CURRENT AFFAIRS:

The Supreme Court, in Madras Aluminum Co. Ltd. vs Tamil Nadu Electricity Board 2023, has held that state action, even in the contractual realm, must adhere to the principles of Article 14 of the Constitution. The court emphasized that the fact that a dispute arises within a contractual framework does not exempt the state from its obligation to comply with Article 14

A breach of contract does not give rise to criminal prosecution for cheating unless fraudulent or dishonest intention is shown right at the beginning of the transaction. Merely on the allegation of failure to keep up promise will not be enough to initiate criminal proceedings. **Sarabjit Kaur vs State of Punjab | 2023**

Rs. 2 Crore compensation for bad haircut excessive: Supreme Court asks NCDRC to decide model's claim afresh. *ITC Ltd. v. Aashna Roy, 2023*

Flat owners do not forfeit the right to claim amenities promised by the developer by taking possession of the apartments- Supreme Court disapproves of NCDRC order dismissing homebuyers' claim on the ground that knowingly purchased the apartments. *Debashis Sinha v. RNR Enterprise, 2023*

In a judgment having wide ramifications in the insurance law sector, a bench comprising Justices Hemant Gupta and V Ramasubramanian held that that a condition in the insurance policy which bars the filing of the claim after the specified time period is contrary to Section 28 of the Indian Contract Act, 1872 and thus void. The Oriental Insurance Company Limited v Sanjesh and Anr| 2022

Civil Hospital vs Manjit Singh

The Supreme Court set aside an NCDRC order that directed a hospital to pay compensation to a woman who delivered a child despite undergoing tubectomy procedure.

In this case, a woman underwent tubectomy procedure twice, though both the procedures remained unsuccessful. She gave birth to a male child in the year 2003. She filed a complaint before the District Consumer Disputes Redressal Forum alleging medical negligence on account of failed tubectomy surgery.

The same was dismissed on the ground that the hospital is not a consumer. The State Consumer Commission (SCDRC) affirmed this order. Later, National Consumer Commission (NCDRC) allowed revision petition and directed to pay compensation as per the guidelines and the policy of the State.

Interpretation of Contract - Contract between FCI and transport contractors - Whether the demurrages imposed on the Corporation by the Railways can be, in turn, recovered by the Corporation from the contractors as "charges" recoverable under this clause? The Corporation in the present contract has chosen not to include the power to recover demurrages and as such the expression "charges" cannot be interpreted to include demurrages - Demurrage is undoubtedly a charge, however, such a textual understanding would not help us decipher the true and correct intention of the parties to the present contract.Scope of contractual expressions must be understood as intended by the parties to the contract - The process of interpretation, though the exclusive domain of the Court, inheres the duty to decipher the meaning attributed to contractual terms by the parties to the contract - Words and expressions used in the contract are principal tools to ascertain such intention. While interpreting the words, courts look at the expressions falling for interpretation in the context of other provisions of the contract and also in the context of the contract as a whole. These are intrinsic tools for interpreting a contract. As a principle of interpretation, courts do not resort to materials external to the contract for construing the intention of the parties. There are, however, certain exceptions to the rule excluding reference or reliance on external sources to interpret a contract. One such exception is in the case of a latent ambiguity, which cannot be resolved without reference to extrinsic evidence. Latent ambiguity exists when words in a contract appear to be free from ambiguity; however, when they are sought to be applied to a particular context or question, they are amenable to multiple outcomes - Extrinsic evidence, in cases of latent ambiguity, is admissible both to ascertain where necessary, the meaning of the words used, and to identify the objects to which they are to be applied. Discretion, a principle within the province of administrative law, has no place in contractual matters unless, of course, the parties have expressly incorporated it as a part of the contract. It is the bounden duty of the court while interpreting the terms of the contracts, to reject the exercise of any such discretion that is entirely outside the realm of the contract. ***Food Corporation of India v. Abhijith Paul, 2022***

Income Tax Act, 1961; Section 194H - Contract Act, 1870; Section 182 - Application of Section 194H of the IT Act to the Supplementary Commission amounts earned by the travel agent - Section 194H is to be read with Section 182 of the Contract Act. If a relationship between two parties as culled out from their intentions as manifested in the terms of the contract between them indicate the existence of a principalagent relationship as defined under Section 182 of the Contract Act, then the definition of "Commission" under Section 194H of the IT Act stands attracted and the requirement to deduct TDS arises. ***Singapore Airlines Ltd. v. C.I.T., Delhi, 2022***

Article 226 - Judicial Review in Contractual matters - Even if it is a non-statutory contract, there is no absolute bar in dealing with a cause of action based on acts or omission by the State or its instrumentalities even during the course of the working of a contract - A monetary claim arising from a contract may be successfully urged by a writ applicant but the premise would not be a mere breach of contract. Being part of public law, the case must proceed on the basis of there being arbitrariness vitiating

the decision. The matter should not fall within a genuinely disputed question of facts scenario. The dispute which must be capable of being resolved on a proper understanding of documents which are not in dispute may furnish a cause of action in a writ court. - Principles summarized. *(Para 78, 54)* ***MP Power Management Company Ltd. v. Sky Power Southeast Solar India Pvt. Ltd., 2022***

The Supreme Court observed that a specific issue on readiness and willingness on the part of the plaintiff must be framed by the trial court in a suit for specific performance. *The object and purpose of framing the issue is so that the parties to the suit can lead the specific evidence on the same* ***V.S. Ramakrishnan vs. P.M. Muhammed Ali | 2022***

Scope of contractual expressions must be understood as intended by the parties to the contract - The process of interpretation, though the exclusive domain of the Court, inheres the duty to decipher the meaning attributed to contractual terms by the parties to the contract - **Food Corporation of India vs Abhijith Paul | 2022**

Consumer Protection

The CCPA levied a 1 lakh rupees penalty on Amazon for selling pressure cookers that did not meet quality standards - 2022

TOPIC 1: Nature and Formation of contract/E-contract

Q. Discuss in detail the principle of promissory estoppel and its application in respect of contractual obligations. Explain the position of this principle as against the government and its agencies [20M]

Ordinarily, a contractual obligation arises from a contract between the two contracting parties. In some cases, however, a person may become bound by a promise not on the basis of a contract, but on the application of the law of estoppel.

PROMISSORY ESTOPPEL

When one party has made a promise or given an assurance and another person has acted to his prejudice on the faith of the same, the person making the promise or giving assurance becomes bound thereby.

This is a well established principle and represents a principle evolved by equity to avoid injustice [*M/S Ali Mohd. Sheikh v State of J &K]*

APPLICATION AGAINST THE GOVERNMENT

In some cases it has been pleaded on behalf of the government that the doctrine is not applicable insofar as the State cannot bind itself to fetter its future executive action. In other words, it was pleaded that the law was not applicable in view of the 'doctrine of executive necessity.'

This plea has been rejected by the SC [*UOI v Anglo Afghan Agencies*]

In *Motilal Sugar Mills v State of UP* the Apex Court observed that 'when the Government makes a promise knowing or intending that it would be acted on and the promisee acting on reliance of it, alters his position the Government would be held bound by the promise, notwithstanding there is no consideration for the promise and the promise is not recorded in the form of a formal contract as required by Article 299 of the Constitution.'

In *Ournami Oils Mills Case v State of Kerala* the State of Kerala issued an order whereby new small scale units were invited to set up their industries in the State with a view of boosting industrialisation. It was promised that they would be exempt from the payment of sales tax and purchase tax for five years from the date of commencement of production. Later the state issued another notification withdrawing the exemption relating to purchase tax. Applying the doctrine of promissory estoppel, it was held by the SC that all industries established within the prescribed date would be entitled to the exemption extended for a full period of five years. New industries after the notice of curtailment would not be entitled to the benefit.

No estoppel when there is no promise. In *PC Wadhwa v State of Punjab,* PC Wadhwa got selected in the Forest Department of the State of PUnjab. He was given training and free education. The selected candidates were to sign a bond of serving the department for at least 5 years after the training, failing which they would refund the amount spent by the Government on their training. Thereafter he was selected in the IPS and without the sanction of the Punjab Government he left the college. He pleaded that earlier on the settlement between him and the Government, the Government had withdrawn an appeal. It was held that the State had never given any assurance by words or conduct that a legal action would not be brought against the appellant for the recovery and therefore the principle of promissory estoppel did not apply in the present case.

OFFER

Q. If certain goods are displayed either in a show window or inside the shop and such goods bear price tags, discuss whether such display amounts to an offer to sell. Explain the distinction between offer and invitation to offer with the help of decided cases [10M, 2018]

An agreement arises by an 'offer' or proposal by one of the parties and the 'acceptance' of such an offer by the other. The term 'proposal' has been defined in **Section 2(a)** of the Indian Contract Act 1872 as follows- 'When **one person signifies to another** his **willingness to do or to abstain from doing anything,** with **a view to obtaining the assent** of that other to such act or abstinence, he is said to make a proposal.'

Offer and Invitation to Treat (offer) distinguished.

The term proposal used in the ICA is synonymous with the term 'offer' used in English law. The willingness to do or to abstain from doing something i.e. the proposal or the offer may be made with a view to obtaining the assent of the other party thereto. For. eg, A's willingness to sell his radio to B for Rs 500 if B accepts, is a proposal. But if the statement is made without any intention to obtain the assent of the other party, that is not a proposal.

An invitation to treat is not an offer.

Eg. Book seller- catalogue of books indicating prices- not an offer

Inviting persons to auction- not offer. Offer made in form of bid.

Advertisement calling for tenders- Submission of tender is the offer

Nobody is bound to accept an offer

M/S Ashirbad Industries v State of Odisha 2021 When the tender is yet to be approved by higher authorities, no right accrues in favor of the participants, and they cannot challenge the action of the authorities in cancelling the tender.

Harris v Nickerson : cancelled auction sale not liable

Pharmaceutical Society of Great Britain v Boots Cash Chemists Ltd : only when accepted

Harvey v Facey: quotation of price (land) not held to be offer

Badri Prasad v State of Madhya Pradesh: Letters from Govt and P, no offer

Q. "The test of contractual intention is objective, not subjective." Discuss. [15M]

In order that an offer, after acceptance, can result in a valid contract, it is necessary that the offer should be made with an intention to create a legal relationship. For instance, promise in the case of social engagements is generally without an intention to create legal intention.

TEST OF CONTRACTUAL INTENTION

The test to know the intention of the parties is objective and not subjective and merely because the promisor contends that there was no intention to create legal obligation would not exempt him from his liability [*Carlill v Carbolic Smoke Ball Co*]

Sometimes the parties may expressly mention that it is not a formal or legal agreement [*Appleson v Littlewood Ltd*] whereas in some other cases such an intention could be presumed from their agreement [*Balfour v Balfour*]

Thus an agreement to go for a walk, go see a movie or play some game cannot be enforced in a court of law.

In *Balfour v Balfour* the Defendant, who was employed on a government job went to England. For health reasons , the wife was unable to accompany him. The husband promised to pay monthly maintenance but failed. It was held that there was no intention to create a legal relationship.

Similarly in *Jones v Padavatton* Mrs Jones persuaded her daughter to leave her job and study in England. She even offered to pay her a monthly allowance. Later some differences arose and Mrs Jones brought an action to evict her daughter. It was held that there was no legal intention as the agreement was not in writing nor the duration mentioned. The mother's action succeeded.

It may be noted that there is nothing which prevents these persons from agreeing to be bound. If an arrangement clearly contemplates an intention to create a legal relationship, the party becomes bound.

Q.3. Under the Indian Contract Act, 1872, when is a contract deemed to be entered into by the parties? Discuss. [20M, 2017]

According to **Section 2(h)** of the Indian Contract Act 1872, 'An **agreement enforceable by law** is a contract.' All agreements are not enforceable by law and therefore, all agreements are not contracts.

The essentials needed for a valid contract, therefore, are given under **Section 10** of the Contract Act as

1. An **agreement** between the two parties. An agreement is the result of a proposal or an offer by one party followed by its acceptance by the other.
2. Agreement should be between the parties who are **competent** to contract
3. There should be a **lawful consideration and lawful object** in respect of that agreement
4. There should be **free consent** of the parties, when they enter into the agreement.
5. The agreement must not be one which has been expressly declared to be **void.**

Agreement[Section 2(e)]: Every **promise and every set of promises** forming the **consideration** of each other is an agreement

Proposal: **Sec 2(a)-** When one person **signifies** to another his **willingness** to do or to abstain from doing anything, with a v**iew to obtaining the assent** of that other to such act or abstinence, he is said to make a proposal.

General Principles of Offer:

Offer and Invitation to offer: An invitation to treat is not an offer eg *Harvey v Facey:* quotation of price not held to be offer

Intention to create legal relationship: The test of Contractual Intention is objective, not subjective.

Intention to *create legal relationship eg Balfour v Balfour- H promise - no intention*

- **Offer must be communicated:**
  Section 2(a) 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

  How Communicated
  Section 3: By any act or omission by which the offeror-
  a**. Intends** to communicate such offer
  b. which has the **effect** of communicating such offer

- **Communication of Offer:**
  Section 4: The communication of a proposal is complete when it comes to the **knowledge of the person** to whom it is made

  Illus: A makes offer
  B cannot be said to have accepted the offer, even if he acts according to the terms of the offer

  Lalman Shukla v Gauri Dutt: D's nephew absconded from home

P, D's servant, went searching
D issued rewards
P ignorant- succeeded.
Held: ignorant therefore, not entitled

Acceptance:

Section 2(b): 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.

- not bound until its acceptance

Section 9: May be express (words), or implied

Effect of Acceptance

- Contract only after acceptance

- Offeror free to revoke or withdraw offer

Effect by **Anson: 'An offer is to an acceptance what a lighted match-stick is to a train of gunpowder. It produces something which something which cannot be recalled or undone.**

- Essentials of valid acceptance

1. Acceptance should be **communicated**

(By conduct or implied acceptance

When is communication complete: **Section 4**

I. As against the **proposer,** when it is put in the course of transmission to him so as to be out of the power of the acceptor

Ii. As against the **acceptor,** when it comes to the knowledge of the proposer)

2. Acceptance should be **absolute and unqualified**

3. Acceptance should be expressed in **usual/ prescribed manner**

4. Acceptance should be made while the **offer still subsists**

- where the contract completes

Communication of acceptance to a wrong person (*Karan Singh v The Collector, Chhatarpur* - no contract

B. Competent to Contract:

According to **Section 11,** 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.'

C. Lawful consideration and lawful object

Section 23: . *What considerations and objects are lawful, and what not.*—The consideration or object of an agreement is lawful, unless—

1. it is forbidden by law ; or

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

3. or is fraudulent ;

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

5. or the Court regards it as immoral,

6. or opposed to public policy.

D. Free Consent

According to **Section 14 consent is said to be free** which is not caused by

1. **Coercion** as defined under Section 15

2. **Undue Influence** as under Section 16

3. **Fraud** as under Section 17

4. **Misrepresentation** as under Section 18

5. **Mistake** subject to the provisions of Sections 20 or 22

E. **<u>Void contract[Section 2(j)]:</u>** An agreement not enforceable by law is said to be void . A void contract is a contract which ceases to be enforceable by law. A contract when originally entered into may be valid and binding on the parties. It may subsequently become void.

Q. 'An offer is to an acceptance what a lighted match-stick is to a train of gunpowder. It produces something which cannot be recalled or undone.'- Anson. Explain. [10M]

A proposal, when accepted, results in an agreement. It is only after the acceptance of the proposal that a contract between the two parties can arise.

Proposal [Section 2(a)]: when he signifies to another person his willingness to do or abstain form doing something.'

Acceptance [Section 2(b)]: 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.

The offerree is not bound to accept the offer. Thus it is perfectly lawful for a company not to accept the highest tender and to re-auction the goods [*Genearl Swa and Blades Co v Bharat Coking Coal Ltd*]

Effect of Acceptance.

A contract is created only after the offer is accepted. Before this, neither party is bound thereby.

Just as when the lighted match comes in contact with gunpowder there would be an explosion and then it would not be possible to bring things back to the original position, similarly, after the offer is accepted, it creates a contract whereby none of the parties can come back.

Q. "Revocation of proposal is death of the proposal." Explain the statement and mention the manners of revocation [15M]

Revocation of proposal is death of the proposal.

Section 5: 'A proposal may be **revoked at any time**, **before the communication** of its **acceptance** is complete **as against the proposer,** but not afterwards.'

Modes of revocation of offer

Section 6

A proposal is revoked-

1. By the ***communication*** **of notice** of revocation by the proposer to the other party: *Offer ripens into contract after acceptance.* Before it has been accepted, no legal obligation. Can be revoked at any time before. *Dickinson v Dodds:* Offer made open till 12th June. 11th June sold prop to someone else. 12th accepted and sued Dodds to specifically perform. Implied revocation.

2. By the ***lapse of the time*** described in such proposal for its acceptance, or, if no time is so prescribed, by the lapse of a ***reasonable time*** without communication of the acceptance: **Section 6 (2)** Even if no prescribed time, lapse of *reasonable time* *Ramsgate Victoria Hotel Co. v Montefiore :* Shares in June- accepted in November

3. By the failure of the acceptor to fulfil a ***condition precedent*** to acceptance: **Section 6 (3)** By Failure to fulfil a condition precedent *State of MP v Goberdhan Dass* - 25% amount paid when tender was accepted

4. by the ***death or insanity*** of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance : **Section 6 (4)**

By death or insanity of the offeror, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance.

- If no knowledge while accepting, valid acceptance

- England position different- not very clear

-Dickinson v Dodds Obiter- on the death, automatically lapses even if offeree is ignorant about death (particular and not addressed to public at large, made to a particular individual)

Q. Distinguish, cite relevant provisions and case laws: 'specific offer' and 'general offer' [20M, 2009]

Specific and General Offers

When the offer is made to a specific or an ascertained person, it is known as a specific offer, but when the same is not made to any particular person but to the public at large, it is known as a general offer. For instance, an offer to give reward to anybody who finds a lost dog is a general offer.

In *Carlill v Carbolic Smoke Ball Co* the D advertised their product 'Carbolic Smoke Ball' a preventive remedy against influenza. In the advertisement they offered to pay a sum of 100 pounds to anyone who contracted influenza, cold or any disease caused by catching a cold, after having used the Smoke ball three times a day for two weeks, in accordance with the printed directions. They also announced that the sum had been deposited with the Alliance Bank to show their sincerity in the matter. The plaintiff purchased a Smoke Ball but still caught influenza.

It was held that this being a general offer addressed to all the world had ripened into a contract with the plaintiff by her act of performance of the required conditions and thus accepting the offer. She was therefore entitled to claim the reward.

CONSIDERATION

Privity of Contract

Q.1. "In the course of time, the courts have introduced a number of exceptions in which the rule of privity of contract does not prevent a person from enforcing a contract which has been made for his benefit but without his being a party to it." Explain the statement with the help of leading case law. [20M]

The doctrine of privity of contract means that only those persons who are parties to the contract can enforce the same. A stranger to the contract cannot enforce a contract even though it may have been entered into for his benefit.
Illustration: If in a contract between A and B some benefit has been conferred upon X, X cannot file a suit to enforce the contract because A and B are the only parties to the contract, whereas X is a stranger to the contract.

English law: *Dunlop Tyre Co Ltd v Selfridge & Co.* The appellants who were the manufacturers of motor car tyres sold some tyres to one Dew & Co. with an agreement that these tyres will not be sold below the list price. Dew & Co. in their turn sold some of these tyres to the respondents that the respondents shall observe conditions as to price and the respondents promised that they would pay to the appellants a sum

of 5 pounds for every tyre sold below the list price. The respondents brought an action against the respondents to recover damages for the same.

The House of Lords held that Dunlop Co. could not bring an action against Selfridge and Co. because there was no contract between the two parties.

Indian Law: The rule of privity of contract is equally applicable in India as in England.

In *Jamna Das v Ram Avtar,* A had mortgaged some property to X. A then sold this property to B, B having agreed with A to pay off the mortgage debt to X. X brought an action against B to recover the mortgage money. It was held by the Privy Council that since there was no contract between X and B, X could not enforce the contract to recover the amount from B.

Exceptions to the rule:

1. Trust of contractural rights or beneficiary under a contract: In *Klaus Mittelbachert v East India Hotels Ltd,* there was a contract between Lufthansa, a German Airline and Hotel Oberoi Inter-continental New Delhi that crew of Lufthandsa will stay in the latter's hotel. The plaintiff, a co-pilot of the Airline, who stayed int he said 5 star hotel got serious head injuries when he dived in a hotel swimming pool. The plaintiff suffered paralysis and after an agony for 13 years, he died. His action against the hotel management succeeded though he himself did not make any contract for stay in the hotel. He was held to be the beneficiary to the contract and awarded compensation for the damage caused to him.
2. Conduct, Acknowledgment or Admission: In *Narayani Devi v Tagore Commercial Corporation Ltd,* where there was no contract between the plaintiff and the defendant but the defendants in their agreement with the plaintiff's husband had agreed to pay a certain amount to the plaintiff's husband during his lifetime and thereafter tot he plaintiff, the question of the right of the plaintiff to sue the defendants had arisen. It was established that the defendants had made certain payments to the P after her husband's death, and had therefore asked for the extension of time to pay. It was held that the D had created privity with the P by their conduct.
3. Provision for marriage expenses or maintenance under family arrangement: In *Veeramma v Appayya* under a family arrangement, the father's house was to be conveyed to his daughter and the daughter undertook to maintain him in his lifetime. The daughter being a beneficiary under the compromise arrangement, it was held that she was entitled to sue for the specific performance in her favour.

Q."An act done at the promisor's desire furnishes a good consideration for his promise even though it is of no significance or personal benefit to him." Discuss. [15M, 2001]

Presence of consideration is one of the essentials of a valid contract [Section 10]. Subject to certain exceptions, the general rule in India is that an agreement without consideration is void. [Section 25].

WHAT IS GOOD CONSIDERATION?

Section 2(d) of the Indian Contract Act 1872 defines consideration.

Essentials:

1. consideration to be given at the desire of the promisor: thus it must be given by the promisor rather than at the instance of some third party. In *Durga Prasad v Baldeo* where the consideration was not moved at the desire of some other person it was held that there was no sufficient consideration. Thus an act done at the promisor's desidre furnishes a good consideration.
2. Consideration by a promise or any other person [Privity of Consideration]: In *Chinnaya v Ramayya* A entered into a contract with B but consideration was given by C to B. A could still enforce it because while consideration is at the desire of the promisor, the consideration may be provided either by the promisee or any other person [unlike English law]
3. Consideration may be Past, Present (Executed) or Future (Executory)

    - A finds B's purse and gives it to him. B promises to give A Rs 50. This is a contract [given at the promisor's request]

Something i.e. an act, abstinence or promise by the promisee constitutes consideration

Consideration need not be adequate: Even if the consideration is of no significance or personal benefit to him or if it is inadequate as long as it is made with their free consent, the contract is still valid [*Vijaya Minerals Pvt Ltd v Bikash Deb*]

Q. "Insufficiency of consideration is immaterial but an agreement without consideration is void." Comment. [15M, 2006]

Consideration means something in return for the promise. It may be either some benefit conferred on one party or some detriment suffered by the other.

Presence of consideration as defined under Section 2(d) of the Contract Act 1872 is one of the essentials of a valid contract [Section 10]. Subject to certain exceptions, the general rule in India is that 'an agreement without consideration is void.' [Section 25]

Consideration need not be adequate

A contract which is supported by consideration is valid irrespective of the fact that the consideration is inadequate. According to Explanation 2 of SEction 25:

'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.'

The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the court when it sought to be enforced [*Bolton v Madden*].

For example, A agrees to sell a horse worth Rs 1000 for Rs. 10. A's consent to the agreement was freely given. The agreement is a contract notwithstanding the inadequacy of the consideration.

However, inadequacy may be a factor the court may take into consideration to know whether the consent of a party was free or not. For instance, in the above example if A denies that his consent to the agreement was freely given, the Court should take into account the inadequacy of the consideration.

In *Vijaya Minerals Pvt Ltd v Bikash Deb* the position was explained in the following words: 'It may be noted that short of undue influence and duress an agreement between the parties cannot be rendered nugatory on the ground that the consideration is not adequate. In fact the Courts do not go into the question of adequacy of consideration when considering whether an agreement is binding or not.

Essentials of consideration

1. Consideration to be given at the desire of the promisor
2. Consideration to be given by the promisee or any other person (Privity of Consideration)
3. Consideration may be past, present or future in so far as the definition states that the promisee:

    Has done or abstained from doing

    Does or abstains from doing or

    Promises to do or to abstain from doing something.

There should be some act, abstinence or promise by promisee which constitutes consideration for the promise

It is pertinent to note that 'insufficiency of consideration' is nowhere mentioned as an essential.

Q. "An agreement without consideration is void." Is there any exception to it? Discuss by giving suitable illustrations. [15 M, 2022]

Consideration is defined under Section 2(d) of the Indian Contract Act 1872. Presence of consideration is one of the essentials of a valid contract [Section 10]. Subject to certain exceptions, the general rule in India is that 'an agreement without consideration is void.' [Section 25].

EXCEPTIONS WHEN AGREEMENT WITHOUT CONSIDERATION IS VALID

1. Promise due to natural love and affection [Sec 25(1)]

    - The parties to the agreement must be standing in a near relationship to each other,
    - The promise should be made by one party out of natural love and affection for the other
    - The promise should be in writing and registered

In *Rajlucky Dabee v Bhootnath Mookerjee* after a lot of disagreements and quarrels between a husband and wife they decided to live apart. At this stage the husband executed a registered document in favour of the wife whereby the agreed to pay for her separate residence and maintenance. It was held that it was apparent that the document had been executed not because of natural love and affection between the parties but because of the absence of it and therefore the wife was not entitled to recover the sums mentioned in the document.

Compensation for past voluntary services- Sec 25(2)

This exception covers cases where a person without the knowledge of the promisor or otherwise than at his request does the latter some service and the promisor undertakes to compensate him for it [*Sindha v Abraham*]. The promise to compensate though without consideration, is binding because of this exception. This exception also covers a situation where the promise is for doing something voluntarily 'which the promisor was legally compellable to do'.

Thus when A finds B's purse and gives it to him and then B promises to pay A Rs 50, or A supports B's infant son and B promises to pay A's expenses in doing so, there is a valid contract in such cases although A's act was a voluntary one.

Promise to pay a time barred debt [Sec 25(3)]

- The promise must be to pay wholly or in part a time barred debt i.e., a debt of which the creditor might have enforced payment but for the law for the limitation of suits
- The promise must be in writing and signed by the person to be charged therewith, or his duly authorized agent.

In *Tulsi Ram v Same Singh* after the expiry of a period of three years from the execution of the promissory note, the D made an endorsement noting that 'it is valid for the next three years.' The Delhi High Court held that these words simply meant an acknowledgment about the existence of the pronote and there were no words stating the intention of the D to pay the time barred debt. The said endorsement did not constitute a contract.

It was held in *Debi Prasad v Bhagwati Prasad* that when the acknowledgment is coupled with an agreement to pay interest, it cannot be regarded as a mere acknowledgment and it should be regarded as an agreement with a promise to pay.

TOPIC 2: Factors Vitiating Free Consent

Q. Explain the meaning of" 'free consent' as an essential element of a valid contract and enumerate the factors vitiating 'free-consent' [15M]

One of the essentials of a valid contract mentioned in Section 10 is that the parties should enter into the contract with their free consent.

FREE CONSENT

[Diagram format (Sunset): Coercion (Sec 15), Undue influence (Sec 16), Fraud (Sec 17), Misrepresentation (Sec 18), Mistake (subject to provisions of Sections 20, 21 and 22].

Except when caused by mistake (agreement void), when consent is caused by the rest, it is voidable.

