Conversion of Companies

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32/38	SUBMITTED TEXT	18 WORDS	83%	MATCHING TEXT	18 WORDS

on the basis of liability of members. 35.3 KINDS OF REGISTERED COMPANIES ON THE 35.2 BASIS OF NUMBER OF MEMBERS

on the Basis of Number of Members; Kinds of Registered Companies on the Basis of Liability of Members;

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33/38	SUBMITTED TEXT	15 WORDS	66%	MATCHING TEXT	15 WORDS

if any; (b) limits the number of its members to fifty, excluding members who are

if any, • Limits the number of its members to fifty including persons who are

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34/38	SUBMITTED TEXT	18 WORDS	80%	MATCHING TEXT	18 WORDS

KINDS OF REGISTERED COMPANIES ON THE 35.3 BASIS OF LIABILITY OF MEMBERS On the basis of liability of members,

Kinds of Registered Companies on the Basis of Number of Members; Kinds of Registered Companies on the Basis of Liability of Members;

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35/38	SUBMITTED TEXT	19 WORDS	84%	MATCHING TEXT	19 WORDS

to contribute to the assets of the company in the event of its being wound up" [Sec. 12(2)(b)). The

to contribute to the assets of the company in the event of its being winding up. [Sec. 237 of the

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36/38	SUBMITTED TEXT	49 WORDS	91%	MATCHING TEXT	49 WORDS

Definition and Importance 36.3 Contents of Memorandum 36.4 Alteration of Memorandum 36.5 The Doctrine of Ultra Vires 36.6 The Obligation to Register Articles 36.7 Contents of Articles 36.8 Alteration of Articles 36.9 Limitations Regarding Alteration of Articles 36.10 Binding Force of Memorandum and Articles 36.11 The Doctrine of Indoor Management 36.12 Exceptions to the Doctrine of Indoor Management 36.13

Definition and Importance; Contents of Memoradum; Alteration of Memorandum; The Doctrine of Ultra Vires Articles of Association: Obligation to Register Articles; Contents of Articles; 32.4 Alteration of Articles; Limitations Regarding Alteration of Articles; Binding Force of Memorandum and Articles; The Doctrine of Indoor Management; 32.8 Exceptions to The Doctrine of Indoor Management

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37/38	SUBMITTED TEXT	30 WORDS	37%	MATCHING TEXT	30 WORDS

the memorandum of association is the foundation on which the structure of a company is based. It states the name of the company, the address of its registered office, whether the

The memorandum of association (MOA) is the first and most important document of a company which informs the general public of the company name, its share capital, the address of its registered office, the

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38/38	SUBMITTED TEXT	15 WORDS	96%	MATCHING TEXT	15 WORDS

to contribute to the assets of the company in the event of its winding up.

to contribute to the assets of the company in the event of its winding up. [

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