1. Coercion: Coercion is said to be caused either by
    - Committing or threatening to commit any act forbidden by the IPC or
    - Unlawful detaining or threatening to detain any property

In *Ranganayakamma v Alwar Setti* where the dead body of the husband was not removed from her house unless she adopted a boy, it was held that the adoption was not binding.

Undue influence: Essentials

- The relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other [diagram: Holds real or apparent authority, stands in a fiduciary relation, where person's mental caacity is temporarily or permanently affected]
- such a person uses his dominant position to obtain an unfair advantage over the other

Fraud: it is proved when it is shown that the representation has been made a) knowingly or b) without belief in its truth or c) recklessly, carelessly whether true or false [*Derry v Peek*]

Misrepresentation: Table- Positive assertion that is not true, breach of duty by misleading, causing a party to make a mistake.
Under misrepresentation, there is no wrongful intention

Mistake:

- Mistake as to consensus ad idem (meeting of minds)
- Mistake as to matter of fact

Thus if the consent of one of the parties is not free consent i.e. it has been caused by one or the other of the above stated factors, the contract is not a valid one.

Law relating to coercion and undue influence has a feature in each which is uncommon to the legal system as a whole. Explain with illustrations [15M]

COERCION

Section 15. "Coercion" defined.—"Coercion" is the **committing, or threatening to commit,** any **act forbidden** by the Indian Penal Code (45 of 1860) or the **unlawful detaining,** or threatening to detain, any property, to the **prejudice of any person** whatever, with the intention of causing any person to enter into an agreement.

Explanation.—It is **immaterial** whether the Indian Penal Code (45 of 1860) is or is not in force in the place where the coercion is employed.

Illustration 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. (45 of 1860). 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 (45 of 1860) was not in force at the time when or place where the act was done.

Thus coercion is said to be caused where the consent of a person has been caused either by

1. Committing or threatening to commit any act forbidden by the IPC or by
2. Unlawful detaining or threatening to detain any property

1. Act forbidden by the IPC: In *Ranganayakamma v Alwar Setti,* the validity of the adoption of a boy by a widow, aged 13 years, was in question. On the death of her husbands, the H's dead body was not allowed to be removed from her house for cremation by the relatives of the adopted boy until she adopted the boy. It was held that the adoption was not binding on the widow.
2. Unlawful detaining of property eg, if an outgoing agent refuses to hand over the account books to the new agent until the principal executes release in his favour (*Muthiah Cettiar v Karupan Chetti)*

    - Threat to strike is no coercion: In *Workmen of Appin Tea Estate v Industrial Tribunal* the demand of the workers for bonus was accepted after a threat of strike. The question which had arisen was, whether such a decision between the union of the workers and the Indian Tea Association could be declared void on the ground that there was coercion. It was held that because of the doctrine of collective bargaining under the Industrial Disputes Act, the demand of the workers could be backed by a threat of strike.
    - Statutory Compulsion no coercion: In *Andhra Sugars Ltd v State of AP* if any cane grower offered to sell his sugarcane to a factory in a certain one, the factory was bound to accept the offer. Even if there was a compulsion, there was no coercion.

Duress under English Law: Under Common law duress consists in actual violence or threat to a person. It only includes fear of loss to life or bodily harm including imprisonment but not a threat of damage to goods.

Difference between coercion and duress:

1. Coercion means committing or threatening to commit an act forbidden by the IPC. Duress under Common Law, consists in actual violence or threat of violence to a person.

2. In India, coercion can also be there by detaining or threatening to detain any property. Duress, not against property
3. In India, coercion may proceed from a person who is not a party to the contract, but it may also be directed against a person who may be a stranger to the contract. In England, duress should proceed from a party to the party and to his wife, parent, child or other near relative.

UNDUE INFLUENCE

Q.1.An action to avoid a contract on the ground of undue influence, the plaintiff has to prove two points. Explain those points and different kinds of relations leading to presumption of undue influence which vitiates free consent. [10M]

According to **Section 14 consent is said to be free** which is not caused by

1. **Coercion** as defined under Section 15

2. **Undue Influence** as under Section 16

3. **Fraud** as under Section 17

4. **Misrepresentation** as under Section 18

5. **Mistake** subject to the provisions of Sections 20 or 22

UNDUE INFLUENCE

Section 16. "Undue influence" defined.—

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

(2) In particular and without prejudice to the generality of the foregoing principle, a person is deemed to be in a position to dominate the will of another—

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

(b) 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.

(3) Where a person who is in a **position to dominate** the will of another, enters into a contract with him, and the transaction appears, **on the face of it** or on the evidence adduced, to be **unconscionable**, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other. Nothing in this sub-section shall affect the provisions of section 111 of the Indian Evidence Act, 1872 (1 of 1872).

Illustrations

(a) A having advanced money to his **son,** B, during his minority, upon B‟s coming of age 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.

(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.

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

(d) A applies to a banker for a loan at a 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.]

1. Real or apparent authority: employer over his employee, an income-tax authority over the assessee (Illus c)
2. Fiduciary relation: This means a relationship of confidence and trust. Eg, solicitor and client, parent and child (Illus a)
   Mannu Singh v Umadat Pande: The P, an aged person executed a deed of gift in respect of the whole of his prop in favour of the D who was the P's guru or spiritual adviser. The only reason for the gift was his desire to secure benefits to his soul in the next world. Due to the fiduciary relationship and the absurdity of the reason, P was entitled to obtain the cancellation of the deed.
3. Mental or body distress (Illus b)

Presumption of undue influence in unconscionable bargains: Ordinarily it is for the P to prove that his consent was not free. But in case of unconscionable bargain, the law raises a presumption of undue influence.

Thus when -

One of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other

The transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence.

An unconscionable bargain is one as no sane man setting under a delusion would make, and no honest man would take advantage of.

Where there is no domination of will: ordinary course of business (Illus d)

In *Shrimati v Sudhakar R Bhatkar,* the P was an illiterate lady managing her properties. The D was living in a part of the house owned by teh P as a tenant. He treated the P as his mother. He persuaded her to gift her property to him, which she did. It was held that mere persuasion by the P to the D to gift the property did not mean undue influence.

Effect of undue influence:

Section 19A. Power to set aside contract induced by undue influence.—When consent to an agreement is caused by undue influence, the agreement is a contract **voidable at the option of the party whose consent was so caused.** Any such contract may be set aside either **absolutely** or, if the party who was entitled to avoid it has received any benefit thereunder, upon such **terms and conditions** as to the Court may seem just.

Illustrations

(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.]

FIFA suspended the AIFF with immediate effect citing the "undue influence from third parties". It may be noted that the Committee of Administrators was constituted under the orders of the Supreme Court.

FRAUD

Q. 'An attempt at deceit which does not deceive is not fraud.' Do you agree.? [20M]

Fraud is well known, vitiates every solemn act. Fraud and justice never dwell together. Fraud is a conduct either by letter or words which includes the other person or authority to take a definite determinative stand as a response to the conduct of the former either by words or letter. It is also well-settled that misrepresentation itself amounts to fraud.

A fraudulent misrepresentation is called deceit and consists in leading a man into damage by willfully or recklessly causing him to believe and act on falsehood. Fraud and deception are synonymous. Although in a given case a deception may not amount to fraud, fraud is **anathema to all equitable principles** and any affair tainted with fraud cannot be perpetuated or saved by the application of any equitable doctrine including res judicata (*Shitla Prasad v Banwari 2014).*

When the consent of a party to the contract has been obtained by fraud, he consent is not free consent which is necessary for the formation of a valid contract. In such a case, the contract is voidable at the option of the party whose consent has been so obtained.

Section 17. "Fraud" defined.—"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** another party thereto of his agent, or to **induce him** to enter into the contract:—

(1) the **suggestion,** as a fact, of that which is not true, by one who does not believe it to be true; (2) the **active concealment** of a fact by one having knowledge or belief of the fact;

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

(4) any other act **fitted to deceive;**

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

Explanation.—Mere **silence** as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak2 , or unless his silence is, in itself, equivalent to speech.

Illustrations

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

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

(c) B says to A—"If you do not deny it, I shall assume that the horse is sound." A says nothing. Here, A‟s silence is equivalent to speech.

(d) 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

In *Derry v Peek,* what constituted fraud was described as under: 'Fraud is proved when it is shown that the representation has been made

Knowingly

Without belief in its truth

Recklessly, carelessly whether it be true or false.

According to **Section 17,** the following are the essentials of fraud:

1. There should be a false statement of fact by a person who himself does not believe the statement to be true.
2. The statement should be made with a wrongful intention of deceiving another party thereto and inducing him to enter into a contract on that basis.

1. <u>False statement of Fact:</u> **Sec 17(1):** Mere Expression of opinion is not enough to constitute fraud. On the other hand, if a person who is aged over 60 years and thus beyond insurable age deliberately makes a false statement that his age is 48 years in order to take out an insurance policy, it amounts to fraud (*Ram Bai v LIC of India)*

    - **Mere silence is not fraud:** A contracting party is not obliged to disclose each and everything to the other party. Eg *Keates v Lord Cadogan* A let his house to B which he knew was in ruinous condition. He also knew that the house is going to be occupied by B immediately. A did not disclose the condition of the house to B. It was held that he had committed no fraud. In *Shri Krishan v Kurukshetra University,* a candidate for the LLB

exam was short of attendance and did not mention that fact in the admission form of the examination. It was held that there was no fraud as the authorities themselves also did not make proper scrutiny.
Exceptions:

Duty to speak (Contracts *uberrima fids*): Certain contracts are contracts uberrima fides ie contracts of utmost good faith. In *P Sarojam v LIC* the assured was suffering from a serious heart ailment not only when the proposal for the insurance of his life was made, but also for several years prior to that. The assured gave false answers to the questions and induced the LIC to accept the proposal. Therefore LIC was entitled to repudiate the policy. However the non discosure of information that has no bearing on the risk undertaken by the insurer does not amount to fraudulent misrepresentation. (*Bhagwani Bai v LIC of India*)

Silence being equivalent to speech: Eg (c) B says to A—"If you do not deny it, I shall assume that the horse is sound." A says nothing. Here, A‟s silence is equivalent to speech.
However if the other party can discover the truth by ordinary diligence, he cannot avoid the contract eg *Shri Krishan v Krurkshetra University.*

- **Active Concealment- Section 17(2)**: Sec 19 (d) B, having discovered a vein of ore on the estate of A, adopts means to conceal, and does conceal, the existence of the ore from A. Through A‟s ignorance B is enabled to buy the estate at an under-value. The contract is voidable at the option of A.
  (e) A is entitled to succeed to an estate at the death of B, B dies: C, having received intelligence of B‟s death, prevents the intelligence reaching A, and thus induces A to sell him his interest in the estate. The sale is voidable at the option of A.
- **Promise made without any intention to perform it - Section 17(3)**
- **Any other act fitted to deceive - Section 17(4)**
- **Any act or omission which the law declares as fraudulent - Sec 17 (5)** eg Section 55 of Transfer of Property Act 1882 declares certain kinds of omissions on the part of the buyer or seller as fraudulent.

2. Wrongful Intention

In *Derry v Peek,* the directors of a company issued a prospectus stating that they had got the authority to run tramways with steam or mechanical power instead of animal power. A plan had been submitted for the same and the directors honestly believed that the Board of Trade would do so as a matter of course. The Board of Trade refused the sanction and the company had to be wound up. It was held that the statement had not been made with an intention to deceive and there was no fraud.

- **Contract on the basis** of false statement

- Statement should be **meant for the party** misled: In *Peek v Gurney,* a person purchased some shares of a company from the market and then sued the promoters of the company for fraud on the ground that there were some false statements contained in the prospectus. It was held that the prospectus is meant for an original allottee of the shares by the company and not a person like the present appellant, therefore the promoters were not liable for fraud.
- **The acts must have in fact, deceived the party –**A mere attempt to deceive the party is not fraud under the ICA unless the party is **actually deceived.** Fraudulent misrepresentation must have been made with an intention to deceive. According to the deceit which does not deceive does not amount to fraud and cannot hence make the contract voidable.

1. **The other party must suffer loss –**To constitute a fraud, under the ICA, it is necessary that the other party must have suffered some material loss as a consequence of the deceit. Hence, there is no fraud without damage.

Effect: **Section 19.** Voidability of agreements without free consent.—When consent to an agreement is caused by coercion, 1 *** fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

Q. "A deceit which does not deceive is no fraud." Discuss. [15M]

MISREPRESENTATION

Section 18. "Misrepresentation" defined.—

"Misrepresentation" means and includes—

(1) 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;

(2) any **breach of duty** which, **without an intent to deceiv**e, 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;

(3) **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.

Derry v Peek

Noorudeen v Umairathu Beevi: The D who was the P's son got a document executed from the P describing it as hypothecation deed to the P's property. In fact, by F and M, the document executed was a sale deed of the P's property. The P was a blind man and the sale was for an inadequate consideration. It was rightly set aside

Fraud and M distinguished:

1. In F the statement is made by a person who knows that it is false or does not believe in its truth, whereas in M the person making the Statement believes the same to be true.
2. In F the I of the person making a false statement is to deceive the other party and induce him to enter the contract on that basis. There is no such wrongful intention in case of misrepresentation.
3. According to Section 19, when the consent fo a party to the contract has been obtained either by F or by M the contract is voidable at the option of the party whose consent has been so obtained. In the case however, there is an additional remedy to the victim of fraud ie action for damages under the law of torts, because fraus is also a tort
4. Where there is M by one party, the contract is voidable at the option of the other party but no such remedy is available if the party seeking to avoid the contract had the means of discovering the truth with ordinary diligence. However, except for fraudulent silence, a person obtaining the consent of the other party by fraud ccannot be allowed to say that the other party could have discovered the truth with ordinary diligence.

Effect of Flaw in Consent

19. Voidability of agreements without free consent.—When consent to an agreement is caused by coercion, 1 *** fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused. A party to a contract whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true.

Thus, in case of the flaw in consent one part or the other may have either:

1. A right of rescission of the contract
2. A right to claim compensation

Limits to the right of recession

1. When the contract is affirmed: In *Long v Lloyd,* A sold his lorry to B by making a false representation that the lorry was in 'excellent condition.' On the lorry's first journey B discovered serious defects in the lorry. He did not rescind the contract but accepted A's offer of half the cost of repairs. The lorry completely broke in the next journey. It was held that by accepting hte offer of sharing hte cost of repairs, he had no right to rescind it.
2. Lapse of time
3. Acquisition of right by a third party
4. Inability to restore the goods: In *Wallis v Pratt* the buyer purchased seeds described as 'English sainfoin seeds.' The seeds supplied by the seller were of an inferior and a different variety known as 'Giant sainfoin seeds.' The defect could be known only after the crop was ready. The buyer could claim compensation only.
5. Damages in lieu of rescission of contract: The remedy of damages is in respect of innocent misrepresentation only. When the misrepresentation is fraudulent, the aggrieved party may recover damages in addition to the remedy of avoiding the contract because fraud is also a tort.

Right to claim compensation

1. Damages in cases of fraud
2. Damages in case of non-fraudulent misrepresenations
3. Duty of a party rescinding the contract to pay compensation

MISTAKE

Q. "There can be a mistake of identity only when a person bearing a particular identity exists within the knowledge of the plaintiff, and the plaintiff intends to deal with him only. If the name assumed by the swindler is factious, there will be no mistake of identity. "Examine the statement with the leading case. [20 M]

When the consent of the parties to the contract is caused by mistake, it is not free consent which is needed for the validity of a contract. Instead, it is the misunderstanding or misapprehension of some fact relating to the agreement that results in its invalidity.

Section 20. Agreement **void** where both parties are under mistake as to **matter of fact.**—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.

Explanation.—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.

Illustrations

(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) A, being **entitled to an estate** for the life of B, agrees to sell it to C. **B was dead** at the time of the agreement, but both parties were ignorant of the fact. The agreement is void.

Thus mistake may work in two ways:

Mistake in the mind of the parties is such that there is no genuine agreement at all. There may be no *consensus ad idem i.e. the* meeting of the two minds. The offer and the acceptance do not coincide.

There may be a genuine agreement, but there may be mistake as to a matter of fact relating to that agreement .

1. Mistake when there is **no consensus ad idem** or there is absence of consent

    - *Raffles v Wichelhaus:* the buyer and the seller entered into an agreement under which the seller was to supply a cargo of cotton to arrive 'ex Peerless from Bombay'. There were two ships of the same name i.e. Peerless and both were to sail from Bombay, one in October and the other in December. The buyer had in mind Peerless sailing in October whereas the seller thought of the ship sailing in December. The seller dispatched cotton by December but the buyer refused to accept the same. As the offer and the acceptance did not coincide, the buyer was entitled to refuse to take delivery.
    - *Tarsem Singh v Sukhminder Singh:* The parties to the agreement for the sale of land were not ad idem with respect to the unit of measuring land, the case was covered by Section 20, making the agreement void.

Mistake **as to matter of fact essential** to the agreement

- Mistake of **both** the parties: **Section 22.** Contract caused by mistake of one party as to matter of fact.—A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as a matter of fact. *Ayekam Angahal Singh v UOI:* There was an auction for the sale of fishery rights and the P was the highest bidder making a bid of Rs 40,000. The fishery rights had been

auctioned for 3 years. The rent, in fact, was Rs 40,000 per year. The P sought to avoid the contract on the ground that he was working under a mistake and he thought that he had made a bid for Rs 40,000 for all three years. It was held that since the mistake was unilateral, the contract was not affected.

- **Mistake of Fact: Section 21.** Effect of mistakes as to law.—A contract is not voidable because it was caused by a mistake as to any law in force in 1 [India]; but a mistake as to a law not in force in 1 [India] has the same effect as a mistake of fact. Illustration A and B make a contract grounded on the erroneous belief that a particular debt is barred by the Indian Law of Limitation; the contract is not voidable.
- Mistake **Essential t**o the Agreement

Mistake as to existence of the **subject matter**: *Galloway v Galloway* a man and woman executed a separation deed, both of them under a common mistaken impression that they were married to each other. Since the fact of the marriage was non-existent, the deed was held void.

- Mistake regarding subject matter only: *Smith v Hughes* there was a sale of a parcel of oats by sample by A to B. B refused to accept the oats on the ground that he thought that the oats were old when in fact they were new. It was held there was no mistake as to the identity of the subject matter, but merely as to the age of oats. The contract was therefore valid.

B. Mistake as to the **possibility** of performance of the contract

A. Mistake as to **title:** In *Cooper v Phibbs:* A agreed to take a lease of a fishery from B. Unknown to both the parties, A was already a tenant for life of the fishery rights and B had no title to the same. The agreement was set aside on the grounds of common mistake.

A. Mistake as to **promise:** *Hartog v Colins & Shields:* There was a contract for the sale of 30000 pieces of Argentine hare-skins. Negotiations as to price were on 'per piece' basis. The sellers by mistake in the offer stipulated to supply at a certain rate 'per pound' of such skins. It was held that there had arisen no contract as the seller's intention was not properly reflected in the offer.

A. Mistake as to **identity** of the parties.

In *Boulton v Jones,* Jones used to have business dealings with Brocklehurst and sent an order to it for the purchase of certain goods. By the time this order reached, Brocklehurst had sold his business to Boulton. The Petitioner supplied the goods to the defendant. The latter refused to pay the price on the ground that he had never placed an order with P and had never intended to make a contract with him. Thus he was not bound to pay for the goods.

In *Said v Butt* the P wanted to attend the first night performance of a certain play in the D's theater. The P knew that if he personally went to take the ticket, it would be refused to him by the D. Therefore he procured the ticket through a friend without disclosing that the ticket was meant for the P. the P was refused admission to the theatre. It was held that no contact had come into existence because the P knew

that the D did not want to make a contract with him, and the D could not be made liable for the breaking of the contract.

Contract by parties in each other's presence (*inter praesentes)*

Phillips v Brooks Ltd, a person North went to the P's shop and selected some pearls and a ring. While writing the cheque he told the P, 'I am Sir George Bullough' and also mentioned his address. The P had heard about Sir George Bullough being a person of credit and he confirmed the address from the directory. The P handed over the ring to North. North then pledged the ring to the D who took the same in good faith and without any notice of fraud. The P sued the D for the return of the ring.

It was held that the agreement was not void on the ground of mistake insofar as the P contracted to sell and deliver the ring to the person who was present in the shop. The contract was only voidable on the ground of fraud. Furthermore, he was a bona fide transferee, therefore he would get a good title.

In *Ingram v Little* the facts were almost the same (car) but it was held that the P had intended to sell the car to the person he mistakenly thought he was and not the swindler, therefore the transferee could not get a good title to the car.

It appears that the first case has been correctly decided. When the parties are face to face, there is no mistake as to identity. The contract in such cases is voidable on the ground of fraud which was in respect to payment only.

A distinction may be drawn between the identity of a person and his attributes. In *Lake v Simmons,* a woman went to a jeweller and posed herself as the wife of a wealthy customer. She was in fact living with him as a mistress. She was allowed to take two pearl necklaces on approval of her husband. The jeweller had been insured against loss by theft. The insurance compny pleaded that the jewellery had been given to a customer. It was held that the case was covered by the insurance as the lady present was not the 'customer' because the shopkeeper wanted to enter into an agreement only with 'Mrs. Van Der Borgh.'

TOPIC 3: Void, voidable, illegal and unenforceable agreements

Q. "All illegal agreements are void but all void agreements are not illegal". Discuss. [15M]

There are some agreements which have been specifically declared as void by the Indian Contract Act. even if such agreements satisfy the conditions of a valid contract, they are not enforceable.

ALL ILLEGAL AGREEMENTS ARE VOID BUT NOT VICE VERSA

One of the essentials of a valid contract is that the consideration and the object should be lawful (Sec 10). Every agreement of which the object or consideration is unlawful is void [Sec 23].

The consideration or object of an agreement is lawful unless-

1. It is forbidden by law or
2. Is of such a nature that, if permitted it would defeat the provisions of law or
3. Is fraudulent or
4. Involves or implies injury to the person or property of another or
5. The court regards it as immoral or opposed to public policy. (this may or may not be illegal)

In *Brij Mohan v MPSRT Corporation* the respondent Corporation entered into an agreement with the petitioner to allow him to run his bus as nominee of the said Corporation. It was held that the said agreement was void as it was violative of the provisions of the Motor Vehicles Act.

An agreement to do what has been prohibited by the IPC or by some other law also cannot be enforced.

Thus an illegal agreement is void.

Void Agreements

The agreements which have been declared void by the act are as follows:

1. Agreement of which the consideration or the object is not lawful - Sections 23 and 24
2. Agreement without consideration- Sec 25
3. Agreement in restraint of marriage- Sec 26
4. Agreement in restraint of trade- Sec 27
5. Agreement in restraint of legal proceedings - Sec 28
6. Agreement which is ambiguous and uncertain- Sec 29
7. Agreement by way of wager- Sec 30
8. Agreement to do an impossible act- Sec 56

Thus it can be clearly seen that all void agreements are not illegal [eg agreement to do an impossible act]

Difference between Void and Illegal Agreement:

In *Rajat Kumar Rath v Govt of India* it has been held that both kinds of agreements have no legal effect. If the contract is merely void, the collateral contracts thereto are not affected. But if a contract is unlawful then the contracts which are collateral thereto are also void.

Thus it can be said that void agreements are the genus and illegal agreements its species.

Q. There is a very limited application of law relating to agreement in restraint of trade in India.' Critically examine the statement and suggest the area of limitations [15 M]

According to Section 27, 'every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.'

[This section does not allow any distinction between a total or partial restraint. For instance in *Madhub Chander v Rajcoomar Dass* 'A' was asked to close his business in a particular locality. Even though the restraint was partial, it was still void.]

Limited Application?

However this rule has several exceptions limiting its application

1. Sale of goodwill: It will be contrary to the spirit of the contract of sale of goodwill, if the seller of the goodwill, who has received money for the same, starts that business in competition with the buyer again. If the object of the agreement is to protect the right of the buyer of the goodwill, the restraint is valid. However if the restraint is very wide eg, restraining the appellants from manufacturing anywhere in the world, or if a goodwill is sold whose business was never carried on in the first place, the agreement will be void [*Vancouver Malt and Sake Brewing Co v Vancouver Breweries Ltd*]
2. Exceptions under the Indian Partnership Act1932

    - Sec 11(2): Partner shall not carry on any business other than that of hte firm which he is a partner
    - Sec 36(2): an outgoing partner is paid his share of the goodwill of the firm and is reasonable that he agrees he will not carry on a similar business
    - Sec 54: Permits such an agreement upon or in anticipation of the dissolution of the firm
    - SEc 55(3): agreement that the partner will not carry on business similar to that of the firm within a specified period or within specified local limits.

Restraint by a contract of service: an agreement of service under which an employee agrees that he will serve a particular employer for a duration and not anybody else is a valid agreement. In *Charlesworth v MacDonald* where the D had agreed to serve as an assistant to teh plaintiff for three years but started his own practice within a year, the plaintiff was entitled to restrain the D from practising.

- Garden Leave Clause: It operates after the cession of employment. The employee is prohibited from carrying on any business which competes directly or indirectly with the whole or any part of the business for a period of three months after the notice period
- Recently moonlighting (secretly having a second job) has been highlighted as a problem by various companies including Infosys.

Trade combinations: sometimes the traders or manufacturers combine together to eliminate competition between themselves and make agreements fixing minimum price, regulating the supply of goods and putting profits in a common pool and dividing the same amongst themselves. Eg OPEC.

Solus Agreements: Sometimes the seller or the manufacturer may agree that he will supply the whole of his product to a particular single buyer only or a buyer may agree that he will purchase from one seller only. This is known as an 'exclusive dealing agreement.' these are valid unless:

- The buyer does not agree to purchase the whole quantity and restrains the seller from selling his surplus to others
- When the object is to corner goods or to monopolize trade or if it is for an unduly long time

Agreement void only to the extent of the trade.

Q. "Public policy is like an 'unruly horse' which cannot be controlled easily." Explain the statement and mention the agreements that are against public policy [10M]

One of the essentials of a valid contract is that consideration and the object should be lawful [Section 10]. Section 23 mentions the circumstances under which it is not lawful: opposition to public policy being one of them.

PUBLIC POLICY: An Unruly Horse

On one hand, a person's right of contractual freedom should be maintained. On the other hand, if the contract is against public policy, the law must not allow that to be enforced. An act which is injurious to the interest of the society is against public policy.

It is said that the task of a judge is to 'expound and not to expand' the law. In the opinion of Justice Burrough, 'public policy is an unruly horse, and when you get astride it you never know where it will carry you.' [*Richardson v Mellish*]

The doctrine of public policy is based on the maxim 'ex turpi causa non oritur actio' [an agreement which opposes public policy would be void and of no legal effect]

Thus to ensure a balance, the question of public policy must be viewed within the parameters fixed by long standing authorities or precedents as also by having recourse to the Preamble of the Constitution, the principles underlying the fundamental rights and the Directive Principles in our Constitution [*Central Inland Water Transport Corporation Ltd v Brojo Nath Ganguly*]

Q.1. Section 28 of the Indian contract act, 1872 makes agreements in restraint of legal proceedings void. Are there any exceptions to this rule? Discuss with the help of relevant provisions and decided cases. [10M]

Section 28 [as amended by the Indian Contract (Amendment) Act 1997] states that an agreement **absolutely restraining** a party from enforcing his rights though a court of law, or an agreement which places a limit as to the time within which a right can be enforced, is void.

Section 28: Agreements in restraint of legal proceedings, void.—2

[Every agreement,—

(a) by which any party thereto is **restricted absolutely** from **enforcing his rights** under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights; or

(b) which **extinguishes the rights** of any party thereto, or **discharges any party** thereto, from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to the extent.]

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

Exception 2.—Saving of contract to **refer questions** that have already arisen.—Nor shall this section render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration4 .

Exception 3.—Saving of a **guarantee agreement** of a bank or a financial institution.—This section shall not render illegal a contract in writing by which any bank or financial institution stipulate a term in a guarantee or any agreement making a provision for guarantee for extinguishment of the rights or discharge of any party thereto from any liability under or in respect of such guarantee or agreement on the expiry of a specified period which is not less than one year from the date of occurring or non-occurring of a specified event for extinguishment or discharge of such party from the said liability.

1. Agreement absolutely restraining legal proceedings

In *Tapash Majumdar v Pranab Dasgupta* a rule of the East Bengal Club authorizing the Executive Committee of the club to take action against any of its members who approached the Court to challenge the election process, was held contrary to Section 28 of the Contract Act, 1872.

In *C. Satyanarayana v KL Narasimham,* the defendant wrote a letter to the plaintiff on top of which was printed: 'Subject to Madras Jurisdiction.' It was held that such words could not become a part of the contract unless it was expressly agreed to by the plaintiff, and therefore these words did not bind the parties to the contract as to the jurisdiction of the court.

Agreement limiting time for a legal action

According to the Indian Limitation Act 1963 there is a time limit for various actions. If an agreement between the parties stipulates a smaller time limit than prescribed, the agreement is void under Section 28.

Amendment of 1997: New provision in Section 28 (b) that agreement which extinguishes the rights of any party thereto from any liability under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing the rights is void to that extent.

Exceptions

1. Contract to refer future disputes to arbitration
2. Contract to refer existing questions to arbitration

Arbitration clause: From provision of Section 7 of Arbitration and Conciliation Act 1996 it is graphically clear that unless an arbitration agreement stipulates that the parties agree to submit all or certain disputes

which have arisen or which may arise in respect of defined relationship, whether contractual or not, there cannot be a reference to an arbitrator. Thus, there has to be an intention expressing the consensual acceptance to refer the disputes to an arbitrator. In the absence of an arbitration clause in an agreement, the disputes cannot be referred to the arbitral tribunal.

The Supreme Court has held that a clause in an agreement barring payment of interest on amounts security deposit, earnest money deposit or any other amount will not be hit by Section 28 of the Contract Act. **Garg Builders Vs Bharat Heavy Electricals Limited 2021**

TOPIC 4: Performance and discharge of contracts

Q.1. "It is well settled that if and when there is frustration, the dissolution of the contract occurs automatically… It does not depend on the choice or election of either party. It depends on the effect of what has actually happened on the possibility of performing the contract." Discuss the effects of frustration of contract. [20M]

When the performance of the contract becomes impossible, the purpose which the parties have in mind is frustrated. If the performance becomes impossible, because of a supervening event, the promisor is excused from the performance of the contract. This is known as doctrine of frustration and is covered by Section 56 of the Indian Contract Act.

In *Taylor v Caldwell,* A agreed with B to give him the use of a music hall and gardens for holding concerts on four different dates. B agreed to pay a rent of 100 pounds for each of the four days. Before the date of performance arrived, the **music hall was destroyed by fire.** B sued A for the breach of the contract. It was held that the contract had become void because of the perishing of the hall without any fault on the part of A. The performance of the contract had become impossible and, therefore, A was not liable for the non-performance of the contract.

Section 56. Agreement to do an impossible act.—An agreement to do an act impossible in itself is void.

Contract to do an act **afterwards becoming impossible** or unlawful.—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.

Compensation for loss through non-performance of act known to be impossible or unlawful.— Where one person has promised to do something which he knew, or, with reasonable diligence, might have

known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the nonperformance of the promise.

Illustrations

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

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

(c) A 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.

(d) A contracts to take in cargo for B at a foreign port. A‟s Government afterwards **declares war** against the country in which the port is situated. The contract becomes void when war is declared.

(e) 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.

1. Initial impossible
2. Subsequent impossibility [Illus b, d, e]

- **Self- induced frustration:** The doctrine of frustration of contract cannot where the event which is alleged to have frustrated the contract arises from the act or election of a party.
- **Death or incapacity** of the party: When the nature of the contract requires the personal performance of the contract by a particular person, the contract is deemed to be conditional upon the continued life or good health of the person so that it is possible for him to perform the contract. Thsu, in case of contract based on **personal skill or confidence** of the parties, the death of a party in such a case puts an end to the contract, and therefore, the representatives cannot be made liable to perform such a contract. **(Section 37)**
  Illustration: 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 representative or by B.
  In *Robinson v Davison* the defendant's wife, who was an eminent **piano** player, promised to play piano at a concert on a particular day. She was unable to give her performance due to illness. It was held that the performance of the contract depended on the continued good health of the D's wife and the contract was discharged due to her illness. The D could not be made liable to pay compensation for the non-performance.

- **Frustration by virtue of Legislation:** It becomes void.
  In *Rozan Mian v Tahera Begum,* an agreement was entered into between the P and the D for the sale and purchase of Thika Tenancy. The agreement having not been carried out, the P filed a suit for specific performance of agreement for sale. During the pendency of the suit, the Calcutta Thika Tenancy Act 1949 was promulgated. It prohibited the transfer of Thika Tenancy rendering the performance of the agreement to sell impossible and hence void.
- **Frustration due to change of circumstances:** The doctrine has been extended to those cases where there was no physical impossibility of performance but because of the change in circumstances the adventure was frustrated, or by the literal performance of the contract the main object of the contract could not be fulfilled.
  Krell v Henry: In this case, the D agreed to hire the P's flat the days on which the coronation process of Edward VII was to pass along a particular road. Due to the King's illness, the procession was canceled. It was observed that viewing of the procession was the foundation of the contract, and by the cancellation of the procession, the purpose of the contract could no longer be achieved, and as such, the parties were discharged from performing their further obligations.
- Not mere **commercial difficulty:** For eg. merely because the procurement of goods becomes difficult due to a strike in the mill, or there is a rise in prices, it is not enough to frustrate the contract.

No frustration of **executed contracts:** Section 56 covers cases of executory contracts only, and does not apply to executed contracts.

Section 65- Restoring benefit received under an agreement discovered to be void or contract becoming void:. Obligation of person who has received advantage under void agreement, or contract that becomes void.—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 for it to the person from whom he received it.

Illustrations

(a) A pays B 1,000 rupees, in consideration of B‟s promise to marry C, A‟s daughter. C is dead at the time of the promise. The agreement is void, but B must repay A the 1,000 rupees.

(b) A contracts with B to deliver to him 250 maunds of rice before the first of May. A delivers 130 maunds only before that day, and none after. B retains the 130 maunds after the first of May. He is bound to pay A for them.

(c) A, a singer, contracts with B, the manager of a theater, to sing at his theater for two nights every week during the next two months, and B engages to pay her a hundred rupees for each night‟s performance. On

the sixth night, A wilfully absents herself from the theater, and B, in consequence, rescinds the contract. B must pay A for the five nights on which she had sung.

(d) A contracts to sing for B at a concert for 1,000 rupees, which are paid in advance. 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 had been able to sing, but must refund to B the 1,000 rupees paid in advance.

The Supreme Court observed that the principle of Restitution under Section 65 of the Indian Contract Act will not apply when the party claiming restitution was equally or more responsible for the illegality of the Contract. It held that, in any case, the claim for restitution under Section 65 would be governed by the principle of *in pari delicto potio rest condition defendentis* (in equal fault, better is the condition of the possessor). **Loop Telecom and Trading Limited vs Union of India 2022**

Q.2. When a contract stipulated that a contract shall be performed by a particular date, and is not performed by the date, what are the rights of the promisee if (a) time is of the essence of the contract and (b) time is not of the essence of the contract?

Every contract consists of reciprocal promises. Each party to a contract is bound to perform the promise made by him. According to **Section 37,** the parties to the contract have a duty to: i. Perform or ii. Offer to perform their respective promises.

Time and place of performance: The parties are free to decide as to when and where the performance of the contract is to be made. Sections 46 to 50 lay down the principles for the performance of contracts containing different stipulations as to time and place for the performance of the contracts.

Effect of failure to perform the contract in time- Section 55

When one party fails to perform the contract in time, the question may arise as to what remedy the other party can have in such a case. Section 55 mentionstwo different remedies: one in a case when the time of performance is the essence of the contract, and the other when the time is not the essence of the contrat.

Essence of the contract: The general principle to determine that time is not the essence of the contract, in agreement for sale relating to immovable property if time specified for payment of sale price, but not for execution of sale deed, it will become essence only for payment of sale price.

1. **When time is the essence of the contract:** in such a case, non-performance of the contract in time would frustrate the purpose which the parties have in mind and therefore if in such a case, there is delay in the performance by one party, the other party has a right to avoid the contract.

- **Determining** whether time is of the essence or not: The parties either expressly or by their conduct can make time as essence of the contract. If the parties have not expressed their intention then it depends on the nature of the contract.
  In *Shakuntala Devi v Mohanlal,* in case of sale of immovable property the presumption is that time is not the essence of the contract. Merely because the date of execution of sale deed has been fixed does not make the time as the essence of the contract, that is more so when the said date is extended from time to time.
- When performance within specific time is **not insistent**
- **Extension** of time: The promisee in a contract may make certain concessions to the promisor under Section 3 and one of such concessions is to extend the time specified for the performance of the contract. But there can be no unilateral extension.
  In *CC of India Ltd v SS Corporation* there was a contract to supply goods 'within 10 days or earlier.' The buyer extended the time and accepted deliveries. He then gave a notice to the seller that no further extension will be given and the contract must be performed by the end of the year. It was held that on the seller's failure to supply the goods by 31st December, the buyer had a right to terminate the contract.
  Thus, when time is the essence of the contract, mere extension of time may not affect his stipulation and the extended time may now be the essence of the contract instead of the time originally fixed.
- **Right to avoid** the contract if delay in performance- therefore voidable at the option of the promisee (Sec 55 para 1)
- **Right of compensation-** an alternative remedy: Sec 55 para 3

When time is not the essence of the contract: When time is not the essence of the contract, it must be performed within a reasonable time. The delay in the performance of such a contract does not make the contract voidable, but the remedy available to the aggrieved party in such a case is to claim compensation [**Section 55 para 2**]

Q. Is a party rightfully rescinding the contract entitled to compensation? Explain with the help of examples. [15M]

Rescission means the termination or annulment of a contract. According to Section 27(1) it may be granted when:

The contract is voidable or terminable by the plaintiff

Where the contract is unlawful for causes not apparent on its face and the defendant is more to blame.

Section 75. Party rightfully rescinding contract, entitled to compensation.—A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

Illustration:

A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her 100 rupees for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contracts. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her 100 rupees for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contracts. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract."

DISCHARGE OF CONTRACT

A contract can be discharged in the following ways:

1. By performance
2. By breach
3. By impossibility of performance
4. By agreement and novation

By Breach

When a party having a duty to perform a contract fails to do that, or does an act whereby the performance becomes impossible to perform, there is said to be a breach of contract on his part.

The breach may either be i. Actual i.e. non-performance of the contract on the due date of performance or ii. Anticipatory i.e. before the due date of performance has come.

Anticipatory Breach:

Section 39 Effect of refusal of party to perform promise wholly.—When a party to a contract has refused to perform, or disabled himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance.

Illustrations

(a) A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B engages to pay her 100 rupees for each night‟s performance. On the sixth night A wilfully absents herself from the theatre. B is at liberty to put an end to the contract

. (b) A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two night‟s in every week during the next two months, and B engages to pay her at the rate of 100 rupees for each night. On the sixth night, A wilfully absents herself. With the assent of B, A sings on the seventh night. B has signified his acquiescence in the continuance of the contract, and cannot now put an end to it, but is entitled to compensation for the damage sustained by him through A‟s failure to sing on the sixth night.

Effect of anticipatory breach of contract:

1. He may **rescind** the contract immediately: He may treat the contract at an end, and may bring an action for the breach of contract without waiting for the appointed date of the performance of the contract.

   In *Frost v Knight,* the defendant promised to marry the P on D's father's death. While the D's father was still alive, he broke off the engagement. The P immediately sued without waiting for the fathers death. She was successful in her action.

He may not put an end to the contract but rest is still subsisting and alive and wait for the performance of the contract on the appointed date. (Illustration b)

Discharge by agreement and novation

Sections 62 and 63 deal with contracts in which the obligation of the parties to it may end by the consent of the parties

Novation: It means the substitution of an existing contract with a new one.

62. Effect of novation, rescission, and alteration of contract.—If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed.

Illustrations

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

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

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

Novation is of two kinds

1. Novation by change in the terms of the contract
2. Novation by change in the parties to the contract.

Statutory substitution of the parties: The general rule is that all the parties to the subsisting contract must consent to the novation of the contract. But the exception is that when a Statute vests certain assets of the State in a statutory corporation and provides that as a consequence, the rights and obligations of the State relating to such assets shall stand transferred to such statutory corporation.

The same rule is applicable in contracts of partnership. When a partner retires, his liability for the past acts still continues. Such liability of a retiring partner could be extinguished and he may be discharged from liability by novation.

In *Evans v Drummond,* A and B who were the two partners of a partnership firm, executed a bill in favor of X. A retired and thereafter, on the due date, B took back the old bill from X and instead of making the payment, B gave the new bill to X for the amount signed by B alone. X accepted the new bill with the full

knowledge of the change in the firm. It was held that he had relied on the sole security of B and thereby he had implied discharged A from liability.

Remission of Performance- Section 63

63. Promise may dispense with or remit performance of promisee.—Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance1 , or may accept instead any satisfaction which he thinks fit.

Illustrations

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

(b) A owes B 5,000 rupees. A pays to B, and B accepts, in satisfaction of the whole debt, 2,000 rupees paid at the time and place at which the 5,000 rupees were payable. The whole debt is discharged.

(c) A owes B 5,000 rupees. C pays B 1,000 rupees, and B accepts them, in satisfaction of his claim on A. This payment is a discharge of the whole claim .

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

(e) A owes B 2,000 rupees, and is also indebted to other creditors. A makes an arrangement with his creditors, including B, to pay them a 3 [composition] of eight annas in the rupee upon their respective demands. Payment to B of 1,000 rupees is a discharge of B‟s demand.

This Section permits a party, who is entitled to the performance of a contract to

1. Dispense with or remit, either wholly or in part, the performance of the contract
2. Extend the time of performance
3. Accept any other satisfaction instead of performance

Discharge by Neglect: According to **section 67**, the promisor is excused of performing his part of the contract if the promisee either neglects or refuses to afford the promisor reasonable facilities for the performance of his promise

TOPIC 5: Quasi-contracts

Q.1. "The principle of unjust enrichment finds place indirectly under the law of contract." Explain its various dimensions [15 M]

Chapter V (Sections 68-72) deals with 'certain relations resembling those created by contract.'

In an action for unjust enrichment, the following essentials have to be proved:

1. The D has been **'enriched'** by the receipt of a **'benefit'**
2. The enrichment is 'at the **expense of the plaintiff'**
3. The retention of the enrichment is **'unjust'**

The Indian Contract Act deals with the following quasi-contractual obligations:

1. Claim for necessaries supplied to a person incompetent to contract (Section 68)
2. Reimbursement of money paid, due by another (Section 69)
3. Obligation of person enjoying benefit of non-gratuitous act (Section 70)
4. Responsibility of finder of goods (Sec 71)
5. Liability of a person getting benefit under mistake or coercion (Sec 72)

Claim for necessaries supplied to a person incompetent to contract

Section 68. Claim for necessaries supplied to person incapable of contracting, or on his account.—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.2

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.

(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.

B. Reimbursement of money paid, due by another

Section 69. Reimbursement of a person paying money due by another, in payment of which he is interested.—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

B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be the annulment of B‟s lease. B, to prevent the sale and the consequent annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid.

For the application of this Section, two essentials are to be there

One person is interested in the payment of money, and therefore, he pays it :
In *Exall v Partridge* the P placed his carriage in the D's premises. Since it was lying in the D's premises, his landlord seized it as distress because the D was in arrears of rent. The P had to clear the arrears of rent which were otherwise to be paid by the D and ot his carriage back. It was held that the P was entitled to recover from the D the rent so paid by him.
In *Brook's Wharf v Goodman Brothers* the D warehoused certain goods which they had imported from Russia with the plaintiffs. The goods were stolen. Under the law the customs duty on the goods could be recovered either from the owners of the goods, or from the warehouseman. The warehousemen i.e. the plaintiffs were called upon to pay the customs duty which the owners of the goods ie the D were bound by law to pay. The P claimed the amount of the duty paid by them from the D. It was held that they were entitled to recover the same.

Another person is bound by law to pay the same but he fails to pay: In *Port Trust Madras v Bombay Company,* an employee of the Port Trust was injured when on duty and the plaintiffs as his employers paid him compensation under the Workmen's Compensation Act 1923. After making this payment to the workmen, the P brought an action against the D due to whose negligence the said workman had been injured. It may be noted that the basis of the liability of the D could possibly be under the law of torts for negligence. The plaintiff's claim was dismissed and was held not entitled to be reimbursed for the following reasons:

- The P was not merely interested in the payment as required by Sec 69, he was rather himself bound by law to pay as the Statute (Workmen's Compensation Act 1923) cast an inescapable liability on him to make this payment
- When the P made this payment, the D was not bound to pay as the D's liability to pay under the law of torts had not yet been determined.

Obligation of a person enjoying the benefit of a non-gratuitous act.

Section 70. Obligation of person enjoying benefit of non-gratuitous act.—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 delivered1 .

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.

(b) A and B‟s property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

For the application of this Section, the following conditions are to be satisfied:

A person should **lawfully do something f**or another person, or should deliver something to him : *Indu Mehta v State of UP* an Advocate was appointed as assistant district government council, in pursuance whereof she rendered her services. The appointment however was found to be void. It was held that even though the said appointment was void, the State had enjoyed the benefit of the services rendered and therefore the Government was not entitled to recover back the fees already paid to her for the services

The person making the payment or delivering the thing must **not do so gratuitously,** he should expect payment for the same: *P Mudaliar v Neelavathi Ammal,* also the act was not intended to be done gratuitously and hence compensation for the same could be claimed. In that case, the defendants were three sisters and the P was the Husband of one of them. On the death of the D's father, there was a dispute regarding certain properties and there were certain proceedings before the arbitrators. The P was asked by the tree D to take over the management of the estate and to carry on the proceedings before the arbitrators After the P had worked for five years, he demanded remuneration for the services performed by him. The D executed a promissory note for Rs. 15000 in favor of the plaintiff. Subsequently, the D sought to avoid the liability on the p note. The P in this case could not be considered to be intending to do the act gratuitously.

The other person should **enjoy the benefit of this payment** or the delivery of the thing: In *PC Wadhwa v State of Punjab* the appellant got selected in the service of the Forest Department of the respondent State. He was given practical training and education at the Indian Forest College at Dehradun. He was later selected in the IPS and left the Forest College in between, without the sanction of the Punjab Govt. The State brought an action to recover the sum of the cost of training and education of the appellant. The plea that he did not take any benefit from the training was rejected. It was held that Mr Wadhwa voluntarily enjoyed the benefit of training, and the same was not supposed to be gratuitous. Thus Sec 70 was applicable in this case.

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In *State of WB v BK Mondal & Sons,* the Respondents constructed certain structures at the request of some of the officers of the appellant. THe R claimed the sum for these works. The appellant trying to escape the liability alleged that the request in pursuance of which constructions were made were invalid and unauthorized and did not constitute valid contract binding the appellant under Section 175(3) of the GoI act, 1935. It was held that the appellant having accepted the benefit of the structures constructed for it, was liable under Section 70 to pay for the same.

D. Responsibility of finder of goods.

Section 71. Responsibility of finder of goods.—A person who finds goods belonging to another, and takes them into his custody, is subject to the **same responsibility as a bailee** .

- For instance, like a bailee of goods, the finder is bound to 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 as the goods found by him [**Section 151**].
- Similarly, he should **not mix the goods found** by him with his own goods [**Section 156 and 157**]
- He like a bailee is **bound to return** the goods to the true owner, if he can, after a reasonable search be found [**Section 160 and 169**]
- If, because of this default, the goods are not returned to the true owner, or there is any loss, destruction or deterioration of the goods, the finder must **compensate t**he owner for the same [**Sec 161**]

The finder of the goods however has been **authorized to sell** the goods found by him under Section 169.

may sue for such reward, and may retain the goods until he receives it. 169. When finder of thing commonly on sale may sell it.—When a thing which is commonly the **subject of sale is lost,** if the owner cannot with **reasonable diligence be found,** or if he refuses, upon demand, to pay the **lawful charges of the finder,** the finder may sell it— (1) when the thing is in danger of **perishing** or of losing the greater part of its value, or, (2) when the **lawful charges of the finder,** in respect of the thing found, amount to **two-thirds of its value.**

- **Finder's right of lien and compensation:** The finder has no right to sue the owner for such compensation for the trouble and expense voluntarily incurred by him to preserve the goods and

to find out the owner; but he may retain the goods against the owner until he receives such compensation **[Section 168]**

Even if no specific reward has been offered, if after the goods are found, the owner promises to pay something to the finder for his services, the finder can enforce this promise under **Section 25(2)**. For example, A finds B's purse and gives it to him. B promises to pay A's expenses in doing so. It is a valid contract and A can recover the amount from B.

- **Finder is bailee only against the true owner:** He is bound to return the goods to the owner as the owner's title is better than his. However, the finder's title is better than everybody except the true owner.

E. Liability of a person getting benefit under mistake or coercion

Section 72. Liability of a person to whom money is paid, or something delivered, by mistake or under coercion.—A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it.

Illustrations

(a) A and B jointly owe 100 rupees to C, A alone pays the amount to C, and B, not knowing this fact, pays 100 rupees over again to C. C is bound to repay the amount to B.

(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.

Section 72 does not apply only to a mistake of fact, it equally applies to a **mistake of law,** and therefore, if the Sales tax has been paid under a mistake of law, the same can be recovered back. In *Sales Tax Officer Banaras v Kanhaiya Lal,*the respondent had paid Sales tax on the R's forward transactions in silver bullion. The levy of sales tax on such transactions was held to be ultra vires by the HC of Allahabad. Then the R claimed the refund of the tax already paid. It was held that sec 72 did not make any distinction between mistake of law and mistake of fact, and the refund of payment made under mistake of law in this case was allowed.

- No refund if the P did not pay from his **own pocket:** In *Roplas (India) Ltd v UOI* the Pet paid excise duty by mistake but the pet had already recovered the whole of duty paid by them from their customers. It was held that the petitioners were not entitled to refund the amount paid by mistake as the money had not gone out of their pockets. Refund would amount to unjust enrichment of the petitioners.

TOPIC 6: Consequences of Breach of Contract

Q.1. "Discharge of a contract includes breach of contract, but breach of a contract does not necessarily include discharge of contract." Examine the statement with suitable illustrations. [15M]

A contract may be discharged in the following ways:

1. By **performance** of the contract
2. By **breach** of contract - **Section 39**
3. By **impossibility** of performance - **Section 56**
4. By **agreement** and novation- **Section 62**

Breach of Contract:

When a party having a duty to perform a contract fails to do that, or does an act whereby the performance of the contract by him becomes impossible, or he refuses to perform the contract, there is said to be a breach of contract on his part.

Effect of breach:

On a breach of contract by one party, the other party is discharged from his obligation to perform his part of the obligation, and also gets a right to sue the guilty party for damages.

Types:

a. Actual/ present- nonperformance of the contract on the due date of performance

b. Anticipatory- before the due date of performance has come

Illustration: A is to supply certain goods to B on 1st January. If A fails to supply the goods on 1st January, it amounts to actual breach of contract. On the other hand, if A informs B on 1st December that he will not perform the contract on 1st January, he has made an anticipatory breach.

Anticipatory Breach:

S39 An anticipatory repudiation occurs when, prior to the promised date of performance, the promisor absolutely repudiates the contract(expressly or impliedly).

Illustration: A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during next two months, and B engages to pay her 100 rupees for each night's performance. On the sixth night A willfully absents herself from the theatre. B is at liberty to put an end to the contract.

Case Law: Frost v. Knight Where a person promises to marry a woman on the death of his father, during the lifetime of his father married another woman, he was held liable for breach.

Consequences of Anticipatory Breach

When anticipatory breach occurs, the aggrieved party can take the following steps:

(A) May treat the contract as discharged-

(i) He can treat the contract as discharged, so that he is no longer bound by any obligations under the contract;

(ii) He can immediately adopt the legal remedies available to him for breach of contract, viz., file a suit for damages or specific performance or injunction.

(B) May not treat the contract as discharged-Anticipatory breach, by itself, does not discharge the contract. The contract is discharged, when the aggrieved party chooses to treat it as discharged. The aggrieved party may decide not to rescind the contract but to treat the contract as alive and operative and wait for the time of performance. In such a case the consequences are as follows:

(i) The contract will be operative for the benefit of both the parties. The contract will continue to exist and may even be performed by the other party.

(ii) If the contract is not rescinded and subsequently an event happens which discharges the contract legally (e.g. a supervening impossibility) the aggrieved party loses his right to sue for damages.

Conclusion Thus, it is pertinent to note that the Discharge of a contract includes breach of contract, but breach of a contract does not necessarily include discharge of contract since breach forms a subset of Discharge. There are other ways to discharge a contract including performance, impossibility, novation etc. At the same time breach itself does not automatically lead to discharge.

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Breach of Contract remedies- [Chapter VI:*Of the consequences of breach of contract*]:

1. **Damages**- Remedy by way of damages is the most common remedy available to the injured party. This entitles the injured party to recover compensation for the loss suffered by him due to the breach of contract, from the party who causes the breach. **Sections 73 to 75** incorporate the provisions in this regard.
2. **Quantum Meruit**- When the injured party has performed a part of his obligation under the contract before the breach of contract has occurred, he is entitled to recover the value of what he has done, under this remedy.
3. **Specific performance and injunction:** Provisions regarding these remedies are contained in the Specific Relief Act 1963.

Damages

Section 73. Compensation for loss or damage caused by breach of contract.—When a contract has been broken, **the party who suffers** by such breach is entitled to receive, from the party who has broken the contract, **compensation for any loss** or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. Such compensation is not to be given for any **remote and indirect loss** or damage sustained by reason of the breach.

Compensation for **failure to discharge obligation** resembling those created by contract.—When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.

Explanation.—In estimating the loss or damage arising from a breach of contract, the **means which existed to remedy the inconvenience** caused by the non-performance of the contract must be taken into account.

Illustrations

(a) A contracts to sell and deliver **50 maunds** of saltpetre to B, at a certain price to be paid on delivery. A breaks his promise. B is entitled to receive from A, by way of compensation, the sum, if any, by which the contract price falls short of the price for which B might have obtained 50 maunds of saltpetre of like quality at the time when the saltpetre ought to have been delivered.

(b) A hires B‟s ship to go to Bombay, and they take on board, on the first of January, a cargo, which A is to provide, and to bring it to Calcutta, the freight to be paid when earned. B‟s ship does not go to Bombay, but A has opportunities of **procuring suitable conveyance for the cargo upon terms as advantageous**

as those on which he had chartered the ship. A avails himself of those opportunities, but is put to trouble and expense in doing so. A is entitled to receive compensation from B in respect of such **trouble and expense**.

(c) 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.

In action for damages for the breach of contract, there arise two kinds of problems-

1. Whether the loss suffered is proximate consequence of the breach of contract by the defendant: **Remoteness of Damage**
2. How much compensation to be paid: **Measurement of Damage**

B. Quantum Meruit

Ordinarily, if a person, having agreed to do some work or render some services, has only done a part of what he was required to do, he cannot claim anything for what he has done. When a person agrees to complete some work for a lump sum, non-completion of the work does not entitle him to any remuneration even for the part of the work done. But the law recognizes an important exception to this rule by way of an action for 'Quantum Meruit.' Under this action, if A and B have entered into a contract, and A who has already performed a part of the contract, is then prevented by B from performing the rest of his obligation under the contract, A can recover from B reasonable remuneration for whatever he has already done (*Appleby v Myers).*

It may be noted that this action is not an action for compensation for the breach of contract by the other side. It is an alternative to an action for breach of contract. This action in essence is one of restitution, putting the party injured by the breach of contract in a position in which he would have been, had the contract not been entered into.

The essentials of such an action are

1. One of the parties makes a **breach** of contract, or **prevents the performance** of it by the other side
2. The party injured by the breach of the contract, who has **already performe**d a part of it, elects to be discharged from further performance of the contract and brings an action for recompensation for the value of the work he has already done.

For instance, if A agrees to deliver B 500 bags of wheat and when A has already delivered 100 bags, B refuses to accept any further supply, A can recover from B the value of wheat which he has already delivered

In *De Bernardy v Harding,* the D, who was to erect and let seats to view the funeral of the Duke of Wellington appointed the plaintiff as his agent to advertise and sell tickets for the seats. The P was to be paid a commission on the tickets sold by him. The P incurred some expense in advertising for the tickets but the authority was wrongfully revoked by the D. The p was entitled to recover the expenses.

This principle is often applied where for some technical reason a contract is held to be invalid. Under such circumstances, an implied contract is assumed, by which the person for whom the work is to be done contracts to pay reasonably for the work done to the person who does the work. The provisions of **Section 70** of Contract Act are based on this principle, but the provisions of the Contract Act admit of more liberal interpretation, being wider than the principle of quantum meruit.

C. Specific Performance

The Specific Relief Act provides for specific reliefs. Specific performance is generally granted when there exists no standard for ascertaining actual damage, for instance when the object of sale is pictured by a painter, or where compensation in money will not provide adequate relief to the plaintiff.

- Recovery of specific **immovable** property: **Section 5**
- **Suit** by person dispossessed of immovable property: **Section 6**
- Recovery of specific **movable** property: **Section 7**
- Liability of person in possession, not as owner to **deliver to persons entitled to immediate** possession: Sec 8
- **Defences** available under law of contract can be availed - **Sec 9**

D. Injunction [Sections 36-44]

- Temporary Injunctions - **Sec 37 (1)**
- Perpetual injunction - **Sec 37 (2) and 38**
- Prohibitory Injunction- **Sec 38**
- Mandatory Injuntion- **Sec 39** : compel the performance or omission

Q.2. "Section 74 of the Indian Contract Act, 1872 has cut down the most troublesome knot of common law doctrine of awarding damages." Discuss the statement. [20M]

Section 74. Compensation for breach of contract where penalty stipulated for.—1 [When a contract has been broken, if a **sum is named in the contract** as the amount to be paid in case of such breach, or if the contract **contains any other stipulation by way of penalty,** the party complaining of the breach is entitled, **whether or not actual damage or loss is proved** to have been caused thereby, to receive from the **party who has broken the contract** reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.

Explanation.—A stipulation for **increased interest** from the date of default may be a stipulation by way of penalty.]

Exception.—When any person enters into any **bail-bond**, recognizance or other instrument of the same nature, or, under the provisions of any law, or under the orders of the 2 [Central Government] or of any 3 [State Government], gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the **whole sum** mentioned therein.

Explanation.—A person who enters into a contract with the Government **does not necessarily thereby undertake any public duty,** or promise to do an act in which the public are interested.

Illustrations

(a) A contracts with B to pay B 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.

(b) A contracts with B that, if A practises as a surgeon within Calcutta, he will pay B Rs. 5,000. He practices as a surgeon in Calcutta. B is entitled to such compensation; not exceeding Rs. 5,000, as the Court considers reasonable.

(c) A gives a recognizance binding him in a penalty of Rs. 500 to appear in Court on a certain day. He forfeits his recognition. He is liable to pay the whole penalty.

(d) A gives B a bond for the repayment of Rs. 1,000 with interest at 12 per cent. 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. 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.

In *TK Sundaram v Co-operative Sugars Ltd,* the appellant agreed to supply 125 tonnes of sugarcane to the respondents with a stipulation that in default, he would pay a penalty of Rs 50/ton. The amount of penalty so fixed was considered to be liquidated damages because there was nothing to indicate that the amount was unconscionable.

The pronouncements of the Constitution Bench in *Sir Chunilal v Mehta & Sons Ltd v Century Spinning and Manufacturing Co Ltd* and later in *Fateh Chand v Balkishan Dass* hold the field.

The first important judgment of this Court on the question of Sections 73 and 74 of the Contract Act is that of the Constitution Bench in *Chunilal v Mehta.* The two significant issues which arose were

First, as to what would constitute a substantial question of law requiring the grant by the HC of a certificate to appeal to this court and

Secondly, the **quantum of damages t**hat can be awarded in that case owing to the breach of the subject contract. It is the second question which is relevant for the present purposes.

The admitted position was that the contract had been wrongfully breached by the D. A clause in the contract between the parties stipulated that in these circumstances the P would be entitled to receive from the D a sum equal to a certain aggregate amount. The constitution bench opined that '**when parties name** a sum of money to be paid as liquidated damages, they must be deemed to **exclude the right to claim an unascertained sum** of money as damages. Where the parties have deliberately specified the amount of liquidated damages, **there can be no presumption that they, at the same time,** intended to allow the party who has suffered by the breach to claim instead a sum of money which was not ascertained or ascertainable at the date of the breach.' This precedent prescribes that if a liquidated sum has been mentioned in a contract, the said amount would be the maximum and upper limit of damages awardable by the Trial Court.

The judgment of the Constitution Bench one year later, in *Fateh Chand v Balkishan Dass* concerns award of damages of the 'liquidated' sum even though actual damages may have been less. The Constitution Bench opined as follows:

'Sec 74 deals with the measure of damages in two classes of cases

Where the contract names a sum to be paid in **case of a breach** and

Where the contract contains **any other stipulation by way of penalty**

In assessing damages the Court has, **subject to the limit of the penalty** stipulated, jurisdiction to award such compensation as it deems **reasonable** having regard to all the circumstances of the case. The Section undoubtedly states that the aggrieved party is entitled to receive compensation from the party who has broken the contract whether or not actual damage or loss is proved to have been caused by the breach.

Thereby it merely **dispenses with proof of actual loss** or damage; it **does not justify** the **award of compensation when no legal injury** at all has resulted.

Duty not to enforce the penalty clause but only to award reasonable compensation is statutorily imposed upon Courts by Section 74. In all cases, therefore, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the court has justification to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture.

In the instant case the Bench found that the value of the property had not depreciated and therefore, no damages could be awarded.

This is also the manner in which this facet of the law has been enunciated in England according to **Halsbury's Laws of England.** According to this, the position stands as:

- In the event of breach the party in default shall pay the stipulated sum of money **per-estimated** (agreed damages) called 'liquidated damages'
- If however the stipulated sum is not a genuine pre-estimate of the loss but is in the nature of a in **penalty intended** to secure performance of the contract then it is not recoverable, and the **plaintiff must prove what damages** he came
- The operation of the rule against penalties **does not depend** on the *discretion of the Court, or on improper conduct, or on circumstances of disadvantage or ascendancy, or on the general character or relationship of the parties.*
- The rule is one of public policy and appears to be sui generis. Its absolute nature inclines the Courts to invoke the **jurisdiction sparingly.**

The position in the **United States,** obviously because of its Common Law origins and adherence is essentially identical. It also finds elucidation in the **American Restatement (Second) of Contracts 1981.**

Q.3. "The object of awarding damages for a breach of contract is to put the injured party in the same position, so far as money can do it, as if he had not been injured." In the light of the above statement, explain the various kinds of damages that the court can award. Also explain the rules relating to assessment of damages. [20M]

Chapter VI Sections 73-75 of the Indian Contract Act, 1872, define remedy by way of damages as the entitlement of the suffering party to recover compensation for losses suffered due to non-performance of the contract. The damages can be of the following types:

1] Ordinary damages On the breach of a contract, the suffering party may incur some damages arising naturally, in the usual course of events. Even if the suffering party knew about the likely damages if the contract was breached, he can claim compensation for such losses. Peter agrees to sell and deliver 10 bags of potatoes to John for Rs 5,000 after two months. On the date of delivery, the price of potatoes increases and Peter refuses to perform his promise. John purchases 10 bags of potatoes for Rs 5,500. He can receive Rs 500 from Peter as ordinary damages arising directly from the breach.

2] Special Damages: A party to a contract might receive a notice of special circumstances affecting the contract. In such cases, if he breaches the contract, then he is liable for the ordinary damages plus the special damages. Eg. Peter hired the services of John, a goods transporter, to deliver a machine to his factory urgently. He also informed John that his business has stopped for want of the machine. However, John delayed the delivery of the machine by an unreasonable amount of time. Peter missed out on a huge order since he didn't have the machine with him.In this case, Peter can claim compensation from John. The compensation amount will include the amount of profit he could have made by running his factory during the period of delay. However, he cannot claim the profits that he would have made if he got the contract since John was not made aware of the same.

3] Vindictive or Exemplary Damages There are two scenarios for awarding vindictive or exemplary damages:

- Breach of a promise to marry because it causes injury to his/her feelings
- Wrongful dishonour of cheque by a banker because it causes loss of reputation and credibility. In case of a wrongful dishonour of cheque from a businessman, the compensation will include exemplary damages even if he has not suffered any financial loss. However, a non-trader is not awarded heavy compensation unless the damages are alleged and proved as special damages. Example: Peter is a farmer. He issues a cheque for procuring seeds for his next crop. He has sufficient funds in his account but the bank erroneously dishonours the cheque. Peter files a suit claiming compensation for damages to his reputation. The Court awards a nominal amount as damages since Peter is not a trader.

4] Nominal Damages: If a party to a contract files a suit for losses but proves that while there has been a breach of contract, he has not suffered any real losses, then compensation for nominal damages is awarded. This is done to establish the right to a decree for a breach of contract. Also, the amount can be as low as Re 1.

5] Damages for Deterioration caused by Delay: In cases where goods are being transported by a carrier and he delays the delivery of goods causing them to deteriorate, the affected party can file a suit for damages for deterioration by the delay. Deterioration can mean physical damage to the goods and/or loss of a special opportunity for sale.

6] Pre-fixed damages: During the formation of a contract, the parties might stipulate payment of a certain amount as compensation upon the breach of the contract. This amount can be a reasonable estimate of the likely loss in case of a breach or a penalty.

Under Section 74 of the Indian Contract Act, 1872, it is specified that if an amount is mentioned in a contract as the sum to be paid in case of a breach, then the suffering party is entitled to reasonable compensation, not exceeding the amount specified.

RULES

In action for damages for breach of contract, there arise two kinds of problems:

1. Remoteness of Damage: Whether the loss suffered by the Plaintiff is the proximate consequence of the breach of contract by the defendant. The person making the breach is liable only for the proximate consequences of the breach and not the damage which is remotely connected with the breach of contract.
2. Measurement of damage: This involves determining the quantum of compensation.

Remoteness of Damage

The provisions contained in Section 73 (para 1) is similar to rule contained in the judgment of *Hadley v Baxendale.* The rule in *Hadley v Baxendale* consists of two parts. On the breach of a contract such damages can be recovered:

As may fairly and reasonably be considered arising naturally ie according to the usual course of things from such breach or

As may reasonably be supposed to have been in the contemplation of both the parties at the time they made the contract.

In either case, it is necessary that the resulting damage is the probable result of the breach of contract. The principle stated in the two branches of the rule is virtually the rule of 'reasonable foresight.'

First branch of the rule in *Hadley v Baxendale:* Damage arising in the usual course of things.

Under this branch of the rule, compensation can be claimed for any loss or damage that arose in the usual course of things from the breach of contract.

Facts of the ase: The P's mill had been stopped due to the breakage of a crankshaft. The broken shaft had to be sent to the makers at Greenwich as a pattern for preparing the new one. The D, who were common carriers, agreed to carry the broken shaft to Greenwich. The only information given to the carriers was that the article to be carried wwas the broken shaft of a mill and the P were the millers of that mill. Owing to the D's negligence the delivery of the shaft was delayed. Thus the mill remained stopped for a longer time. The P brought an action to recover damages for the loss of profits due to delay.

Held: It could not be contemplated that the mill would be stopped in the usual course of things, by snending the shaft as the millers might have another shaft in reserve. Moreover, the special circumstances were not communicated by the P to the D. The P were therefore not entitled to recover the loss.

TOPIC 7: Contract of indemnity, guarantee and insurance

Q. A contract by which one party promises to save the other from loss caused to him by the conduct of the promise sir himself or by the conduct of any other person, is called, a contract of indemnity. Explain. [15M]

According to the dictionary meaning, indemnity is protection against loss, especially in the form of a promise to pay, or payment for loss of money, goods, etc. It is a security against, or compensation for loss, etc. In a contract of indemnity, the person who promises to indemnify is known as 'indemnifier' and the person in whose favour such a promise is made is known as 'indemnified' or indemnity holder.'

CHAPTER VIII OF INDEMNITY AND GUARANTEE

Section 124. "Contract of indemnity" defined.—A contract by which **one party promises to save the other** from **loss caused to him** by the **contract** of the promisor himself, or by the **conduct** of any other person, is called a "contract of indemnity".

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 200 rupees. This is a contract of indemnity.

This provision incorporates a contract where one party promises to save the other from loss which may be caused either:

By the **conduct of the promisor** himself or

By the **conduct of any other person**

This definition covers indemnity for loss caused by **human agency only.** It does not deal with those classes of cases where the indemnity arises from loss caused by **events or accidents** which do not or may not depend upon the conduct of the indemnifier or any other person, or by reason of liability incurred by something done by the indemnified at the request of the indemnifier.

Insurance Contract, if contract of indemnity: It has been noted above that Section 124 recognizes that only such a contract as a contract of indemnity where there is a promise to save another person from loss which may be caused by the conduct of a human agency itself is covered. Therefore, a contract of insurance is not covered by the definition of Section 124. Thus, if under a contract of insurance, an insurer promises to pay compensation in the even of loss by fire, such a contract does not come within the purview of Section 124. Such contracts are valid contracts, as being contingent contracts as defined in Section 31.

Rights of the indemnity holder.

In a suit against the indemnity holder, he may have been compelled to pay damages, and incurred costs etc. In his own turn, he can bring an action against the promisor (indemnifier) to recover damages and costs, etc paid by him if the indemnifier has promised an indemnity in such a case. The provision in this regard is contained in Section 125.

125. Rights of indemnity-holder when sued.—The promise in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

(1) all **damages** which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all **costs** which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;

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

When can an indemnifier be made liable?

There has been a controversy regarding the point as to whether the indemnifier can be asked to indemnify before the indemnity holder has actually suffered the loss or his liability arises only after the loss has been suffered by the indemnity holder.

According to the English Common Law, no action could be brought against the indemnifier until the indemnity holder had suffered **actual loss.** This situation created great hardship in those cases where the indemnity holder was not in a position to meet the claim out of his pocket. Relief was provided to the indemnity holder in such cases by the **Court of Equity.**

According to the rules evolved by the Court of Equity, it was no longer necessary for the indemnity holder to be demnified before he could be indemnified. In other words, the indemnity holder can now compel the indemnifier to save him from the loss in respect of liability against which indemnity has been promised.

According to the view expressed by **Lahore and Nagpur** HC, a person must be demnified before he can be indemnified, i.e. no indemnity can be claimed until the indemnity holder has already actually suffered the loss.

The HC of **Bombay, Calcutta, Madras, Patna and Allahabad** have expressed a different view and they are in favour of the application of law similar to the one recognized in England by the Court of Equity.

Referring to the equitable principle and also the desirability of its being followed in India, Justice Chagla (Bombay HC), while delivering the judgment in *Gajanan Moreshwar v Moreshwar Madan* observed that, Sections 124 and 125 of the contract Act are not exhaustive of the law of indemnity and the Courts would apply the **same equitable principle** that the Courts in England do. Therefore, if the indemnified has incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and to pay it off.

The LC of India has expressed the opinion that the view expressed by Justice Chagla is correct and should be adopted in the legislature (13th Report 1958). The LC recommended that as in English law, the right of the indemnity holder should be more fully defined and the remedies of an indemnity holder should be indicated even in cases where he has not been sued.

According to Anson, "Contract of insurance bears a certain superficial resemblance to wagering agreement but they are really transaction of different nature". Elucidate [10M] Carlill case

Q. "A surety is said to be discharged from liability when his liability comes to an end. 'Throw light on the statement with relevant legal provision under the Indian Contract Act, 1872. [10M]

A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The **person who gives the guarantee is called the "surety"**; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written. **[Section 126 of ICA]**

Liability of Surety- Its nature and extent:

According to **Section 128,** The liability of the surety is **co- extensive with that of the principal** debtor, unless it is otherwise provided by the contract.

Illustration A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonored by C. A is liable, not only for the amount of the bill, but also for any interest and charges which may have become due on it.

If the principal debtor's liability is reduced, the liability of the surety is also reduced accordingly. In *Narayan Singh v Chattarsingh* it has been held that if the PD's liability is scaled down in an amended decree or extinguished in whole or in part, the liability of the surety would also *pro tanto* be reduced or extinguished.

Facts: The liability of the agriculturist, the PD was scaled down under the Rajasthan Relief of Agricultural Indebtedness Act 1956. The surety's liability was also reduced. The reason is that if the surety is made liable for the full amount, he in his turn will become entitled to recover the same front eh PD and this will eventually negatively affect the benefit conferred upon the agriculturist PD under the statute.

Discharge of surety from liability:

1. Revocation by the surety - Sec 130
2. By surety's death - Se 131
3. By variance in the terms of the contract- Sec 133
4. By release or discharge of PD - Sec 134
5. When creditor compounds with, gives time to, or agrees not to sue, the PD - Sec 135
6. By creditor's act or omission impairing surety's eventual remedy - Sec 139

7. By loss of the security by the creditor - Sec 141

1. By revocation by the surety (Sec 130)

Sec 130. Revocation of continuing guarantee.—A continuing guarantee may at any time be revoked by the surety, **as to future transactions, by notice** to the creditor.

Illustrations (a) A, in consideration of B‟s discounting, at A‟s request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

This section permits revocation of guarantee by the surety:

When it is a continuing guarantee and

As regards future transactions only

In *Offord v Davies,* A promised in favour of B that if B discounted the bill for C, A would guarantee the payment of bills to the extent of 600 pounds during a period of 12 calendar months. Some bills were discounted by B and the payment for the same was made. Thereafter A gave notice to B that A would no more guarantee the discounting of any bills. In spite of the notice, B continued to discount the bill. It was held that A could not be made liable as a surety for the B's bills after A's notice.

2. By Surety's death (Sec 131)

131. Revocation of continuing guarantee by surety's death.—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.

There may however be no revocation on the death of the surety if there is a contract to that effect. For eg if it is stipulated that on the death of the surety, his property or his legal representatives will be responsible for such liability.

3. By variance in the terms of contract- Sec 133

133. Discharge of surety by variance in terms of contract.—Any variance, made without the surety‟s consent, in the terms of the contract between the principal 1 [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations

(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) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then, existing debts between B and C. A is not liable on his guarantee for any goods supplied after: this new arrangement.

(e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays the 5,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, inasmuch as C might sue B for the money before the 1st of March.

In *Bonar v Macdonald,* the Defendant was a surety for the conduct of a bank manager. Subsequent to this agreement, the bank enhanced the manager's salary and the manager agreed to be liable for ¼ of the losses on discounts allowed by him. This arrangement between the bank and its manager had been made without knowledge of the surety. It was held that this arrangement resulted in the discharge of surety.

4. By release or discharge of the PD (Sec 134)

134. Discharge of surety by release or discharge of principal debtor.—The surety is discharged by any contract between the **creditor and the principal debtor,** by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A‟s land and to deliver it to B at a fixed rate, and C guarantees A‟s performance of this contract. B diverts a stream of water which is necessary for the irrigation of A‟s land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) 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.

5. When creditor compounds with, gives time to, or agrees not to sue the PD - Sec 135

135. Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor.—A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

According to this Section, a contract between the creditor and the PD discharges the surety in the following three circumstance:

When the creditor makes composition with the PD: For eg, A borrows Rs 10,000 from B. C stands as a surety as regards the repayment of loan by A to B. Thereafter A and B agree that A may repay Rs 5000 instead of Rs 10000. C is thereby discharged from liability as a surety.

Creditor promising to give time to the PD: Not contemplated in the contract of guarantee. In *Kurian v The Alleppey CCMS Society,* the creditor filed a suit against the debtor for the recovery of some money due for the debtor. Then there was a compromise according to which the debtor was allowed to pay the decretal money within nine months from the date of compromise without the knowledge or consent of the surety. It was held that the surety was discharged from liability

Creditor promising not the sue the principal debtor

- Mere forbearance to sue not enough: **137. Creditor's forbearance to sue does not discharge surety.**—Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety. Illustration 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 his suretyship.

6. By creditor's act or omission impairing surety's eventual remedy- Sec 139

139. Discharge of surety by creditor's act or omission impairing surety's eventual remedy.—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.

Illustrations

(a) B contracts to build a ship for C for a given sum, to be paid by installments as the work reaches certain stages. 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 installments. A is discharged by this prepayment.

(b) C lends money to B on the security of a joint and several promissory note made in C‟s favour by B, and by A as surety for B, together with a bill of sale of B‟s furniture, which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realized. A is discharged from liability on the note. (c) A puts M as apprentice to B, and gives a guarantee to B for M‟s fidelity. B promises on his part that he will, at least once a month, see M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

In *State of MP v Kaluram* the State of MP made a contract for the sale of 'felled trees' with one Jagat Ram who was the highest bidder in the auction sale. The payment was to be made by installments. Kaluram was a surety for the payment. The purchaser failed to pay the second and subsequent instalments. It was held that since the SG had failed to take necessary steps to recover the amount from the purchaser by allowing him to take away the trees, the surety's remedy had been impaire, the surety was discharged from his liability.

7. By loss of the security by the creditor - Sec 141

141. Surety's right to benefit of creditor's securities.—A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Illustrations

(a) C, advances to B, his tenant, 2,000 rupees 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 discharged 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.

Q. "'Indemnity' has a relation to the conduct either of the indemnifier himself or of a third party. A 'guarantee' is always related to conduct of a third party". Elucidate [10M]

Contract of Guarantee: Section 126 —A "contract of guarantee" is a contract to p**erform the promise, or discharge the liability,** of a third person in **case of his default.** The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

For eg A takes a loan from a bank. A promise to repay the loan. B also makes a promise to the bank saying that if A does not pay the loan then 'I will pay.' In this case, A is the principal debtor, who undertakes to repay the loan, B is the surety, whose liability is secondary because he promises to perform the same duty in case there is default on the part of A. The bank in whose favor the promise has been made is the creditor.

Main features of the contract of guarantee

1. It may be either **oral or in writing**
2. There should be a **principal debt:** Without this, it would amount to a contract of indemnity.

   Thus when A and B go to a shop, A purchases goods and B tells the seller 'if A does not pay you, I will,' it is a contract of guarantee. On the other hand if A is not the principal debtor, only B makes a promise to the shopkeeper to pay for instance, tells the shopkeeper, 'Let A have the goods, I will be the paymaster,; it is a contract of indemnity.'

Benefit to the PD is sufficient consideration: For the surety's promise, it is not necessary that there should be direct consideration between the creditor and the surety, it is enough that the creditor had done something for the benefit of the principal debtor.

127. Consideration for guarantee.—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

(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 a sufficient consideration for C‟s promise.

(b) A sells and delivers goods to B. C afterwards requests A to **forbear to sue** B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C‟s promise.

(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

Consent of the surety should not have been obtained by **misrepresentation or concealment- Sec 142.** Guarantee obtained by misrepresentation invalid.—Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

<u>Distinction between Contracts of Indemnity and Guarantee</u>

1. **Parties:** There are **two** parties in a contract of I- indemnifier and the indemnity holder or the indemnified.

   There are **three** parties in a contract of guarantee, the creditor, the PD and the surety.

Contract: CoI consists of only **one** contract under which the indemnifier promises to indemnify the indemnified in the event of a certain loss.

There are **three** contracts in a CoG. One contract is between the PD and the creditor in respect of a certain promise or obligation undertaken to be performed by the PD. By a second contract, the surety undertakes to perform the same obligation which the pd has undertaken. The third contract, which is an implied one, is between the pd and the surety. It means that after the surety is discharged from his obligation, he is invested with all the rights which the creditor had against the pd.

Object: The object of the CoI is to protect the promisee against some likely loss. The object of a CoG is the security of the creditor. It presupposes a PD and a certain debt of obligation for which the PD is primarily liable.

Liability: In a CoI the liability of the indemnifier is a primary one. He undertakes to be liable when the contemplated situation is there. In a CoG, the liability of the surety is only a secondary one. It arises only when the PD makes a default.

Subjugation: In a CoI the loss falls on the indemnifier and therefore after he has indemnified the indemnity-holder he cannot recover the amount from anybody. In a CoG, after the surety had discharged his liability and paid to the creditor, he steps into the shoes of the creditor and he can realise the payments made by him, from the PD.

England: In England, a CoI may be either oral or in writing whereas a CoG should be in writing. There is no such distinction in India. Whether it is a contract of I or G, the same may be either oral or in writing.

Thus when A and B go to a shop, A purchases goods and B tells the seller 'if A does not pay you, I will,' it is a contract of guarantee. On the other hand if A is not the principal debtor, only B makes a promise to the shopkeeper to pay for instance, tells the shopkeeper, 'Let A have the goods, I will be the paymaster,; it is a contract of indemnity.'

Q. The very object of taking a surety is defeated, if the creditor is required to postpone his remedies is against the surety. Explain the liability of the surety. [15M]

According to **Section 128**, 'The liability of the surety is coextensive with that of the principal debtor.'

Narayan Singh v Chattarsingh

Thus, the liability of the surety is joint and several with the PD. It means that if the PD makes a default ie he fails to perform his obligation, the creditor can sue either the PD, or the surety or both of them.

In *Bank of Bihar v Damodar Prasad,* it was held that 'before payment the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance. In the

absence of some special equity, the surety has no right to restrain an action against him by the creditor on the ground that the principal is the solvent or that the creditor may have relief against the principal in some other proceedings.'

Facts: The plaintiff bank lent money to the defendant on the guarantee of the surety. Despite demands by the bank, the loan was neither reparid by the PD nor the surety. The bank then filed a suit against both the PD and the surety. A decree was passed in favour of the bank but with the condition that the plaintiff bank shall be at liberty to enforce dues against the surety only after having exhausted its remedies against the PD. in its appeal before the SC the p bank challenged the validity of the condition in the decree. It was held that the Appellant Bank was at liberty to recover the loan amount jointly and severally from all the Defendants.

Liability on surety's ability to contract: It has already been noted that Section 128 declares that the liability of the surety is coextensive with that of the PD, unless it is otherwise provided by the contract. It means that if the contract between the parties so provides surety's liability may not be there to the full extent as that of the PD but smaller than that. Thus if the surety undertakes to be liable to the extent of 250 pounds, his liability is limited to that extent. [*Hobson v Bass*]

RIGHTS OF SURETY

Rights against the PD

1. **Right of Subrogation (Section 140)**

   140. Rights of surety on payment or performance.—Where a guaranteed debt has become **due, or default** of the principal debtor to perform a guaranteed duty has taken place, the **surety upon payment or performance** of all that he is liable for, is **invested with all the rights which the creditor** had against the principal debtor.

Right of indemnity against the PD (Section 145)

> **145.** Implied promise to indemnify surety.—In every contract of guarantee there is an **implied promise by the principal debtor** to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

Illustrations (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, 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 drawn by B upon A to secure the amount. 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. He 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, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

In *CK Aboobacker v KP Ayishu,* it has been held that a guarantor is liable for any payment or performance only to the extent the PD has defaulted. If a substantial portion of the loan has been paid by the PD, the guarantor is to pay only the balance due. After the surety has paid the amount the PD should indemnify the surety for everything the surety has rightfully paid under the contract of guarantee.

Rights against the Creditor

Right to securities with the creditor- Sec 141

141. Surety's right to benefit of creditor's securities.—A surety is entitled to the benefit of every security which the **creditor has against the principal debtor** at the time when the contract of suretyship is entered into, **whether the surety knows of the existence** of such security or not; and if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Illustrations

(a) C, advances to B, his tenant, 2,000 rupees 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 discharged 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.

Securities received by the creditor after the contract of guarantee: A surety is entitled to the benefit of the security which the creditor has at the time when the contract of suretyship is entered into. On this point the English law is different. According to the English law, a surety is entitled to the benefit of even those securities which the creditor had received after the making of the contract of guarantee.

Surety has no right to goods in hypothecation: In case of hypothecated goods, the creditor does not have the possession of the goods, the surety cannot invoke the provisions of Section 141 of such a case.

TOPIC 8: CONTRACT OF AGENCY

Q. What are the essentials of an agency? How is an agency created and terminated under the Indian Contract Act, 1872? [20M, 2022]

Section 182 defines the terms 'agent' and 'principal' as follows:

An agent is a person employed to do any act for another or to represent another in dealings with third person.

The person for whom such act is done, or who is so represented is called the principal.

ESSENTIALS OF AGENCY

1. Intention to create agency relationship: In ***Sakthi Sugars Ltd v UOI*** it was held that the State Trading Corporation, which is a legal entity when permitted to export sugar, does not become the agent of Union of India, while exercising that commercial function.
2. The principal should be competent to contract (Sec 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.
3. The agent may not be competent to contract (Section 184):

- The capacity to act so as to bind his principal and third person: Any person may become an agent
- Agent's capacity to bind himself to the principal: Necessary that the agent should also be competent to contract

No consideration is necessary to create an agency (Section 185): From the very nature of the contract of agency, the principal agrees to be bound by the acts done by the agent on his behalf and that serves as a sufficient detriment to the principal. Moreover the principal's duty to indemnify the agent is also there. The law does not require any consideration as such for the validity of a contract of agency.

HOW IS AGENCY CREATED

1. By actual authority being conferred on the agent to act on behalf of the principal. Such authority may be either express or implied: Section 187 defines express and implied authority as under-

    - Express authority: when it is given by words spoken or written
    - Implied: When it is to be inferred from the circumstances of the case. Sec 188 explains the extent of the authority as the authority to do every lawful thing necessary for the purpose.

By agent's authority to act on behalf of the principal in a situation of 'Emergency': Sec 189: 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.

By the conduct of the principal which creates an agency on the basis of the Law of Estoppel: whereby the principal by his conduct creates an impression in the mind of the third person that the agent has an authority to act on his behalf, the principal is liable towards the third person for the acts done by the agent (Sec 237)

By ratification of the agent's act by the principal even though the same has been done without the principal's prior authority (Sec 196-200)

- Act should be done on behalf of another person (Sec 196)
- The principal should be in existence and competent to contract when the act is done
- Ratification may be express or implied (Sec 197)
- Ratification should be with full knowledge of the facts (Sec 198)
- Ratification should be of the whole transaction (Sec 199)
- Ratified acts should not be injurious to third person (Sec 200)
- Ratification should be made within a reasonable time

By presumption of agency in Husband-Wife relationship: When a man and woman are living together and they appear to be husband and wife to a third person, the woman will be able to bind the man in the same way as if she was his wife [*Debenham v Mellon*]

TERMINATION OF AGENCY

1. By revocation of agent's authority

Revocation may be express of implied -Sec 207

No revocation of agency when agent has interest in the subject matter- Sec 202

Revocation possible before the authority has been exercised- Sec 203

Revocation when authority has been partly exercised- Sec 204

Principal to compensate, if there is premature revocation without justification- Sec 205

Principle should give reasonable notice of revocation- Sec 206

By renunciation of the business of agency by the agent

By the completion of the business of agency

By the death or insanity of either the principal or the agent

By insolvency of the principal

Q. "Agency in law connotes an authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties." Critically discuss the concept of 'agency'. Explain the duties of an agent to principal [20M], 2006]

Q. In legal Phraseology 'every person who acts for another is not an agent.' Comment. [10M]

Chapter X Agency: Section 182- An "agent" is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the "principal".

Test for determining the existence of agency

In **Loon Karan Sohanlal v. John & Co**.[9], Dhawan J. of the Allahabad High Court put forward the test for determining whether there exists the relationship of agency. He explained that in American Jurisprudence it is clearly mentioned that mere use of the words **agent** and **agency** does not by itself create a relationship of agency and the same law is followed in India. He added that it has been held in several decisions that just because the parties have named their relationship as **agency** is not a conclusive proof unless the incidence of this relationship, as disclosed by evidence, justifies a finding of agency. He also said that the courts, while examining the evidence, must try to find out the true nature of the relationship and the functions and powers assigned to the so-called agent.

Applying this test, it was held that a **procurement agent** is not an agent in the legal sense of the term as he does not represent another and is directed to do an act on a commission[10].

For the creation of a legally valid contract of agency, there are certain requirements that need to be fulfilled.

The Indian Contract Act[11] provides that in order to take up the role of a principal, a person should have attained the age of majority according to the law to which he is subject and should be a person of a sound mind.

Another point highlighted by this act is that a minor cannot take up the position of a principal. This is based on the simple logic that since a minor cannot enter into a contract, the appointment of an agent by him under a contract of agency would also be void[12].

However, there are certain exceptions to this rule. In cases where the minor is capable of binding himself by the contract, he may appoint an agent to enter into a contract on his behalf[13]. Moreover, there is nothing in this act that prevents the guardian of a minor from appointing an agent for him[14]. Also, no consideration is necessary for a contract of agency[15].

As far as the question whether it is compulsory for an agent to be competent to contract is concerned, it is clearly mentioned in section 184 that **as between the principal and third persons any person may become an agent**. This is mainly because an agent under ordinary circumstances incurs no personal liability while acting on behalf of his principle and thus it is not compulsory that he should be competent to contract[16].

Same is the condition under the English law where it is possible for a person to contract through a minor but the minor will not be responsible to his principal[17]. In case of a company, it may act as an agent beyond its capacity[18]

Whenever a contract of agency is entered into, it is the principal and the agent who predetermine their mutual rights and obligations. Their mutual undertakings may be expressed or implied as can be inferred to a greater or less extent, from the nature and the circumstances of the particular agency. The obligations that are peculiar of certain categories of agents, such as factors and brokers, are defined by their usage. However, there exist certain duties of general nature that are generally imposed by law upon every agent unless excluded or modified by a special contract. We shall now be dealing with some of such duties in detail.

Q.1. "Contract of agency is revocable like an ordinary contract, but sometimes it is impossible to repudiate it."Analyze with the help of decided cases and relevant provisions [10M]

Chapter X Agency: Section 182- defines the term 'agent' and 'principal'. In an agency one person (principal) employs another person (agent) to represent or act on his behalf.

Contract of agency is revocable:

Sec 201 mentions various modes of the termination of agency of an agent

1. By revocation of agent's authority
2. By renunciation of the business of agency by the agent
3. By the completion of the business of agency
4. By the death or insanity of either the principal or the agent
5. By insolvency of the principle

Sometimes it is impossible to repudiate it:

The instances where an agency cannot be repudiated are

1. No revocation when agent has interest in the subject matter- Sec 202
2. Revocation when authority has been partly exercised (Sec 204): there can be no revocation for acts already done

Furthermore principal to compensate if there is premature revocation without justification (Sec 205)

In *Birat Chandra v Taurian Exim Pvt Ltd* where interest was created in favour of power of attorney holder Sec 202 was attracted.

Hence sometimes agency is impossible to repudiate.

Q.2. "If a person falsely represents that he is an agent of another, the principal may ratify the act even though the same was done without his authority." Discuss, in the light of the above statement, the essentials of valid ratification and its effect. [15M]

Section 196. Right of person as to acts done for him without his authority. Effect of ratification.— 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.

When an act has been done by one person on behalf of another though without his authority or knowledge, the person on whose behalf the act is done has the following options:

Disown the act

Ratify the same.

On ratification, the principal **becomes bound** by the act.

<u>Essentials of valid ratification</u>

1. The act should be done **on behalf** of another person- **Sec 196**
2. The **principal should be in existence**, and competent to contract when the act is done
3. Ratification may be **express or implied - Sec 197**
4. Ratification should be with **full knowledge** of the facts- **Sec 198**
5. Ratification should be of the **whole** transaction- **Sec 199**
6. Ratified acts should **not be injurious to third** person- Sec 200
7. Ratification should be made within a **reasonable time.**

1. Act done on behalf of another: It is necessary that the same has been done on behalf of the person who seeks to ratify the same. A person cannot ratify an act done on behalf of his **wife** (*Saunderson v Griffiths).*Similarly, if an **agent acts on his own account,** such an act cannot be ratified by another person.

   In *Keighley, Maxsted & Co. v Durant* the plaintiff instructed Roberts to buy wheat on a joint account at a certain rate. Wheat was not available to Roberts at that rate, so he purchased wheat at a slightly higher rate. It was purchased by Roberts on his own account only. The plaintiff purported to ratify the agreement but subsequently, when the price fell, refused to take delivery of wheat. It was held that they could not be made liable because the act by Roberts not have been done on their behalf, purported ratification by them was ineffective.

Principal should be in existence and competent to contract: When a principal ratifies an act, the validity of the act relates back to the time of doing the act by the agent. The act is as valid as if the same had been done with the prior authority of the principal. In *Kelner v Baxter* the promoters of a company, which had not yet been formed entered into a contract on behalf of the company. After the company was formed, it ratified the contract. Then the company went into liquidation. An action was brought against the promoters to make them liable on the contract. They tried to avoid their liability by pleading that after the contract made by them had been ratified by the company, their liability was over. It was held that since the company was in existence at the time of doing of the act, the purported ratification was a nullity, and therefore the liability of the promoters continued in spite of ratification.

Ratification may be express or implied- Sec 197

This may be explained by the following illustrations:

(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 for him by A. (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

Ratification with full knowledge of facts- Sec 198

No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective. In *Savery v King* A entered into a mortgage agreement on B's behalf. The agreement was invalid. Without knowing this fact, B purported to ratify the transaction. It was

held that since B was not knowing about the invalidity of agreement, the purported ratification of the same by him, was of no effect.

Ratification of the whole transaction- Sec 199

A person ratifying any unauthorized act done on his behalf ratifies the whole of the transaction of which the act formed a part. The object of this provision is that no principal may ratify only those parts of the transaction which are favourable to him, and disown others. If he makes a ratification it is deemed to be the ratification of the whole of the act.

Ratified act should not be injurious to a third person- Sec 200

Section 200. Ratification of unauthorized act cannot injure third person.—An act done by one person on behalf of another, without such other person‟s authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect.

Illustrations

(a) A, not being authorized 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 unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A

Ratification within a reasonable time

Effect of Ratification: The doctrine of relating back

When the principal ratifies an act which has been done on his behalf but without his authority or knowledge, the same effects follow as if the act had been performed with the principal's prior authority.

In *Badri Prasad v State of MP* there was an auction sale of cut timber. A week before the Chief Conservator of Forests ratified the contract, a fire had broken out and the goods purchased by A had been destroyed by fire. It was held that though the formal signature of the competent authority ratifying the

deed of contract had been made after the fire, the contract was deemed to have been made on the date of the auction sale. Therefore B was liable to pay surety.

Q.3. "The revocation of an agent's authority can be made by the principal subject to certain rules." Examine these rules in the light of protection to agents. [15M]

201. Termination of agency.—An agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors.

Various modes of termination of agency are

1. By **revocation** of agent's authority
2. By **renunciation** of the business of agency by the agent
3. By the **completion** of the business of agency
4. By the **death or insanity** of either the principal or the agent
5. By **insolvency** of the principal

Rules of revocation of authority

1. Revocation may be express or implied (Section 207): For eg, A empowers B to let A's house. Afterwards, A lets it himself. Tis is an implied revocation of B's authority. In *RD Saxena v Balaram Prasad Sharma* the Apex court said that the right of the litigant was to be read as the corresponding counterpart of the professional duty of the advocate. Therefore the refusal to return the files to the client when he demanded the same, amounted to misconduct under the Advocates Act. Thus the client losing confidence and faith in the advocate could terminate Vakalatnama and such return of files.

No revocation of agency when agent has interest in the subject matter- Section 202

2. Termination of agency where agent has an interest in subject-matter.—Where the agent has himself an interest in the property which forms the subject-matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Illustrations (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

Revocation possible before the authority has been exercised- Section 203

203. When principal may revoke agent's authority.—The principal may, save as is otherwise provided by the last preceding section, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal.

Revocation when authority has been partly exercised- Section 204

204. Revocation where authority has been partly exercised.—The principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency. Illustrations (a) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A‟s moneys 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. (b) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A‟s moneys 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 can revoke B‟s authority to pay for the cotton.

4. **Principal to compensate if there is premature revocation without justification (Section 205)**

205. Compensation for revocation by principal, or renunciation by agent.—Where there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent, or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause.

Principal should give reasonable notice of revocation (Section 206)

206. Notice of revocation or renunciation.—Reasonable notice must be given of such revocation or renunciation, otherwise the damage thereby resulting to the principal or the agent, as the case may be, must be made good to the one by the other.

Termination of agency terminates sub-agency also (Section 210)

> 210. Termination of sub-agent's authority.—The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent‟s authority) of the authority of all sub-agents appointed by him.

Agent's duty on termination of agency by principal's death or insanity- Section 209

> 209. Agent's duty on termination of agency by principal's death or insanity.—When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

Time from which the termination of agent's authority becomes effective- Section 208

> **208.** When termination of agent's authority takes effect as to agent, and as to third persons.— The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them. Illustrations (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, revoke B‟s authority. B, after the letter is sent, but before he receives it, sells the goods for 100 rupees. The sale is binding on A, and B is entitled to five rupees as his commission. (b) A, at Madras, by letter, directs B to sell for him some cotton lying in a warehouse in Bombay, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Madras. 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 to 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.

It is thus a trite law that so far as third parties are concerned, the law is that the termination of a contract of agency takes effect only from the time the third party obtains knowledge of it and that the third party is not affected unless he has knowledge of such termination.

Q.3. "The liability of the sub-agent towards principal is not direct, except in case of fraud and wilful wrong." Explain giving reasons [10M]

According to **Section 191,** '—A "sub-agent" is a **person employed by**, and acting under the **control** of, the **original agent** in the business of the agency.'

Position when a sub-agent is properly appointed:

Sec 192. Representation of principal by a sub-agent properly appointed.—Where a sub-agent is properly appointed, the principal is, so far as regards third persons, represented by the sub-agent, and is **bound by and responsible** for his acts, as if he were an **agent originally appointed** by the principal.

Agent's responsibility for sub-agent.—The agent is responsible to the principal for the acts of the sub-agent.

Sub-agent's responsibility.—The sub-agent is responsible for his acts to the agent, but not to the principal, except in cases of fraud or wilful wrong.

The following position emerges from the above stated provision:

1. The acts of the sub-agent bind the principal towards the persons: Properly appointed.
2. Responsibility of the agent or sub-agent towards the principal: There is privity of contract only between:

    - Sub agent and agent and
    - Agent and principal

Therefore, the sub-agent is responsible to the agent but he is not directly responsible to the principal. Similarly, the agent is responsible to the principal for the acts of the sub-agent. There is no privity of contract between the sub-agent and the principal and, therefore, he is not personally responsible to the principal.

Position when sub agent is not properly appointed

Sec 193. **Agent's responsibility for sub-agent appointed without authority.—**Where an agent, without having authority to do so, has appointed a person to act as a sub-agent, the agent stands towards such person in the relation of a principal to an agent, and is responsible for his acts both to the principal and to third persons; **the principal is not represented,** by or responsible for the acts of the person so employed, nor is that person responsible to the principal.

Substituted agent: Like a sub-agent, the appointment of a substituted agent is made by an agent. A sub-agent is the agent of the agent whereas a substituted agent is an agent of the principal.

Sec 194. Relation between principal and person duly appointed by agent to act in business of agency.—Where an agent, holding an **express or implied authority** to **name another person** to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent, but an **agent of the principal** for such part of the business of the agency as is entrusted to him.

Illustrations

(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 authorizes 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 is solicitor for A.

195. Agent's duty in naming such person.—In selecting such an 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.

Agent and Substituted agent distinguished

1. A sub agent is the agent's agent whereas a substituted agent is the principal's agent.
2. After appointing a sub-agent, the agent continues to be responsible for the act of the sub-agent towards the principal. An agent's responsibility on the other hand, is over when he names a substituted agent.

Principal's liability for agent's fraud, misrepresentation and torts (Sec 238)

238. Effect, on agreement, of misrepresentation of fraud, by agent.—Misrepresentation made, or frauds committed, by agents acting in the **course of their business** for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or

committed by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

Illustrations

(a) A, being B‟s agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized 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 bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended cosigner.

Qui facit per alium per se

Lloyd v Grace, Smith ad Co. Mrs Lloyd who owned two cottages was not satisfied with the income from them. She went to the office of Grace, Smith & Co, a firm of solicitors to consult them about the matter of her property. The managing clerk, who was acting as the firm's agent, advised her to sell the two cottages and then invest the money in a better way. She was asked to sign documents which were supposed to be sale deeds but instead were gift deeds. He then disposed of the cottages and misappropriated the proceeds. Event though he was acting without the principal's knowledge for his own personal gain, as he was acting in the course of the P's business, the P was liable for fraud.

In iNational Bank of Lahore v Sohanlal, the Bank was held liable for the fraud committed by the manager of one of its branches.

State bank of India v Shyama Devi

Q. Explain with illustrations when a principal may unilaterally cancel an agency relation without incurring liability for breach of contract. [15M, 2012]

Chapter X of the Indian Contract Act 1872 deals with 'Agency'. In an agency one person (principal) employs another(agent) to represent or act on his behalf. Sec 182 defines both these terms.

When can the Principal Unilaterally cancel an agency?

Section 201 mentions various modes of termination of agency. They are:

1. By revocation of agent's authority
2. By renunciation of the business of agency by the agent
3. By the completion of the business of agency
4. By death or insanity of either the principal or the agent
5. By insolvency of the principal

Thus the principal has powers to unilaterally cancel an agency. However, there are certain rules of revocation:

1. Revocation may be express or implied (Sec 207): in *RD Saxena v Balaram Prasad Sharma* the withdrawal of Vakalatnama was held to be implied revocation
2. Revocation possible before the authority has been exercised (Sec 203)
3. Principal to compensate if there is premature revocation without justification (Sec 205)
4. Principal should give reasonable notice (Sec 206): *In re M/S Om Prakash Pariwal* the agency was terminated by FCI without any reason or notice. It was held to be illegal
5. Termination of agency terminates sub-agency also (Sec 210)

However the principal is not allowed to unilaterally terminate under the following circumstances:

1. No revocation when agent has interest in the subject matter (Sec 202): in *Birat Chander Dagara v Taurian Exim Pvt Ltd* where an interest was created in favour of the attorney older, Sec 202 was attracted
2. Revocation when authority has been partly exercised (Sec 204): no revocation as regards acts already done.

Thus the law of termination of agency is well defined in the Act.

TOPIC 9: Sale of Goods and Hire Purchase

Q. Elaborate the conditions and warranties provided under the Sale of Goods Act, 1930. [10M, 2022]

If a stipulation forms the very basis of the contract or, as stated in Sec 12(2) is essential to the main purpose of the contract, it is called a condition. On the other hand, if the stipulation is not essential but only of secondary importance or as Sec 12(3) puts it, is collateral to the main purpose of the contract, it is called a warranty.

For example, a lady orders a red saree and says that she will pay the price by 15th January, the day of her marriage. The stipulations regarding the colour and the date are essential therefore are 'conditions' whereas stipulations regarding time and payment of price and mode of despatch are collateral, therefore are warranties.

Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract [Sec 12(4)]

Consequences of Breach:

- Condition: since it is essential, the breach allows the other to treat the contract as repudiated [Sec 12(2)]
- Warranty: Gives a right to claim for damages but not to treat the contract as repudiated [*Svenska Handels Banken v M/s Indian Charge Chrome*]

Thus there is a thin line of difference between the two.

Q. Write short notes on the following: [i]. Caveat Emptor [iii] Nemo dat quod non habet

Caveat Emptor

Sometimes the goods purchased by the buyer may not suit the particular purpose for which the buyer wants them. The question which in such a case arises is, whether the buyer can reject the goods or he is supposed to take the risk of the goods turning out not suitable for the required purpose.

The rule contained in the maxim caveat emptor means buyer beware. According to this rule, the buyer himself should be careful while purchasing the goods and he should himself ascertain that the goods suit his purpose. If the goods are subsequently found to be unsuitable for his purpose, he cannot blame the seller for the same, as there is no implied undertaking by the seller that he shall supply such goods as to suit the buyer's purpose.

For example, A purchases a horse from B. A needs the horse for riding but he does not mention this to B. the horse is not suitable for riding but is suitable only for being driven in a carriage. A can neither reject the horse nor can he claim any compensation from B.

This rule is also incorporated in Section 16 of the Act. The section provides that, as a general rule, 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.

In re Andrew Yule & Co the buyer ordered for hessian cloth without specifying the purpose for which he wanted the same. It was in fact needed for packing. Because of the unusual smell, it was unsuitable for the purpose. It was held that the buyer had no right to reject the same, even if it did not suit his purpose.

Nemo dat quad non habet

When the seller himself is the owner of the goods which he sells or he is somebody's agent to dispose of the goods, he conveys a good title to the buyer. Difficulty arises when the seller is neither himself the owner nor has any such authority.

In regard to the question, the rule is given in the maxim 'nemo dat quad non habet' which means a seller cannot convey a better title than his own. For instance, if the title of the seller is defective the buyer's title will also be subject to the same defect.

The general rule is contained in Section 27 of the Sale of Goods Act, 1930.

Thus this section and the rule tries to protect the interest of the true owner.

Exceptions: the rule in Sec 27 'is subject to the provisions of this Act and any other law for the time being in force.'

1. Sale under the implied authority of the owner or transfer of title by estoppel (Sec 27)
2. Sale by a mercantile agent (Proviso to Sec 27)
3. Sale by one of joint owners (Sec 28)
4. Sale by a person in possession under a voidable contract (Sec 29)
5. Sale by the seller in possession of goods, the property in which has passed to the buyer [Sec 30(1)]
6. Sale by the buyer in possession of the goods before the property in them has passed to him [Sec 30(2)]
7. Re-sale of the goods by an unpaid seller after he has exercised the right of lien or stoppage in transit [Sec 54(3)]
8. Sale by finder of goods (Sec 169, Indian Contract Act)
9. Sale by a pawnee when the pawner makes a default in payment (Sec 176, ICA)
10. Sale in market overt- exception recognised in England.

Thus this rule is not absolute.

"Parties to the contract of sale may reduce or enhance the risk relating to passing of property." Elucidate the various dimensions under the law of sale of goods [20M, 2019]

The literal meaning of passing of property is the transfer of ownership on an agreed price. Teh ownership is transferred only when the proprietary of property rights are transferred from the seller to the buyer.

Various dimensions of passing of property:

Goods under transfer of property

- Specific goods: identified at the time of making the contract
- Unascertained goods eg A contracts with B for sale of 'sack of grains'

Essentials of transfer

1. Ownership of property must be of ascertained goods
2. Property is transferred only when it is intended to be transferred

Passing of Property (Sections 18-26)

Risk Related to Passing of Property

Risk follows property (Sec 26). The general rule is that the goods are at the risk of the person in whom the property in the goods vests.

- The goods remain at the seller's risk until it is transferred to the buyer
- When the property is transferred to the buyer, the goods are at the buyer's risk whether the delivery has been made or not

However the exceptions to the rules (provided in Sec 26) are:

1. 'Unless otherwise agreed': The parties may express their intention which is contrary to the above stated rule. The marginal note itself mentions that 'Risk prima facie passes with property.'

   In *Rutter v Palmer* the owner of a motor car deposited the same with the keeper of a garage for sale on commission basis. One of the terms was 'on customer's risk'. The car having been subsequently damaged by the garage keeper's servant, it was held that hte garage keeper was protected due to the clause.

If delivery has been delayed due to the fault of either the buyer or seller due to which some loss occurs, the party at fault has to bear the loss.

In *Demby Hamilton & Co Ltd v Barden* the buyer refused to take further deliveries after certain installments had been delivered. When the apple juice turned putrid, the loss had to be borne by the buyer.

Responsibility as the bailee of goods: Sec 151 of Indian Contract Act imposes a duty of care on every bailee. If, therefore, a seller continues in possession of goods the property of which has passed to the buyer, he is bound to take good care as mentioned in Sec 151 in his capacity as a bailee. If he negligently allows the goods to be lost, damaged or stolen, he will be liable for the loss even though the buyer is the owner of such goods.

The liability of the buyer or seller might also arise if he makes an unauthorised use of goods (sec 154) or without the consent of the other party who is the owner of the goods, mixes his own goods with those of the other party [Sec 156 and 157]

Q.1. "The rights of unpaid sellers do not depend upon any agreement, expressed or implied, between the parties. They arise by implication of law." Elucidate [20M]

The seller and the buyer are bound to perform certain duties. Broadly speaking, the seller's duty is to deliver the goods and the buyer's duty is to accept and to pay for them in accordance with the contract. If either party does not perform his duty in the proper way, he can be made liable. In case of the unpaid seller, he can exercise the following rights against the goods: Lien, stoppage in transit, re-sale.

Chapter V of the Sale of goods Act deals with **Rights of Unpaid Seller against the Goods** under **Sections 45- 54.**

The seller of goods is deemed to be an "unpaid seller" within the meaning of this Act— (a) when the **whole of the price has not been paid** or tendered; (b) when a **bill of exchange or other negotiable instrumen**t has been received as conditional payment, and the **condition** on which it was received has not been fulfilled by reason of the dishonor of the instrument or otherwise. **[Section 45 (1)]**

<u>Unpaid Seller's rights:</u>

1. Lien on the goods for the price while he is in possession of them **(Sections 47-49)**

2. A right of stopping the goods in transit while the goods are in transit and the buyer has become insolvent **(Secs 50-52)**
3. A right of re-sale of goods **(s. 54)**

Lien

The right of lien means **retaining the goods or refusing to deliver them** until the price in respect of them has been paid by the buyer. By way of exercise of this right, the seller can refuse to deliver the goods to the buyer until the payment of the price, even though the ownership has already passed to the buyer. By a mere exercise of this right, the contract of sale of goods is **not automatically rescinded. [Sec 54(1)**].

When can this right be exercised?

According to **Sec 47**, this right can be exercised in the following situations

1. When the goods have been **sold without any stipulation as to credit** i.e. the sale of goods has been on **cash basis.** If the goods have not been sold on credit, the seller expects that the buyer shall pay the price against the goods.
2. When the goods have been sold on credit, the seller can exercise the right of lien on the e**xpiry of the period of credit.** As soon as the period expires, the price becomes due and the seller can exercise the right of lien thereafter.
3. When before the delivery of the goods to him, the buyer becomes **insolvent.** The buyer is insolvent according to **Section 2(8)** 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 has committed an act of insolvency or not.

The right of lien can be exercised if the seller is still in possession of the goods even though his capacity is not that of the seller but only that of **an agent or bailee f**or the buyer. There is **constructive delivery** of the goods to the buyer as stated in **Sec 33** but since the seller is still in possession of the goods, even though his capacity is only that of a bailee, he can exercise the right of lien.

Lien and Part Delivery- According to **Sec 48,** if the seller has delivered a part of the goods, he can exercise his right of lien over the **remainder** unless the part delivery was made under such circumstances as to show that he had waived the right of lien.

If for example, out of 100 bags of wheat which were to be supplied by the seller to the buyer, 20 have already been delivered to the buyer, the seller may exercise his right of lien over the other 80 bags. If

however, the buyer gets the whole of the goods weighed but takes away only a part of them, the delivery of the part of the goods in such a case would operate as delivery of the whole and the seller's right of lien over the remaining goods would come to an end. (*Hammond v Anderson)*

Termination of lien

1. By **payment** of price: **Sec 49(2)** states that an unpaid seller, having a lien on the goods, does not lose his lien by reason only that he has obtained a decree for the price of the goods.
2. By **delivery to the carrier**: Seller loses the possession.
3. By the **buyer obtaining possession** of hte goods: In *Eduljee v Cafe John Bros* where a refrigerator after being sold was delivered to the buyer and since it was not functioning properly, the buyer delivered two of its parts to the seller for repairs, it was held that the seller could not exercise his lien over those parts.
4. By **waiver:** A party to a contract may waive his rights, expressly or impliedly, according to **Section 62.**
5. By **disposition of the goods** by the buyer: According to **Sec 53,** the unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition of the goods by the buyer. This general rule is subject to to exceptions:

    - When the **seller himself assents** to a sub-sale or other disposition of the goods by the buyer
    - When the buyer having lawfully obtained possession of a document of title to the goods **transfers the same to a transferee in good faith** and **for consideration** and the transfer is by way of sale.

Unpaid seller's lien on goods: A lien necessarily pre-supposes that the property in the goods has passed, as the seller cannot be said to possess a right of lien on his own property, which is in the nature of a right of distress over the property of another. The lien ceases to subsist, the moment the seller loses possession of the goods.

<u>B. Stoppage in transit.</u>

This right means that when the goods have already been delivered to a carrier for being transmitted to the buyer, the carrier at the seller's request is to deliver the goods back to the seller and not to deliver to the buyer even though the buyer might have got the possession of a document of title to the goods. The exercise of this right, according to **Sec 54(1)** does not result in the **rescission of the contract or revesting** of the property in the goods of the seller. It only means that the seller after getting back the goods from the carrier has a **right to retain them until the buyer pays** for them. If the buyer still fails to pay, the unpaid seller may even **resell** those goods.

Conditions:

Seller should be an **unpaid seller** as defined in **Sec 45**

The buyer should be **insolvent** within the meaning of **Sec 2(8)** i.e. a person 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.

The goods should be in **transit.**

Different capacities of transmission in carrier:

The carrier may be the **buyer's agent.** When the possession has been received by the carrier as the buyer's agent, there is no question of exercise of right of stoppage in transit because when the buyer or his agent has received possession of the goods the seller cannot exercise any right in respect of them;

The carrier may be the **seller's agent.** If the carrier is the seller's agent, then the seller himself is deemed to be in constructive possession of the goods and he can exercise even the right of lien in respect of them

The carrier may be neither the buyer's agent nor the seller's agent but may be holding the **goods as a carrier.** Then the right of stoppage in transit can be exercised by the seller.

Duration of transit:

Sec 51 (1), the goods are deemed to be in the course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission of buyer. The transit continues until the buyer or his agent in that behalf **takes delivery of them** from such carrier or other bailee.

Sec 51(5) provides that when the goods are delivered to a ship chartered by the buyer, it is a question depending on the **circumstances of each case** whether they are in the possession of the master as a carrier or as agent of the buyer.

In *Schotmans v. Lancanshire & Yorkshire Ry Co,* there was delivery of the goods by the seller on board a ship belonging to the buyer. The bill of lading was also taken in the buyer's order. It was held that in this case it amounted to the delivery of the goods to the buyer so that the seller was precluded from exercising his right of stoppage in transit.

When transit comes to an end

1. When the **buyer takes delivery: Sec 51(1)**

   According to Sec 51(2) if the buyer or his agent obtains delivery before their arrival at the appointed destination, the transit is at end.

When the carrier or other bailee a**cknowledges to the buyer: Sec 51 (3)** if, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as the bailee for the buyer or his agent, the transit is at end.

> In *Whitehead v Anderson,* on arrival of the ship, the assignee of the buyer who had become insolvent, went to take the delivery of the timber. They only saw and touched the timber. The Captain refused to deliver the same until the freight had been paid. It was held that neither the buyer's assignee had taken the actual possession nor had the Captain of the ship contracted to hold the timber as the buyer's agent, the seller's right of stoppage in transit had not come to an end.

When the **carrier wrongfully refuses** to deliver the goods to the buyer: In *Bird v Brown,* a notice to stop goods in transit was given by a certain stranger who had no authority from the seller to do so. On a demand for the delivery of the goods by the assignees of the insolvent buyer, the carrier refused to deliver the goods to them. Subsequently, the seller tried to ratify the stoppage in transit made by the stranger. It was held that the transit had come to an end when the buyer's assignees demanded the delivery of the goods because the carrier's refusal to deliver the goods to them was a wrongful one and the right of stoppage, which had come to an end, could not be revived by subsequent ratification.

Effect of part delivery: According to **Sec 51(7),** when a part delivery of the goods has been made by the carrier to the buyer or his Agent, the seller may still exercise the **right to stoppage in transit** over the remainder of the goods.

Effect of rejection of goods by the buyer- If, after the arrival of the goods at their destination, the buyer refuses to take their delivery, according to **Sec 51(4)**, then the transit is not deemed to be at end.

How the right is exercised: The act does **not prescribe any particular form** or mode of exercise of the right of stoppage in transit. The only thing required is that the unpaid seller may either **take actual possession** of the goods, or give a notice of his claim to the carrier or other bailee in whose possession the goods are.

In *Litt v Cowley* after the receipt of the notice to stop the goods, the carriers by mistake delivered the goods to the buyer. It was held that the assignees of the insolvent buyer were bound to restore back the goods to the seller, or be liable for damages.

Effect of sub-sale or pledge: Acc to **Sec 53(1)** the unpaid seller's right of lien or stoppage in transit is **not affected by any sale or other disposition** of the goods which the buyer might have made.

However there are **two exceptional** cases when the right of unpaid seller may be affected by disposition of the goods:

1. When the **seller has assented to the sale** or other disposition which the buyer may have made.
2. Proviso of **Sec 53(1)**

The buyer has **lawfully obtained** the possession of the document of title to the goods

The buyer then **transfers the document of title** to another person

The transferee takes the document of title in **good faith and for consideration.**

Difference between Lien and Stoppage in Transit

1. **Retain** and regain
2. Once the seller **loses possession**, whether by delivery to the buyer, his agent, carrier or some other bailee, the right of lien comes to an end. Even after delivery to a carrier.
3. Even when the buyer is not **insolvent.** Only when insolvent.

Common:

1. Both rights when seller is an **unpaid** seller
2. Can be exercised **after the property in the goods has passed** to the buyer.

C. Re-sale

1. Where the goods are of perishable nature **[Sec 54(2)]**
2. Where the unpaid seller who has exercised his right of lien or stoppage in transit gives notice to the buyer of his intention to re-sell **[Sec 54(2)]**

3. Where the seller expressly reserves a right of resale in cawse the buyer should make default **[Sec 54(4)]**

Notice of re-sale: Must be given to the buyer. No such notice is required if the goods are of a perishable nature. Notice must be reasonable and be given within a reasonable time, as well as a reasonable opportunity of either fulfilling the contract or supervising the sale. [**Sec 63-** What is a reasonable time is a question of fact]

Loss or profit on resale: **Sec 54(2)** provides that if the resale is properly made, the unpaid seller can **recover from the original buyer damages** for any loss occasioned by his breach of contract but the buyer shall not be entitled to any profit which may occur on resale.

Measure of damages on resale: Loss is occasioned to the seller as the difference between the **contract price and the resale price** [in other cases, **Sec 73** of ICA- difference between the **contract price and the market price** prevailing on the date of breach of contract]. If resale is not properly made, then follows Section 73.

In *Mysore Sugar co Ltd Bangalore v Manohar Metal Industries,* the buyer having made a default in taking the goods, the seller gave him a notice that if the buyer did not lift the goods within three days,the contract would be treated as canceled. The buyer did not lift the goods. The Seller made a resale of the goods and sought to recover the loss. It was held that there was an inordinate delay of over 3 months in making the resale after the notice to the buyer and due to such delay particularly in the falling market as in the recent case, the value realized on re-sale did not afford a good ground to fix the damages. Thus, the seller's claim was rejected.

Title of the new buyer: General rule contained in **Sec 27** is *nemo dat quod non habet* i.e. a seller cannot convey a better title to his buyer than of his own. However **Sec 54(3)** provides an exception to that rule and states that on a resale of the goods, the buyer acquires a good title to the goods as against the original buyer notwithstanding that a notice of the resale has been given to the original buyer. It means that even though the unpaid seller himself is not the owner oft the goods, the new buyer will acquire a good title.

Sec 54(1) provides that subject to the provisions of this section, a contract of sale is not rescinded by the mere exercise of tis right of lien or stoppage in transit by an unpaid seller, **Sec 54(4)** provides that where the seller expressly reserves the right of resale in case the buyer should make a default then the original contract of sale is thereby rescinded. This sub sec protects the rights of the seller to claim damages from the buyer whose default necessitated the resale.

Q3. "In a contract of sale of goods property or ownership in the goods will pass from seller to the buyer which the parties intend to pass." Explain the statement with necessary legal provisions and case law. [20M]

Transfer of property in the goods from the seller to the buyer is the essence of the contract of sale. It has been noted in Section 4 that in such a contract, the seller either transfers or agrees to transfer the property in the goods to the buyer for a price.

If after the contract the goods are destroyed or damaged, the party who is the owner at the time will have to bear the loss. If the property in the goods has already passed, the buyer will have to bear the loss, but if the seller still continues to be the owner, the loss will have to be borne by him, as stated in Sec 26.

For the purpose of transfer of property, goods may be divided into two classes i.e. specific or unascertained. Specific goods are those goods which have been identified and agreed upon at the time of the contract of sale [Sec 2(4)]. If for eg, the seller has 1000 bags of wheat in his godown and the buyer agrees to purchase 100 bags out of them, if those bags are identified at the time of the making of the contract, it is a sale of specific goods. On the other hand, if it has not been described as to which 100 of those 1000 bags are to be delivered, the goods are unascertained.

Sections 19, 20, 21, 22 and 24 provide the rules regarding the transfer of property in specific goods. Sections 18, 23 and 25 provide the rules regarding the transfer of property in unascertained or future goods.

Transfer of Property in Specific goods:

19. Property passes when intended to pass.— (1) 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 he transferred. (2) 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. (3) Unless a different intention appears, the rules contained in sections 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

In *Agricultural Market Committee v Shalimar Chemical Works Ltd,* pursuant to the agreement between the parties the seller fo ascertained goods, loaded the goods on a lorry in the State of Kerala and despatched the same to be delivered in the State of Andhra Pradesh. As per the terms, the seller was not to be liable for any future loss of goods and that the goods were despatched at the risk of the purchaser. The purchaser had also obtained insurance of the goods and had paid the policy premium. He therefore intended the goods to be treated as his own so that if there was any loss of goods in transit, he could

validly claim the insurance. In viw of the conduct of the parties, the Apex ourt held that the property in goods had passed in the State of seller.

Ownership of movable property: The ownership is not dependent upon the entries in the registration certificate. Even the ownership in the vehicle will be governed by Section 19.

In *Sugar Warehousing Corpn v Pawan Hans Helicopters Ltd* there was an agreement for the sale of 19 Helicopters. In terms of the agreement, property was to pass only upon payment of the sale fo consideration. In view of Section 19 it was held that part payment of the sale consideration would not have the effect of transferring the property to the buyer.

B. Specific goods in a Deliverable State

TOPIC 10: FORMATION AND DISSOLUTION OF PARTNERSHIP

Q.1. "The dissolution of partnership is the dissolution of a partnership firm, but the dissolution of a partnership firm is not the dissolution of partnership." Elucidate with the help of legal provisions and cases. [10M]

Section 4 of the Indian Partnership Act 1932 defines Partnership. It is the **relation between persons** who have **agreed to share the profits** of a business **carried on by all or any of them acting for all.**

Dissolution of Firms:

When the relation between all the partners of the firm comes to an end, this is called dissolution of the firm. **Section 39** of the Indian Partnership Act, provides that "the **dissolution of the partnership between all the partners** of a firm is called the **dissolution of a firm."** It implies the complete breakdown of the relation of partnership between all the partners.

Dissolution of partnership v. dissolution of firm:

• Dissolution of a partnership firm merely involves a **change in the relation of partners;** whereas the dissolution of a firm amounts to a complete **closure of the business**.

• When any of the partners **dies, retires or become insolvent** but if the remaining partners still agree to continue the business of the partnership firm, then it is dissolution of partnership not the dissolution of the firm.

• Dissolution of partnership **changes the mutual relations** of the partners. But in case of dissolution of the firm, all the relations and the business of the firm comes to an **end.**

• On dissolution of the firm, the **business of the firm ceases to exist** since its **affairs are wound up** by selling the assets and by paying the liabilities and discharging the claims of the partners.

• The dissolution of partnership among all partners of a firm is called dissolution of the firm.

Modes of dissolutions [Sections 40-44]

1. **By agreement (sec 40)**

With the **consent** of all the partners

In **accordance with a contract** between the partners.

As partners create partnership by making a contract between themselves, they are also similarly free to end this relation and thereby dissolve the firm by their **mutual consent.**

2. Compulsory dissolution [Sec 41]

When all the partners or all except one are adjudicated **insolvent,** the firm is compulsorily dissolved.

If the business of the firm though lawful when the firm came into existence, subsequently becomes **unlawful.** [23- lawful object and consideration; 56- unlawful after making of the contract]

3. Dissolution on happening of certain conditions- Sec 42

Unless there is a contract to the contrary. Contingencies are

Expiration of the partnership term

Completion of the adventure

Death of a partner

Insolvency of a partner

4. Dissolution by notice in 'Partnership at will' - Sec 43

When the partnership is at will as defined in **Section 7,** the partners are not bound to remain as partners or continue the partnership for any fixed period. According to **Sec 43,** the firm may be dissolved by any partner giving **notice in writing** to all the other partners of his intention to dissolve the firm.

5. Dissolution by the Court [Sec 44]

That a partner has become of **unsound mind** in which case suit may be brought by the next friend of the partner or by any other partner

That a partner, other than the partner suing has become in any way **permanently incapable** of performing his duties as a partner

That a partner, other than the partner suing is **guilty of conduct** which is likely to affect prejudicially the carrying on of the business

That a partner, **wilfully or persistently commits breach of agreements** relating to the management of the affairs of the firm or the conduct of its business or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him

That a partner has in any way **transferred the whole of his interest in the firm** to a third party, or has allowed his share to be charged under the provisions of Rule 49 of Order XXI of the First Schedule to the Code of Civil Procedure 1908 or has allowed it to be sold in the recovery of arrears of land revenue or of any dues recoverable as arrears of land revenue due b the partners

That the business of the firm **cannot be carried on** save at a loss

On any other ground which renders it **just and equitable** that the firm should be dissolved.

In *Harrison v Tenant,* one of the partners in a firm of solicitors ignored the other two partners and declined to settle their disputes by mutual consultation. It was held that the conduct of one of the partners

being destructive of mutual confidence, which could not be restored, was a valid ground for the dissolution of the firm.

In *Abbot v Crump* adultery by one partner with another partner's wife was held to be a good ground for the dissolution of the firm by the court.

Liability for acts done after dissolution- Sec 45

It has been noted that when a partner ceases to be a partner by retirement or compulsion his liability for the acts of the firm done after such retirement or expulsion, towards the third parties can still arise until a **public notice of the fact** is given.

Q.2. "In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relations between the parties as shown by all the relevant facts taken together." Do you agree with this statement? Give reasons [10M]

The Indian Partnership Act was enacted in **1932** and it came into force on the **1st day of October 1932.** The present Act superseded the earlier law relating to Partnership which was contained in **Chapter XI** of the Indian Contract Act 1872. A partnership arises from a contract and therefore such a contract is governed not only by the provisions of the Partnership Act in that regard, but also by the general law of contract where the Partnership Act does not specifically make any provision.

Section 4 of the Indian Partnership Act 1932 defines Partnership as under: 'Partnership is the **relation between persons** who have agreed to share the profits of a business **carried on by all or any of them acting for all.'**

Essentials of Partnership

1. There should be an **agreement** between the persons who want to be partners
2. The purpose of creating partnership should be **carrying on of business**
3. The motive for the creation of partnership should be earning and sharing profits
4. The business of the firm should be carried on by **all of them or any of them acting for all** i.e. in **mutual agency.**

Persons who have entered into partnership with one another are called individually partners and collectively a firm and the name under which their business is carried on is called the firm name.

1. An agreement

Section 5 provides that 'the relation of partnership arises from **contract and not from status.'** Thus it is the element of agreement which distinguishes a partnership from various other relationships like members of a Joint Hindu Family, joint owners or joint heirs. Thus, the existence of a contract is a sine qua non of relationship of partnership. Such a contract can either be expressed or implied.

- *Persons capable of becoming partners*: It has to be between two or more persons. A minor or a person of unsound mind, who is not competent to contract cannot become partners. An HUF (Hindu Undivided family) also cannot become a partner. If a Karta or any other member of the HUF joins a partnership he can do so only as an individual. A partnership firm is not a legal person and therefore, a firm as such is not capable of entering into partnership with another. The partners however can enter into partnership in their individual capacity. The Partnership Act permits partnership between any tow or more persons which may be either natural or artificial. Thus, a partnership could be formed between a number of companies.

Section 34 however states that when a partner is adjudicated **insolvent** he ceases to be a partner.

Carrying on of business.

The object of every partnership must be carrying on a business and sharing its profit. It may be any business which is not unlawful. The act defines business as including , **'every trade, occupation or profession.' [Section 2(b)]**

In *Coope v Eyer* there was an agreement between the defendant and three other persons that the defendant would purchase some oil and distribute the same between itself and other three persons and others would then pay for the oil to him. The purchase was made only in the name of the defendant. Later, the defendant became bankrupt and the seller of oil sued the other three persons. It was held that the oil in this case was **not meant for resale** and therefore there was no business being carried on by the defendant and the others and no partnership existed between them.

In *Mahadeodas v Gherulal Parekh* a partnership were the partners agree to engage in **forward contracts** without an intention of actual delivery but only to **deal in differences** the agreement is merely **wagering.** Such a partnership is valid because the wagering agreement thought they have been merely declared void, are not illegal, immoral or opposed to public policy.

Particular Partnership: **Sec 8**

According to Sec 8 there can be 'Particular partnership' between partners whereby they engage in **particular adventures or undertaking.** A single venure or transaction **finishes immediately** after the purchase and the sale. There is no continuity or 'carrying on of the business.;

In *K Jaggaaiah v Kokumanu* the P and the two defendants joined together and obtained a contract for the **maintenance of a road.** There was held to be partnership in the road building activity. Such activity though arising out of a single contract was spread over a particular period and all that meant carrying on of business.

Sharing of profits

The term profit has not been defined in the Act. It means net gain i.e. the excess of returns over outlay.

Although sharing of profits is one of the essential elements of every partnership, every person who shares the profits need not always be a partner.

In *Cox v Hickman* it was laid down that the persons sharing the profits of a business do not always incur the liability of partners unless the **real relation** between them is that of partners. The principle laid down in this case forms the baissi of the provisions of Section 6 of the Partnership Act.

Section 6 MODE OF DETERMINING EXISTENCE OF PARTNERSHIP. In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, **regard shall be had to the real relation** between the parties, as **shown by all relevant facts taken together**.

Explanation I : The sharing of profits or of gross returns arising from property by persons holding a **joint or common interest in that property** does not of itself make such persons partners.

Explanation II : The **receipt by a person of a share of the profits** of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not itself make him a partner with the persons carrying on the business; and, in particular, the receipt of such share or payment -

(a) by a **lender of money** to persons engaged or about to engage in any business

(b) by a **servant or agent** as remuneration,

(c) by the **widow or child of a deceased** partner, as annuity, or

(d) by a **previous owner or part-owner** of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.

Money lender sharing the profits.

Facts of *Cox v Hickman*, Smith and Son carried on business as iron merchants. According to a deed of arrangement with the creditors, **five representatives** of the creditors were appointed as five trustees. The business was to be managed by these trustees and net income also to be distributed by these trustees amongst the general creditors of Smith & Son. While the business was being managed by the trustees, the defendant, supplied goods to the firm. ONe of the trustees accepted bills of exchange drawn by him and undertaking to pay the price of those goods. It was held that although the creditors were sharing the profits and the business was being managed by the trustees still the relationship between Smith and Son on the one hand and the creditors (including trustees) on the other was that of debtor and creditor and not that of partners and thus they could not be made liable.

b. Servant or agent sharing the profits

In *McLaren v Verschoyle,* an assistant in a firm of brokers were paid a share in the profits over and above his salary. At times he signed some letters and documents on behalf of the firm. It was held that such a servant only acted as an agent for the firm and the mere fact that he shared the profits did not make him a partner in the firm.

c. Widow or child of a deceased partner sharing profits

In *Holme v Hammond,* 5 persons entered into partnership for 7 years and agreed to share the profits and losses equally. They further agreed that if any one of them died before the expiry of the said 7 years, the others would continue the business and pay the share of the profits of the deceased to the executors. On the death of one of the partners the survivors continued the business. The executors of the deceased were paid 1/5th of the share of profits. It was held that the executors had not become partners and could nto be made liable in respect of a contract entered into by the surviving partners.

d. Seller of goodwill sharing the profits

In *Pratt v Strick,* a doctor sold the goodwill of medical practice and entered into an agreement with the buyer of the good will that he would help such buyer to introduce patients for 3 montsh and would be entitled to half the share of proits and incur half the expenses. It was held that the doctor had not become a partner.

Salaried Partners: There is a possibility that a partner may not get the payment contingent on the partners. He may be paid salary or a fixed sum periodically every month or year.

In *RN Kothare v Hormasjee,* there was an agreement between two partners that one of them was to get a salary in lieu of profits and moreover he has not responsible for any loss or liability in the firm. It was held that there was a valid partnership in which one of the partners was a **'salaried partner.'**

4. Mutual agency

According to Section 4, the partnership **business must be carried on by all or any of them acting for all.'** In *Cox v Hickman* the reason by the trustees were merely agents of Smith & son but not the principal swas that the principals and business still belonged to *Smith & Son* and not to trustees.

Q.3. Explain the various circumstances in which a firm may be dissolved. What are the rights and obligations of partners after dissolution of firm? [15 M]

By dissolution of the firm the partners cease to be partners with one another and therefore, the mutual agency which existed between them to act on behalf of each other to continute to carry on the busineess of the firm also comes to an end.

1. Continuing authority of partners for the purposes of winding up the firm (Sec 47): For eg, the contracts already entered into have to be performed, amount due to the creditors has got to be paid, amount due from the debtor's has got to be realised etc. When a partner dies and the partnership comes to an end, it is not only the right, but the duty, of a surviving partner to realise the assets for the purpose of winding up the partnership affairs including the payment of partnership debts (*Bourne v Bourne)*. Proviso to the Sec 47 states that the rule of the existence of mutual agency between the partners for the purpose of winding up does not apply in the case of an insolvent partner, and the firm is in no case bound by the acts of a partner who has been adjudicated insolvent.

2. Right to have the business wound up - Sec 46: On the dissolution of a firm every partner or his representative has a right to see that the affairs of teh firm are properly wound up. Each partner continues to be exposed to the risk of being made jointly and severally liable towards the third parties. Every partner or his representative has been made entitled as against all the other partners or their representatives to have the property of the firm applied in payment of the debts and liabilities of the firm, and then there is distribution of the surplus amongst the partners or their representatives according to their rights. The right contained in this section is also known as the partner's general lein over the surplus assets of the firm (*Re Bourne).*
3. Modes of settlement of accounts- Sec 48

Losses are to be shared equally: In *Nowell v Nowell*, A and B had contributed unequal amount of 1929 and 29 pounds respectively towards the capital. They had agreed to share hte profits and losses equally. A deficiency of 500 pounds in capital having arisen it was held that the same was to be shared equally between A and B.

If one or more partners become insolvent and they are not able to contribute their share of the loss, the solvent partners are not bound to contribute for the share of the insolvent parteners.

b. On the dissolution of the firm, if the amount availabe is sufficient to meet all the claims of the partners and the third parties, there is no problem. If however, the amount available is insuffiencient, the payments are to be made in a certain order. Section 48 (2) provides that the amount available is to be utilised int he following order:

- Making payments for the debts of the firm to the third parties
- If some partners have given advance over and above the capital then the amount is to be utilised in making payment to each one of them rateably
- Making payment to each partner rateably what is due to him on account of capital
- The residue, if any, is deemed to be profit and the same is to be divided among the partners in the proportions in which they were entitled to share profits.

4. Payment of the firm debts and separate debts - Sec 49

- The property of the firm shall be applied in the first instance in payment of the debts of the firm, and if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him.
- The separate property of any partner shall be applied first in the payment of his separate debts and the surplus, if any, may be utilised in the payments of the debts of the firm.

<u>Liability for acts done after dissolution- Sec 45</u>

It has been noted that when a partner ceases to be a partner by retirement or compulsion his liability for the acts of the firm done after such retirement or expulsion, towards the third parties can still arise until a **public notice of the fact** is given.

According to Section 72, a public notice means a notice in the Official Gazette in at least one vernacular newspaper circulating in the district where the frim to which it relates has its place or principal place of business.

Q. Mere succession of trading does not result in dissolution of a partnership. Rights and liabilities need to be settled between the partners. Explain [15M]

Dissolution of partnership means coming to an end of relation known as partnership. The Modes of Dissolutions [Sec 40-44] are: a. By agreement; b. Compulsory dissolution; c. contingencies; d. By notice and v. by the court.

However the mere succession of trading does not result in dissolution. Rights and liabilities need to be settled.

Rights

1. Right to have business wound up- Sec 46: there has to be winding up of affairs of the firm which includes realisation of the assets of the firm and also paying off all the liabilities and then to distribute the surplus if any, amongst the partners. Every partner has the right to see that the affairs are properly wound up.

   Modes of settlement of accounts[Sec 48]

   - Losses to be shared equally
   - Order of payments: Debts to third parties, payment to partners who have given advance, payment to partner on account of capital, Residue deemed as profit and shared equally

Rights on rescission of partnership contract [Sec 52]:

- Right of lien on the surplus assets
- Right to rank as a creditor in respect of any payment made towards debts
- Right to claim indemnity from partners guilty of fraud and misrepresentation

Right to restrain from use of firm name or firm property [Sec 53]: in *Rajendra Kumar Sharma v BK Sharma* it has been held that in the absence of a contract, no partner can use firm's property for his won benefit without the consent of partners

Liabilities

1. Liability for acts done after dissolution [Sec 45]: even after dissolution his liability towards the third parties can still arise until a public notice under Sec 72 of the fact is given
2. Continuing authority for the purposes of winding up [Sec 47]: In *Butchart v Dresser* where the partnership was dissolved and shares were pledged to complete a previously made contract, the action was held to be valid.

Q. "The effects of non-registration of partnership firms are so fatal that ordinarily the firms are registered." Explain with the help of legal provisions and decided cases. [20M]

Chapter VII (Sections 56-71) deals with the registration of partnership firms. The act does not make the registration compulsory in India nor does it impose any penalties. However, the effects of non-registration of firms are so fatal that ordinarily they are registered.

EFFECT OF NON-REGISTRATION

Sec 69 contains the provision describing the effects of non-registration of partnership firms.

Registration is optional but for the purposes of a suit, registration is mandatory. Subsequent registration has no effect on the pending suit. [*DDA v Kochhar Construction Works*]

1. Suits between partners and the firm [Sec 69(1)]

   No suit to enforce a right arising from a contract can be instituted unless

   - The partnership firm is registered
   - The partners filing the suit have been shown in the Register of Firms as the partners of the firm.

In *Oriental Fire & General Insurance Co Ltd v UOI* when a firm takes an insurance policy, the claim arises out of the contract of insurance and not out of statute (the Insurance Act) therefore, the same cannot be enforced by filing a suit if the firm is unregistered.

Suits between firms and third parties [Sec 69(2)]: No suit to enforce a right can be instituted against a third party. In *M/S Shreeram Finance Corp v Yasin Khan,* the new partners were not shown on the Register of Firms therefore the suit was dismissed.

Claims of set-off or other proceedings [Sec 69(3)]: Claims cannot be adjusted against that of third parties.

Exceptions: The disabilities mentioned above are not applicable to the unregistered firm in the following exceptional cases:

1. Suit for dissolution [Sec 69(3)(a)]: Sec 44 mentions certain circumstances under which a partner may dissolve a firm. This section permits a suit even by the partners of an unregistered firm to sue for the dissolution of a firm or the accounts of a dissolved firm.
2. Suit on behalf of an insolvent partner [Sec 63(3)(b)]
3. Provisions mentioned under Sec 64(4)(a): where because of a notification under Sec 56, this chapter does not apply
4. When value of the suit does not exceed Rs 100 [Sec 69(4)(b)]

Procedure for registration: Sections 58 and 59

Q. As an agreement is an essential ingredient in the partnership, it follows that a minor cannot enter into an agreement of partnership. Critically examine the statement and discuss the circumstances under which the Indian Partnership Act permits minors to participate in the benefit of partnership. [20M, 2009]

A contract is an agreement enforceable by law [Section 2(h), Indian Contract Act]. one of the essentials of a valid contract is the 'capacity to contract' [Sec 10, ICA] which implies that the contracting person must be of the age of majority (and of sound mind).

MINORS and the INDIAN PARTNERSHIP ACT

In this context it becomes relevant to examine the position of a minor admitted to the benefits of partnership.

The agreement by a minor is void but he is capable of accepting benefits of partnership.

In consonance with this position of law, Sec 30(1) of the Indian Partnership Act provides that a minor may not be a partner in a firm but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

In *Lachhmi Narain v Beni Ram*one of the partner's died and his minor son alleged that after his death he was admitted to the benefits of partnership. Held, he could not be admitted as no partnership existed after his father's death.

Minor's position during minority:

- The minor thus admitted has a right to such share of the property and of the profits of teh firm as may be agreed upon. He can also have access to any of the accounts and can inspect and copy them [Sec 30(2)]
- Unlike a partner who has the right to access books of the firm, a minor's right is limited to accounts only. [Sec 12(d)]
- A minor, unlike a partner, is not personally liable for any act. It is only his share which is liable for the acts of the firm [Sec 30(3)]
- He cannot go to a court of law to enforce his rights. This disability is removed when he severs his connection with the firm [Sec 30(4)]

Option on attaining majority [Sec 30(5)]: at any time within six months or of obtaining knowledge he had been admitted to the benefits of partnership, he can elect to become or not to become a partner by issuing a public notice under Sec 72. [The burden of proving that the person had no knowledge of admission shall lie upon the person asserting the fact Sec 30(6)]

Doctrine of Holding out [Sec 30(9)]: If after attaining majority, he represents or knowingly permits himself to be represented as a partner in the firm's liability on the ground of holding out can still be there.

Minor's position if

- He becomes a partner [Sec 30(7)]: Rights and liabilities vis-a-vis partners continue to be the same but towards the creditors he becomes personally liable from teh date of his admission
- He elects not to become a partner [Sec 30(8)]: His rights and liabilities remain the same but is not personally liable.

Thus the position of the minor in partnership is well defined under the Act.

Q. Distinguish between partnership by estoppel and partnership by holding out. Discuss the chief ingredients of Section 28 of the Indian Partnership Act [20M]

Every partner is liable for all the acts of the firm done while he is a partner. Therefore, generally a person who is not a partner in the firm cannot be made liable for an act of the firm. In certain cases however, a person who is not a partner may be deemed or held out to be a partner for the purpose of a liability towards a third party.

Partnership by Estoppel v Partnership by Holding out

A partner by estoppel is someone who is not a partner of the firm but allows others to think he is a partner, through his behaviour or conduct.

A partner by holding out is someone who is not a partner of a firm but knowingly allows the firm to project to others that he is a partner of the firm.

In both cases, such people are liable for debts of the firm.

Thus the doctrine of holding out is a branch of the law of estoppel.

Ingredients of Section 28

As per Sec 28(1) for the application of the doctrine of holding out, the presence of the following essentials is required:

1. The person sought to be made liable has either himself represented or knowingly permitted somebody else to represent that he is a partner in the firm
2. The third party, who wants to bring an action must have acted on the faith of the representation and given credit to the firm

Representation: this could be by words spoken or written or by conduct.

In *Snow White Food Products Pvt Ltd v Sohan Lal Bangla* it was held that by his verbal negotiations and subsequent correspondence Sohan Lal represented as a partner of a firm of carriers and therefore he was a partner by holding out.

- *Knowingly permitted:* In *Munton v Rutherford* a statement was published that a person and Mrs Rutherford had formed a partnership. The statement was false and Mrs Rutherford did nto know about the same. It was held that she was not liable as a partner by estoppel or holding out.

B. Acting on the faith of representation and giving credit

In order to entitle a person to bring an action under the doctrine of holding out, it has to be shown that he acted on the faith of the representation and gave credit to the firm. But if a person while giving credit to the firm did not know about the representation, he can't take advantage of this doctrine and make such a person liable as a partner. [*Tower Cabinet Co v Ingram*].

For example, D, who is not actually a partner in the firm consisting of A, B and C, represents to X that he is also a partner in that firm. On the faith of that representation, X gives credit to the firm. X can make D liable. But if Y, who does not know of the representation, gives representation to the firm of A, B and C, he cannot make D liable.

Liability for Torts: if the basis of the action is the tort committed by one of the partners, the doctrine of holding out does not apply in such a case.

Position of a retired partner: From the point of view fo the thid parties, the mutual agency which had earlier come into existence is still presumed to be continuing until public notice of retirement is given.

Death of a partner: the legal representatives will not be liable for the acts of the firm done after the death of the partner even though no public notice of partner's death is given.

What is meant by "Reconstitution of a firm"? In what circumstances can a partnership firm be reconstituted? Refer to the relevant statutory provisions and the decided cases in your answer [20M]

<u>TOPIC 11: Negotiable Instruments Act 1881</u>

1. *Discuss the quasi criminal-nature of Section 138 of the Negotiable Instruments Act, 1881. 10M*
2. *"The objective of section 138 of the Negotiable Instrument Act, 1881 is to promote the efficiency of banking operations to ensure credibility in transacting business through cheques." Explain the statement with recent amendments. 20M*
   Analyse 2015 and 2018 Amendment Act See- Dashrath Rupsingh Rathod Vs. State of Maharashtra
3. *If an officer with an intelligence agency of the government receives a cheque for consideration on the basis of an agreement to pause on intelligence inputs, can such a cheque be enforceable under section 138 of the Negotiable Instruments Act, 1881? Discuss the scope of the legally enforceable liability of the drawer under sections 138 and 139 of the Act. 20M*
   Legal enforceability Case- Laxmi Dyechem v. State of Gujarat 2012 SC
4. *Explain holder and holder in due course and distinguish between the two. Also discuss their rights 15M*
   Section- 8 and 9 of Negotiable Instrument Act, 1881.
5. *Every sole maker, drawer, payee or endorsee, or all of the joint makers, drawers, payees, or endorsees, of a negotiable instrument may endorse and negotiate it'. In the light of the above statement, distinguish between endorsement and negotiation and also explain different kinds of 'endorsements' 10M*
   Statement question – Section- 14 of the Negotiable Instrument Act, 1881
6. *Explain clearly what is meant by 'negotiation and endorsement'. How does negotiation different from ordinary assignment? 15M*
7. *"Once an instrument passes through the hands of a holder in due course, it is purged of all defects, it is true like a current coin". Explain. 10M*
8. *Discuss the law regarding dishonour of checque for insufficiency, et cetera of funds in the account. 10M*
9. *What do you understand by a promissory note? Discuss. 15M* [Sec 4]
10. *Explain the concept of 'holder' and 'holder in due course' as envisaged in the Negotiable Instruments act and also examine the privileges and protection to which they are entitled under the act. Illustrate your answer with decided cases. 20M* [Sec 8 and 9]
11. *"The object of Sec. 138 of the Negotiable Instruments Act, 1881 is to inculcate faith in the efficacy of banking operations and credibility in transacting business on negotiable instruments." Elucidate with the help of the latest Supreme Court cases. 20M*
    Section 138 of Negotiable Instrument Act, 1881. Case- Dalmia Cement Ltd. V. Galaxy Traders & Agencies Ltd
12. *Who can make negotiable instrument? Whether a promissory note duly executed in favour of minor is void? Give reasons. 20M*
13. *What is meant by 'material alteration' in the negotiable instrument? Under what circumstances an alteration in the negotiable instrument may be treated as material alteration under the-Negotiable Instruments Act, 1881? 20M*
14. *"Any material alteration of a negotiable instrument renders the same void." Discuss 10M*
15. *Distinguish between Holder and Holder in due Course. Support your answer with decided cases. 20M*
16. *. What are various kinds of Indorsement recognised by law? Discuss the effect of forged indorsement. Give reasons 20M*

17. *"A cheque marked 'not negotiable' is nevertheless negotiable." Discuss. 15M*
18. *. Examine the reasons which make it necessary that there should be a concept like "holder in due course" in the law of negotiable instruments. State the characteristics of a "holder in due course" and his privileges and protections under the Negotiable Instruments Act, 1881. 20M*
19. *What conditions must an instrument possess to become negotiable? How do you distinguish negotiability from endorsement? Explain with illustrations. 20M*
20. *. "Once a bearer instrument is always a bearer instrument." Discuss. 10M*
21. *Discuss the circumstances in which a bill of exchange is said to be dishonoured. What are the consequences of such dishonour?20M*
22. *P, Q and R are sisters, and their parents died soon after the eldest of them, P got married to S. S started managing the properties left by the parents to the three sisters. At the instance of S, the three sisters jointly executed a promissory note for a sum of Rs. 30,000 in favour of S. The sum was stated to be the amount which S himself spent for managing properties. Q and R discovered that S did not spend more than Rs. 3,000. They have sued for rescission of the promissory note. Give your decision.*

In Re Expeditious Trial Of Cases Under Section 138 of N.I Act 2021 A constitution bench of the Supreme Court on Friday issued a set of directions to expedite the trial of cheque dishonour cases under Section 138 of the Negotiable Instruments Act. *Magistrates to record reasons before converting trial of complaints under Section 138 of the Act from summary trial to summons trial.Inquiry shall be conducted on receipt of complaints under Section 138 of the Act to arrive at sufficient grounds to proceed against the accused. Section 258 of the Code is not applicable to complaints under Section 138 of the Act*

public policy is an unruly horse, but it is for an able and competent judge to ride that unruly horse and to bring it down on the side of justice. - Justice Krishna Iyer.

With a view of reduce the pendency of cheque bounce cases under Section 138 of the Negotiable Instruments Act, the Supreme Court on Thursday directed the establishment of pilot courts presided over by retired judges in 5 districts of 5 states with the highest pendency (namely, Maharashtra, Rajasthan, Gujarat, Delhi and Uttar Pradesh). IN RE: EXPEDITIOUS TRIAL OF CASES UNDER SECTION 138 OF N.I. ACT 1881 | 2022

The argument that an additional accused can be impleaded subsequent to the filing of the complaint merits no consideration, once the limitation prescribed for taking cognizance of the offence under Section 142 of NI Act has expired ***Pawan Kumar Goel v. State of U.P., 2022***For maintaining the prosecution under Section 141 of NI Act, arraigning of the company as an accused is imperative and non-impleadment of the company would be fatal for the complaint. (Para 19-21) ***Pawan Kumar Goel v. State of U.P., 2022***

The Supreme Court observed that a complaint under Section 138 cannot be transferred as per the convenience of the accused. After noticing that the petitioner is a woman and a senior citizen, Justice

Abhay Oka observed that she can always seek exemption from personal appearance. ***S Nalini Jayanthi vs M. Ramasubba Reddy 2022***

Circumstances in which a bill is said to be dishonoured

Sec 91. Dishonour by non-acceptance.—A bill of exchange is said to be dishonoured by non-acceptance when the drawee, or one of several drawees not being partners, makes default in acceptance upon being duly required to accept the bill, or where presentment is excused and the bill is not accepted. Where the drawee is incompetent to contract, or the acceptance is qualified the bill may be treated as dishonoured.

Non acceptance of a bill of exchange by the draweee within 48 hours or being presented

Fictitious drawee

Drawee is not traceable

Drawee is dead or an insolvent

Sec 92. 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.

Q1. "The objective of section 138 of the Negotiable Instrument Act, 1881 is to promote the efficiency of banking operations to ensure credibility in transacting business through cheques." Explain the statement with recent amendments [20M]

According to **section 6** of the NEGOTIABLE INSTRUMENT ACT,1881(hereinafter called as NI ACT), C**heque 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.

DISHONOR OF CHEQUE is a condition in which a **bank refuses to pay** the amount of cheque to the payee due to insufficiency of funds etc.

Whenever the cheque is dishonored, the drawee bank instantly issues a **Cheque Return Memo** to the payee banker specifying the reasons for dishonor. The marginal note of **Section 138** of the NI ACT

explicitly defines the offence as being the dishonor of cheques for insufficiency, etc., of funds in the account.

Objective:

Chapter XVII containing **Sections 138 to 142** was introduced to inculcate confidence in the efficacy of banking operations and build public confidence in negotiable instruments employed in business transactions.

The objective of Parliament was to strengthen the use of cheques, distinct from other negotiable instruments, as **mercantile tender** and therefore it became essential for the Section 138 NI Act offence to be freed from the requirement of proving mens rea.

The objective of sec 138 of NI Act is **To promote the efficiency of banking operations and to ensure credibility in transacting business through cheques** is mentioned in the case law *Modi Cements Ltd. v. Kuchil Kumar Nandi*. Section 138 of NI Act thereof incorporated with a specified object of making a special provision by incorporating a strict liability so far as the cheque, a negotiable instrument, is concerned. The law relating to negotiable instruments is the law of the commercial world legislated to simplify the activities in trade and commerce making provision of giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another.

It is mentioned in the case law *M/s. Dalmia Cement (Bharat) Ltd. V. M/s. Galaxy Traders and Agencies Ltd. and Others* that Section 138 of the NI Act is not to protect unscrupulous drawers who never intended to honour the cheques issued by them, it being a part of their modus operandi to punish the unscrupulous person.

Essential Ingredients:

1. A person (will be drawer of the cheque) should have a **legally enforceable debt** or other liability towards another person (will be payee or holder of the cheque, as the case may be) and a cheque is drawn to discharge the debt or liability.

2. Cheque is **returned due to insufficient funds or exceeds the amount** agreed upon to be paid by the bank.

3. Cheque is to be **presented within six months** from date of its drawn or till its validity, whichever being earlier.

Ø **Note:**
As per RBI guidelines, with effect from April 1, **2012,** the validity period of Cheques, Demand Drafts, Pay Orders and Banker's Cheques will be reduced from six (6) months to **three (3) months**, from the date mentioned in the instrument.

4. A **written notice within 30 days** is sent to the drawer along with the receipt of information from the bank about failure of payment of cheque.

5. The payee or holder doesn't **receive the payment within 15 days** of the receipt of send written notice to the drawer.

These ingredients are mentioned in the case law *Kusum Ignots and Alloys ltd. V. Pennar Peterson Securities Ltd*

Liability

1. **Civil Liability:** As per section 138 of the NI Act provides the civil liability by imposing a fine twice the amount of dishonored cheque. But if the payee files a suit under **Order 37 of Code of Civil Procedure, 1908,** then the judgement is in favor of the payee, then the drawer should pay the amount mentioned in the court order.

2. **Criminal liability:** Sec 138 provides the punishment of imprisonment of **two years** or fine or both and the drawer of the cheque will be prosecuted under sections of **417 and 420 of Indian Penal Code (IPC),**1860.

2015 Amendment

The Negotiable Instruments (Amendment) Act, 2015 is focused on clarifying the **jurisdiction related** issues for filing cases for offence committed under section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015, facilitates filing of cases **only in a court within whose local jurisdiction the bank branch of the payee**, where the payee delivers the cheque for payment through his account, is situated, except in case of bearer cheques, which are presented to the branch of the drawee bank and in that case the local court of that branch would get jurisdiction. The Negotiable Instruments (Amendment) Act, 2015 provides for **retrospective validation** for the new scheme of determining the jurisdiction of a court to try a case under section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015 also mandates **centralisation of cases against the same drawer.**

The clarification of jurisdictional issues may be desirable from the **equity point** of view as this would be in the interests of the complainant and would also ensure a **fair trial.**Further, the clarity on jurisdictional issue for trying the cases of cheque bouncing would **increase the credibility of the cheque** as a financial instrument. This is expected to help the trade and commerce in general and allow the lending institutions, including banks, to continue to extend financing to the productive sectors of economy, as the process of pursuing the cheque bouncing cases relating to loan default has been made simpler and efficient through the proposed amendments to the Negotiable Instruments Act, 1881.

Earlier, the Hon'ble Supreme Court, in its judgment dated **1st August, 2014,** in the case of *Dashrath Rupsingh Rathod versus State of Maharashtra and another* (Criminal Appeal No. 2287 of 2009) held that the territorial jurisdiction for cases relating to offence of dishonour of cheques is **restricted to the court within whose local jurisdiction such offence was committed,** which in the present context is where the cheque is dishonoured by the **bank on which it is drawn.** The Supreme Court had directed that only in those cases where post the summoning and appearance of the alleged accused, the recording of evidence has commenced as envisaged in section 145(2) of the Negotiable Instruments Act, 1881, proceeding will continue at that place. All other complaints (including those where the accused / respondent has not been properly served) shall be returned to the complainant for filing in the proper court, in consonance with exposition of the law, as determined by the Supreme Court.

Various financial institutions and industry associations had expressed difficulties, arising out of the legal interpretation by the Supreme Court about the jurisdiction of filing cases under section 138 of the Negotiable Instruments Act, 1881. In view of the urgency to create a suitable legal framework for determination of the place of jurisdiction for trying cases of dishonour of cheques under section 138 of the Negotiable Instruments Act, 1881, it was decided by the Government to introduce suitable amendments to the Negotiable Instruments Act, 1881.

Jurisdiction

After the amendment in 2015, The Gujarat High Court in its judgment in *Brijendra Enterprise v. State of Gujarat and Another* has explained the law relating to territorial jurisdiction for filing a complaint for dishonor of cheques.

As per the Negotiable Instruments (Amendment) Act, 2015 a complaint can be filed under Section 138 for dishonor of cheque at a court within whose local jurisdiction:

- The branch of the bank is located.

- The payee or the holder maintains an account.

2018 Amendment:

Rationale behind the Amendment:

In the Statement of Objects and Reasons appended to the Amendment Act, it was stated that "injustice is caused to the payee of a dishonored cheque who has to spend considerable time and resources in court proceedings to realize the value of the cheque" on account of "delay tactics of unscrupulous drawers of dishonoured cheques due to easy filing of appeals and obtaining stay on proceedings." The Amendment Act, thus, seeks to provide relief to payees of dishonoured cheques who get caught up in lengthy litigations and to discourage frivolous and unnecessary litigation.

In order to strengthen the ease of doing business in India, the parliament passed the Negotiable Instruments (Amendment) Act 1881 and thereby inserted/introduced following two provisions: -

Section- 143A: With the amendment, the new provision entitles any Court while trying a cheque dishonor offence, to order the drawer of the cheque to pay **interim compensation** to the complainant, where the **drawer pleads not guilty** to the accusation made in the complaint and in any other case, **upon framing of charge.** The provision further stated that the interim compensation **shall not exceed twenty percent of the amount** of the cheque and it was also provided for that this interim compensation has to be paid within a prescribed time period of **60 days** from the date of the passing of the Order by the Court, or within the extended period of **30 days**, if allowed/ directed by the Court on justifying significant cause for the delay in payment.

It has been specifically provided in the amended provision that if the drawer of the cheque is **acquitted,** the Court shall direct the complainant to repay to the drawer, the amount of interim compensation, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on showing sufficient cause.

Further it has been provided that the interim compensation payable under this section may be recovered as if it were a fine under section 421 of the CrPC 1973. Later on the amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the CrPc, shall be reduced by the amount paid or recovered as interim compensation.

But Section 143 is not made applicable retrospectively.

Section- 148

The amendment inserted a new section that is section 148 and stated that in case of an Appeal filed by the drawer against conviction under section 138, the Appellate Court may order the Appellant to deposit such sum which shall be **minimum of twenty percent** of the fine or the total compensation awarded by the trial Court. The provision further stated that the amount payable shall be in addition to any interim compensation paid by the Appellant under section 143A.

Further the provision stated that the above amount shall be deposited within **sixty days** of the date of order or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the Appellant. The Appellate Court has been further given the power to release the said amount in favour of the Complainant at any time during the pendency of the Appeal. However, if the defaulter/Appellant is acquitted from the offence, then the Court instructs the complainant to repay the amount to the Appellant.

The indicial Judicial system is facing a huge backlog of cases and as per the 213th Law Commission Report, about 20% of the cases relating to litigation, pertains to cheque bounce. So the newly introduced provisions would give some life into the dead provisions of the Negotiable Instruments Act 1881.

Critical Analysis of the Amendment:

Merits

- Helps in tackling delay in the proceedings under the Act leading to quicker relief.
- Apt discretion has been provided to the Court to assess whether under the facts and circumstances of the case, the imposition of the compensation is called for and if so, to what extent. This prevents prejudicial treatment of the Drawer and equitable treatment of parties.
- These provisions are Complainant centric and are aimed to safeguard their interests. While proceedings and appeals are *sub judice*, it is the complainant who suffers substantial losses both in the form of loss of the cheque amount and the consequent legal costs of litigation.
- Section 148 protects the Complainant from the endless appeals and stays.
- These provisions create a framework of certainty and stringency, thus having a deterrent effect on those who seek to preclude the rights of others through dishonor of cheques and consequent illicit and evasive tactics.
- These amendments would reduce pendency in courts because of the deterrent effect on the masses.

Demerits/ Challenges:

- Section 148 operates in prejudice of the Accused as the imposition of such costs upon the Drawer without the final determination by the Court operates on a presumption of guilt against the Drawer.
- The Act provides for unbridled discretion to the Court which will in turn lead to increased litigation and pendency of cases in the Courts.

- Though the provisions stipulate that where the Drawer is Acquitted, the Court shall order the Complainant to return the money sum received by him under Section 148, in practice, same provision would turn out to be very contentious in cases where the Complainant either refuses to or is unable to return the sum because of inability to do the same. This would give rise to further litigation.
- Under the aforementioned provision for repayment of the sum by the Complainant to the Drawer, the Complainant must make a payment of interest along with the principal sum. This provision can act in prejudice of the Complainant who might be wary to even request the Court to order the Drawer to make payment of interim compensation or an amount under appeal as the cost of paying further interest upon the sum upon losing the bout before the court would act against the interest of the Complainant.

Concluding remarks:

The changes brought forth by way of the 2018 amendment to the Negotiable Instruments Act, 1881 are substantial in nature and focus heavily on upholding the interests of the Complainants in such proceedings. Yet, the aforementioned Sections operate essentially upon the discretion of the judge. This raises another challenge for the complainant to prove his cause before the Court towards getting such relief. Nonetheless, these amendments are a positive step towards a more equitable and efficacious regime, and are welcomed as such.

Q. Discuss the quasi criminal-nature of Section 138 of the Negotiable Instruments Act, 1881 [10, 2022]

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 truncated cheque [Sec 6]. Section 138 defines the offense as dishonor of cheques.

Quasi-Criminal Nature:

Sec 138 of NI Act can be called a 'civil sheep' in a 'criminal wolf's clothing.' this is because of the nature of liability.

Liability

1. Civil liability: imposes a fine twice the amount of cheque
2. Criminal liability: punishment of 2 years or fine or both (also u/s 417, 420 of IPC)

Recently in *P Mohanraj v Shah Brothers (2021)* the Bench made certain observations while ascertaining the nature of Sec 138 of the NI Act:

1. The provision contains both punitive punishment and fine. The court noted that it is a hybrid provision to ensure payment of bounced cheque if it is otherwise enforceable in civil law
2. The provision allows the drawer to pay back by providing statutory provision of serving notice
3. The offences under Section 138 of NI lack mens rea
4. The proceedings come under the ambit of Section 14 of IBC

The conviction in the criminal proceeding under Section 138 of NI Act will not absolve the drawer from civil liability. Hence it is only quasi-criminal in nature. (*Golden Menthol Export Pvt Ltd v Sheba Wheels P Ltd)*

Q. Explain holder and holder in due course and distinguish between the two. Also discuss their rights [15M]

Sec 8. "Holder".—The "holder" of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

Sec 9. "Holder in due course".—"Holder in due course" means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or indorsee thereof, if 1 [payable to order,] before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

BASIS FOR COMPARISON	**HOLDER**	**HOLDER IN DUE COURSE (HDC)**
Meaning	A holder is a person who legally obtains the negotiable instrument, with his name entitled on it, to receive the payment from the parties liable.	A holder in due course (HDC) is a person who acquires the negotiable instrument bonafide for some consideration, whose payment is still due.

Consideration	Not necessary	Necessary
Right to sue	A holder cannot sue all prior parties.	A holder in due course can sue all prior parties.
Good faith	The instrument may or may not be obtained in good faith.	The instrument must be obtained in good faith.
Privileges	Comparatively less	More
Maturity	A person can become holder, before or after the maturity of the negotiable instrument.	A person can become holder in due course, only before the maturity of negotiable instrument.

it is quite clear that a holder and holder in due course are two different persons. Further, a person needs to be a holder first, to become a holder in due course, whereas, in the case of a holder, he need not be an HDC first.

Eg: A steals bill from B and endorses to C then C as a holder in due course has the right to receive amount from B even if A cannot recover that amount.

Holder must satisfy the following conditions:

Entitled to possess the instrument in his own name i.e. legal custody of an instrument

He should have a right to receive or recover the amount due on the instrument from the party liable to pay.

However, it is not necessary that the instrument must be in his possession. Rather, to be a holder, he is required to have a right to possession under some valid and legal title. Thus, the holder should be a 'de-jure' holder (holder in law).

Case Law: *Sarjoo Prasad v Ram Payari Devi:* In this case, S advanced a sum of Rs 2500 under a promissory note. The note however was executed not in the name of S but in the name of P who was 'Benamindar.' On maturity S sued to recover the amount front eh debtor. It was held that he could nto recover as he was not a holder having a right of possession and payment. Thus to become a holder, it is not enough to have lawful possession of the instrument. The person must also have the right to receive or recover the amount from the party liable to pay so as to give him valid discharge.

Holder in due course conditions:

He must be a holder

He must be a holder for consideration

He must acquire the instrument before maturity

Instrument should be complete and regular

Holder must take the instrument in good faith

"Once an instrument passes through the hands of a holder in due course, it is purged of all defects, it is true like a current coin". Explain [10M]

Q. "Every sole maker, drawer, payee or endorsee, or all of the joint makers, drawers, payees, or endorsees, of a negotiable instrument may endorse and negotiate it'. In the light of the above statement, distinguish between endorsement and negotiation and also explain different kinds of 'endorsements' [10M]

Every sole maker, drawer, payee or indorsee or all several joint makers of a negotiable instrument may, if the negotiability of such instrument has not been restricted as mentioned in Section 50, indorse and negotiate the same. [Sec 51]

DIFFERENCE BETWEEN ENDORSEMENT AND NEGOTIATION:

Endorsement.	**Negotiation**
When the maker or holder of a negotiable instrument **signs** the same, otherwise than as such maker, for the purpose of	—When a promissory note, bill of exchange or cheque is **transferred**

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 a negotiable instrument, he is said to indorse the same, and is called the "indorser". [Sec 15]	to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated. [Sec 14]
for the purpose of negotiation, intended to be completed as a negotiable instrument	so as to constitute that person the holder thereof
Endorsement may be in blank or in full [Sec 16]	It is transferred completely

Types of Endorsement

An endorsement is basically of two sorts:

1. The Endorsement in Blank
2. The Endorsement in full

As indicated by Section 16 of the Negotiable Instrument Act, 1881, if the endorser signs his name just, the underwriting is supposed to be in the clear, and on the off chance that he adds a heading to pay the sum referenced in the instrument to, or to the request for, a predetermined individual, the Endorsement is supposed to be in full, and the individual so determined is known as the endorsee of the instrument. There are some different sorts which are established, however, not well known, which are given underneath.

There are six types of endorsement. These are applicable for endorsement in banking and various types of endorsement cheques:

1. **Blank or General Endorsement:** An endorsement is supposed to be blank or general endorsement when the endorser puts his unmistakable just on the instrument and doesn't compose the name of anybody to whom or to whose request the installment is to be made.
2. **Full Endorsement or Special Endorsement :** A special Endorsement or full Endorsement is when the endorser, notwithstanding his mark, additionally notices the name of the individual to whom or to whose request the installment is to be made. There is a heading added by Endorsement to the individual indicated called the endorsee of the instrument who presently turns into its payee qualified to sue for the cash due on the instrument.
3. **Conditional Endorsement:** The restrictive endorsement is an arrangement that produces results on the occurrence of an expressed occasion, or not something else. Segment 52 of the Negotiable

Instrument Act 1881 gives the endorser of a debatable instrument may, by express words in the Endorsement, reject his own risk subsequently, or make such obligation or the privilege of the endorsee to get the sum due consequently rely on the occurrence of a predetermined occasion, albeit such occasion may never occur. Where an endorser so prohibits his risk and a short time later turns into the holder of the instrument, all intermediates endorsers are obligated to him.

4. **Restrictive Endorsement:** Restrictive Endorsement tries to end the chief qualities of a Negotiable Instrument and seals its further debatability. This may sound somewhat unordinary, yet the endorsee is especially inside his privileges on the off chance that he so signs that its resulting move is limited. This forestalls the danger of unapproved individuals acquiring installment through misrepresentation or falsification and losing their cash.
5. **Partial Endorsement:** An endorsement is supposed to be a partial endorsement when the endorser indicates to move to the endorsee, just an aspect of the sum payable. In straightforward terms, support which permits moving to the endorsee an aspect of the sum payable is known as halfway underwriting.
6. **Facultative Endorsement:** Facultative Endorsement is an underwriting where the endorser defers some privilege to which he is entitled. For instance, the endorsee is subject to pull out of disrespect to the endorser, and typically inability to pull out will vindicate the endorser from his risk.

Explain clearly what is meant by 'negotiation and endorsement'. How does negotiation different from ordinary assignment? [15M]

Every sole maker, drawer, payee or endorsee or all several joint makers of a negotiable instrument may, if the negotiability of such instrument has not been restricted as mentioned in Section 50, endorse and negotiate the same [Sec 51]

MEANING OF:

Negotiation

The term negotiation simply means a 'transfer.' the rights in a negotiable instrument can be transferred from one person to another by:

1. Negotiation under the Negotiable Instrument Act
2. Assignment under Transfer of Property Act

Section 14 states that when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof the instrument is deemed to be negotiated. Thus ther is a transfer of ownership.

Modes of Negotiation: Either by delivery (Sec 47) or by Endorsement (Se 58)

B. Endorsement

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 or on a slip of paper annexed thereto or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same [Sec 15].

Endorsement may be in blank or in full [Sec 16]

Types: Blank or General, Full or Special, Conditional, Restrictive, Partial, Facultative

Negotiation v Ordinary Assignment

Negotiation	**Ordinary Assignment**
Makes the person the holder of the instrument	Purpose of receiving the debt payment
Regulated by the NI Act 1881	Regulated by the Transfer of Property Act 1882
Consideration is presumed	Consideration is proved
In case of: • Bearer Instrument: done by delivery • Order instrument: Endorsement and delivery	Assignment is effected by a written agreement to be signed by the transferor, both in the case of bearer and order instrument.
No requirement of transfer notice	Notice of assignment is compusory
Transferee has the right to sue the party in his/her name	No such right
No requirement of stamp duty	Stamp duty must be paid.

Q. What do you understand by a promissory note? Discuss. [15M]

Negotiable means transferability and instrument means piece of paper or any document. Thus, a negotiable instrument is actually a written document and is transferable.

Kinds of Negotiable instrument (Sec 13): [table]

Promissory note (Sec 4)

Bills of exchange (Sec 5)

Cheque (Sec 6)

Promissory Note

A Promissory note is a legal financial instrument issued by one party, promising to pay the debt owed to another party.

Definition: A promissory note is

- An instrument in writing
- Containing an unconditional undertaking
- Signed by the maker
- To pay a certain sum of money
- Only to, or in the order of a certain person, or to the bearer of the instrument [Sec 4[-]

However, it must be noted that a bank note or a currency note is not a promissory note.

Parties to a promissory note [table]

- Maker: the person who makes the promissory note and promises to pay is called the maker
- Payee: the person to whom the payment is made is called the payee

Essentials of a promissory note:

1. The note must be in writing
2. It must contain an undertaking to pay
3. There must be an express promise to pay
4. The promise to pay should be unconditional
5. The promissory note must be signed by the maker
6. The sum payable must be certain
7. The instrument must contain a promise to pay money and money only.

Other important points:

- Stamping is essential under the Indian Stamp Act 1899 (else not admissible in evidence)
- Limitation period is 3 years from the date of execution or acknowledgment
- It must contain date.

Q. Who can make negotiable instrument? Whether a promissory note duly executed in favour of a minor is void? Give reasons [20M]

Q. What is meant by 'material alteration' in the negotiable instrument? Under what circumstances an alteration in the negotiable instrument may be treated as material alteration under the-Negotiable Instruments Act, 1881?

file:///C:/Users/euges/Downloads/Negotiable%20Instruments_%20Material%20alteration%20and%20its%20fall-outs%20(1).pdf

"A cheque marked 'not negotiable' is nevertheless negotiable." Discuss.

Conditions of a negotiable instrument. https://www.shsu.edu/klett/Chapter%2024.htm#:~:text=In%20general%2C%20a%20negotiable%20instrument,or%20at%20a%20definite%20time.&text=Payment%20On%20Demand%3A%20An%20instrument,to%20the%20payor%20or%20drawee.

TOPIC 12: Arbitration and Conciliation Act 1996

Q.1. "Parties cannot appeal against an arbitral award as to its merits and the court cannot interfere on its merits." Critically examine the statement and also explain the highlights of the Arbitration and Conciliation (Amendment) Act, 2019. [15 M]

Section 2 (a) "arbitration" means any arbitration whether or not administered by a permanent arbitral institution; (b) "arbitration agreement" means an agreement referred to in section 7. Arbitration is a form of alternative dispute resolution where the parties to a dispute settle the dispute out of Court through an arbitral tribunal. The arbitration law in India was modeled on the English Arbitration Law and evolution

of law led to the replacement of the old Arbitration Act 1940 with the new Arbitration and Conciliation Act 1996. In India the UNCITRAL model of arbitration is followed.

Grounds for setting aside Arbitral Award:

The parties cannot appeal against an arbitral award as to its merits and the court cannot interfere on its merits.

Under the **repealed 1940 Act** three remedies were available against an award- **modification, remission and setting aside.** These remedies have been put under the 1996 Act into two groups. To the extent to which the remedy was for rectification of errors, it has been handed over to the parties and the Tribunal. The remedy for setting aside has been molded with returning back the award to the Tribunal for removal of defects.

If the decision on matters submitted to arbitration can be separated from those not submitted; only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside.

Section 34 (Chapter VII: Recourse against Arbitral Award) of the Act is based on **Article 34** of the UNCITRAL Model Law and the scope of the provisions for setting aside the award is far less than it was under the **Sections 30** or **33** of the 1940 Act. In ***Municipal Corp. of Greater Mumbai v. Prestress Products (India)***, the court held that the new Act was brought into being with the express Parliamentary objective of curtailing judicial intervention. **Section 34** significantly reduces the extent of possible challenge to an award.

There are five grounds under Section 34 (2)(a):

1. Incapacity of the parties
2. Invalidity of the agreement
3. Notice not given to party; unable to present case
4. Award beyond the scope of reference
5. Illegality in composition of AT

Notice not given to party; Unable to present case

- Party not given proper notice of the appointment of arbitrator
- Of arbitral proceedings
- Was unable to present his case

Section 12 gives right to parties to challenge on grounds of integrity and impartiality. They may file their statement of claim or defence as required by Section 23. It is the prerogative of the AT to determine the time in which the statement needs to be filed. Thus, there must be communication by proper notice.

Award beyond the scope of reference: Sec 34(a)(iv) provides that the AA is liable to be set aside if it deals with the dispute

Not **contemplated** by reference

Not **falling** within the terms of reference

Contains a decision in matters **beyond** reference

Reference defines the limits of authority and jurisdiction or arbitration. Arbitration has its source in the reference (authority). Whatever is beyond the jurisdiction of AT would also be beyond the authority, but the converse is not true. The jurisdiction of the arbitration therefore is limited by reference.

Section 16 states the stage at which the objection to jurisdiction should be raised.

If award exceeds submissions: the AT is empowered to modify by separating the excess part if it can be done without vitiating the other part.

Illegal Composition of Tribunal or an arbitral procedure

An application under Section 34 for setting aside the AA on the ground that

The **composition** of the T is not in accordance with agreement

Procedure agreed to by the parties not followed in the conduct of proceedings

That in the absence of an agreement to procedure, the procedure prescribed by the **Act** was not followed

Cases:

Rajendra Kishan Kumar v UOI: The relief sought in this case was

- Damages for destruction of houses, crops and orchids and

- Directions to the respondents to reclaim the agricultural land rendered unfit by their operation

The AT awarded a sum of money for loss of potential land. The SC held that the award was outside the scope of reference. In the writ petition there was no such averment in particular on that behalf.

b. ONGC Ltd v Saw Pipe Ltd: An award which dishonors these provisions is illegal. Although the AT has independence wrt deciding the procedure, it cannot be in contravention with the provisions of the Act.

Grounds for setting outside AA

Sec 34(2)(b) lays down grounds on the basis of which an award can be challenged by parties to the arbitration

1. The **subject-matter** of the dispute is not capable of settlement by arbitration under the law for the time being in force. Disputes not arbitrable

    - All matters in a dispute, except **criminal** ones
    - Where law provides only **specified** tribunals
    - Insolvency, probate, trust in public
    - Where **liability** is fixed
    - Matters of public rights

Matters of Public Policy: According to Sec 34(2)(b)(ii) an application for setting aside if in conflict with public policy of India. It is in conflict if

i) the making of the award was induced or affected by **fraud or corruption** or was in violation of **Sec 75** (Confidentiality) or **Sec 81** (Admissibility of evidence in other proceedings)

ii) **fundamental policy** of Indian Law

iii) conflict with basic notions of **morality or justice** [Explanation 1]

The 2nd and third points are ambiguous therefore judgements have broadened its scope.

Explanation 2.—For the avoidance of doubt, the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.

In *Ramnagar Power Co Ltd v General Electric Co* it was stated that an award against public policy would be an award that was passed in contravention of

- Fundamental policy of Indian law
- Interests of India
- Justice or morality

Limitation for filing application for setting aside: **Sec 34(3)- 3 months**

- From the date on which the party receives the arbitral award
- From the date of disposal of application u/s 33

Proviso: May extend to a maximum time of 30 days

2015 Amendment [15M]

The Arbitration Act was enacted in 1996, with the intention of providing speedy and effective resolution of disputes through arbitration or conciliation and reducing the burden on courts. However, the arbitration experience in India has been subject to intense scrutiny over the years, leaving the parties to ponder whether or not to incorporate arbitration clauses. Taking note of the criticisms in the earlier arbitration regime, the Law Commission of India ("Law Commission") had submitted its **Report No.246 in August 2014** ("Law Commission Report") recommending several changes to the Arbitration Act.

Explantation 2 under Sec 34(2)(b)(ii): If contravention of fundamental policies it does not entail a review on the merits of the dispute

Section 34 (2A): **Patent Illegality-** so unfair and unreasonable as to shock the conscience of the court.

Sec 34(5)n application only after issuing prior **notice** to the other party and an **affidavit**

Sec 34(6) disposed of expeditiously **within 1 year** from the date of notice.

1. Interim Relief from Court: After the judgment of the SC in *Bharat Aluminium and Co v Kaiser Aluminium and Co* (BALCO) the Indian Courts had no jurisdiction to intervene in arbitrations which were seated outside India. Since the interim orders made outside India could not be enforced in India, it created major hurdles for the parties. This anomaly has been addressed in the

Amendment Act with the insertion of Section 2(2), which makes the provision for interim relief(s) also applicable in cases where the place of arbitration is outside India, subject to an agreement to the contrary. However, there are few concerns. This option is only applicable to parties to an "international commercial arbitration" with a seat outside India. This means that the protection will not be available to two Indian parties who choose to arbitrate outside India.

The Amendment Act provides that in case the court passes an interim order, arbitration proceedings must commence within a period of **90 (ninety) days** from the date of such order or within such time as prescribed by the court. However, there is no clarity on whether the 90 (ninety) day period would commence from the date of the exparte or ad interim order or the final order in the proceedings under Section 9.

Arbitral Tribunal: The amendments to **Section 17** empowers the arbitral tribunal with the same powers **as that of a court under Section 9.** In order to facilitate the parties to approach the arbitral tribunal and reduce the intervention of courts, the Amendment Act provides that once the arbitral tribunal has been constituted, courts cannot entertain application for interim measures, unless there are circumstances which may not render the remedy of obtaining interim orders from the arbitral tribunal efficacious. The Amendment Act also clarifies that such interim measures granted by the arbitral tribunal would have the same effect as that of a civil court order under the Civil Procedure Code, 1908 ("CPC").

Limited Scope to refuse arbitration request: The amended Section 8 empowers the judicial authority to refer the parties to arbitration when there is an arbitration agreement. While Section 8(1) refers to "judicial authority", inexplicably, in Section 8(2) the word "Court" has been used instead of "judicial authority" which appears to be an oversight.

Amendments to grounds for challenging arbitral award: The scope of "public policy" in Section 34 has been narrowed and the award can be set aside only if the arbitral award (i) was induced or affected by fraud or corruption; or (ii) is in contravention with the fundamental policy of India; or (iii) conflicts with the most basic notions of morality or justice. In order to counter the judgment of the Supreme Court in *ONGC Limited v. Western Geco International Limited*,[5] (which expanded the scope of "public policy" to include Wednesbury principle of reasonableness which would necessarily entail a review on merits of the arbitral award), the Law Commission had submitted its Supplementary Report in February 2015, which recommendations have been accepted and incorporated through insertion of Section 2A. In terms of this amended provision, an award cannot be set aside merely on the ground of erroneous application of the law or by re-appreciation of evidence. However, interestingly, the test of "patent illegality appearing on the face of the award" has not been made applicable to international commercial arbitrations. This provision may be subjected to challenge by Indian parties, who may contend that different standards ought not to be set for international commercial arbitrations. The test of "patent illegality" could perhaps have been deleted all together to avoid this anomaly.

No automatic stay of arbitral award upon filing of a challenge to the arbitral award: Prior to the Amendment Act, mere filing of a challenge petition to the arbitral award would result in an automatic stay of the arbitral award. In a welcome move, the Amendment Act provides that there would be no automatic stay of the arbitral award and a separate application will have to be filed seeking stay of the arbitral award.

The court is now required to record reasons for grant of stay and the provisions of the CPC for grant of stay of a money decree have been made applicable, meaning thereby that the losing party will necessarily be required to either deposit some part or the entire sum awarded in the arbitral award, or furnish security, as the court deems fit.

Time bound proceedings: The Amended Act provides for faster timelines to make the arbitration process more effective. Proviso to Section 24 has been added providing for the arbitral tribunal to hold oral hearings for evidence and oral argument on day-to-day basis and not grant any adjournments unless sufficient cause is made out. The arbitral tribunal has been vested with the power to impose heavy costs for adjournments without sufficient cause. Every arbitral award must be made within 12 (twelve) months from the date the arbitrator(s) receives a written notice of appointment. The parties may mutually decide to extend the time limit by not more than 6 (six) months. If the award is not made within 18 (eighteen) months, the mandate of the arbitrator(s) will terminate unless the court extends the period upon an application filed by any of the parties. However, there is no time period fixed for approaching the court seeking extension of time which may again contribute to delays.

Further, while extending the time for making the award, if the court finds that the delay was attributable to the arbitral tribunal, it may order reduction in the arbitrator's fee by not exceeding 5% (five percent) for each month of such delay. The court while extending the time limit would also have the right to change the arbitrator(s) as it may deem fit. An application to the court, as stated above would be endeavoured to be disposed by the court within 60 (sixty) days from the date the opposite party receives the notice. A challenge to an arbitral award should be disposed expeditiously and in any event within a period of one year from the date on which notice is served upon the other party. Section 11 will now have to be decided within a period of 60 (sixty) days from the date of service of notice to the opposite party.

Further, the proposed time line of 12 (twelve) months to pass the arbitral award is very ambitious, even by international standards. There are some complex disputes, the resolution of which may not be possible within this time frame. Even the Law Commission Report had recommended a time period of 24 (twenty four) months to complete the arbitration proceedings.

Fast Track Procedure: Section 29B has been introduced which gives an option to the parties to agree on a fast track mechanism under which the award will have to be made within a period of 6 (six) months from the date the arbitrator(s) receiving written notice of appointment. The dispute would be decided based on written pleadings, documents and submissions filed by the parties without any oral hearing. Oral hearing can be held only if all the parties request or the arbitral tribunal considers it necessary for clarifying certain issues.

New expansive Cost REgime: Section 31A has been introduced which gives wide powers to the arbitral tribunal to award costs. The expansive regime to award costs based on rational and realistic criterion rule, as recommended in the Law Commission Report, has been accepted. The arbitral tribunal can decide whether the costs are payable, the amount of costs to be paid and when they need to be paid. The provision further provides that generally the unsuccessful party will be ordered to pay the costs to the successful party. The costs may include fees and expenses of the arbitrators, courts and witnesses, legal fees and expenses, administrative costs of the institution and any other costs incurred in relation to the

arbitral or court proceedings and the arbitral award. The conduct of parties is a determining factor in awarding costs including the refusal of a party to unreasonably refuse a reasonable offer of settlement made by the other party.

Disclosure requirements of the arbitrator: The Amendment Act has borrowed the disclosure requirements from the IBA Guidelines on Conflict of Interest in International Arbitration. The Fifth and Seventh Schedule has been inserted which provides a guide in determining circumstances for ineligibility of the arbitrator.

Cap on fees to arbitrator: The Fourth Schedule has been introduced which provides the model fees in case of arbitrations other than international commercial arbitrations and in cases where parties have agreed to the rules of an arbitral institution, with a view to ensure that the arbitration process does not become very expensive. Section 11A (2) has been introduced which details the procedure for Central Government to amend the Fourth Schedule. However, since the High Court of each State is required to frame rules after taking into consideration the rates mentioned in the Fourth Schedule, this may lead to a disharmonised fee regime[7] across the country.

Analysis: The Amendment Act also does not clarify if Indian parties can choose foreign law to resolve disputes through arbitration. While some argue that this is possible since the choice of the party to determine the choice of law must be recognised

n order to provide statutory recognition to the "emergency arbitrator" as provided under some institutional rules, the Law Commission Report had recommended the addition of "emergency arbitrator" to the definition of "arbitral tribunal" under Section 2(d) of the Arbitration Act. The concept of "emergency arbitrator" has been recognised by most international arbitration rules and has gained popularity for its effectiveness. The recommendations made by the Law Commission Report in this regard have not been accepted

Though the Law Commission Report suggested using the expressions "seat" and "venue" instead of "place" of arbitration keeping it consistent with international usage of a "seat of arbitration" to denote the legal home of the arbitration, the proposal has not been accepted.

While, a time limit has been fixed for challenge to a domestic arbitral award, no such time limit is prescribed for the enforcement of foreign arbitral awards, despite the recommendations in the Law Commission Report. There cannot be any rationale for this considering the amendments have been made to make India more arbitration friendly.

5. The Amendment Act does not address the issue of confidentiality in arbitrations.

6. The Law Commission Report had recommended changes to Section 16 of the Arbitration Act, to empower the arbitral tribunal to decide disputes that involve serious questions of law, complicated questions of fact or allegations of fraud, corruption etc. While the provisions of Sections 8 and 11 have

been amended to the effect that the parties will be referred to arbitration "... *Notwithstanding any judgment, decree, or order of the Supreme Court...*" perhaps to overcome the conflicting judgments of the Supreme Court on whether or not questions of fraud are arbitrable; the recommended changes to Section 16 of the Arbitration Act ought to have been accepted, to make this position clear and provide more teeth to the powers of the arbitral tribunal. A two judge bench of the Supreme Court in *Radhakrishna v. Maestro Engineers*[12] ("Radhakrishna judgment"), held that issues of fraud are not arbitrable. However, the Single Judge of the Supreme Court, while deciding a petition under Section 11 of the Arbitration Act, in *Swiss Timing Ltd. v. Organising Committee*[13], held that judgment in Radhakrishna judgment *is per incuriam* and therefore not good law. In a situation, where the parties are before an arbitral tribunal in a manner other than Sections 8 or 11 of the Arbitration Act, and the arbitrator's jurisdiction is questioned by a party alleging that there are questions of fraud involved in the dispute, it would appear that the arbitral tribunal may be bound to follow the Radhakrishna judgment, and consequently rule that it does not have the jurisdiction to deal with questions of fraud. The better approach could have been to amend Section 16 consistent with the recommendations made in the Law Commission Report.

7. Section 44(b) requires that the foreign award not only be made in a reciprocating territory, but also that the reciprocating territory be notified by the Central Government in Official Gazette. With only about 50 (fifty) countries having been notified as reciprocating territory, the scope of enforcing foreign arbitral awards is significantly reduced. The Government should either notify most countries in the Official Gazette, or do away with the requirement of Section 44(b) that provides for notifying reciprocating territories in the Official Gazette.[14]

8. Though the Law Commission Report recommended inserting clauses 3A and 3B to Section 7 to provide greater clarity and meaning to the definition of "arbitration agreement", the same has not been accepted. The Law Commission Report had further recommended adding an explanation to define "electronic means" which has also not been accepted.

9. The Arbitration Amendment has created confusion as to whether the amendments will have a retrospective or prospective effect for court actions concerning arbitration and the arbitration proceedings. Section 26 of the Amended Act provides that "*Nothing contained in this Act shall apply to the arbitral proceedings commenced in accordance with the provisions of Section 21 of the principal Act, before the commencement of this Act unless the parties otherwise agree but this Act shall apply in relation to arbitral proceedings commenced on or after the date of commencement of this Act*". The Madras High Court in *New Tripur Area Development Corporation Limited v. M/s Hindustan Construction Company Limited & Ors*., has ruled that Section 26 of the Amended Act is not applicable to post arbitral proceedings including court proceedings, since the words "*in relation to*" has been deleted. Therefore, the court held that a separate application under the amended law had to be filed for seeking a stay on the arbitral award even in respect of arbitral awards passed prior to October 23, 2015. However, the Calcutta High Court in *Electrosteel Casting Limited v. Reacon Engineers (India) Private Limited*, has taken a contrary view and held that the enforcement of arbitral award, borne out of arbitration proceedings commenced before October 23, 2015, would be stayed automatically upon the filing of application for setting aside the same. This is a critical issue and needs to be decided by the Supreme Court at the earliest since the courts are unsure about which law to follow. This has resulted in inconsistencies in practice and uncertainty about the law, within just a few months of the introduction of the new arbitration regime.

AMENDMENT ACT 2019

The Arbitration and Conciliation (Amendment) Bill, 2019 was introduced in Rajya Sabha by the **Minister for Law and Justice, Mr. Ravi Shankar Prasad**, on July 15, 2019. It seeks to amend the Arbitration and Conciliation Act, 1996. The Act contains provisions to deal with **domestic and international arbitration,** and defines the law for conducting conciliation proceedings. Key features of the Bill are:

1. Arbitration Council of India (Part IA Sections 43A-M): The Bill seeks to establish an independent body called the Arbitration Council of India (ACI) for the promotion of arbitration, mediation, conciliation and other alternative dispute redressal mechanisms. Its functions include: (i) **framing policies for grading arbitral institutions** and accrediting arbitrators, (ii) **making policies** for the establishment, operation and maintenance of uniform professional standards for all alternate dispute redressal matters, and (iii) maintaining a **depository of arbitral awards** (judgments) made in India and abroad.

2. omposition of the ACI (Sec 43C): The ACI will consist of a Chairperson who is either: (i) a Judge of the **Supreme Court**; or (ii) a Judge of a **High Court;** or (iii) **Chief Justice of a High** Court; or (iv) an **eminent person** with expert knowledge in conduct of arbitration. Other members will include an eminent **arbitration practitioner, an academician** with experience in arbitration, and **government appointees.**

3. Appointment of arbitrators (Section 11): Under the 1996 Act, parties were free to appoint arbitrators. In case of disagreement on an appointment, the parties could request the Supreme Court, or the concerned High Court, or any person or institution designated by such Court, to appoint an arbitrator.
   Under the Bill, the **Supreme Court and High Courts may now designate** arbitral institutions, which parties can approach for the appointment of arbitrators. For **international commercial arbitration**, appointments will be made by the institution designated by the Supreme Court. For d**omestic arbitration,** appointments will be made by the institution designated by the concerned **High Court.** In case there are no arbitral institutions available, the Chief Justice of the concerned High Court may maintain a **panel of arbitrators** to perform the functions of the arbitral institutions. An application for appointment of an arbitrator is required to be disposed of within **30 days.**

4. Relaxation of time limits (Section 29A): Under the Act, arbitral tribunals are required to make their award within a period of **12 months** for all arbitration proceedings. The Bill seeks to remove this time restriction for international commercial arbitrations. It adds that tribunals must **endeavor** to dispose of international arbitration matters within 12 months.

5. Completion of written submissions (Sec 23): Currently, there is no time limit to file written submissions before an arbitral tribunal. The Bill requires that the written claim and the defence to

the claim in an arbitration proceeding, should be completed within **six months** of the appointment of the arbitrators.

6. Confidentiality of proceedings (Sec 42A): The Bill provides that all details of arbitration proceedings will be kept confidential except for the details of the arbitral award in certain circumstances. Disclosure of the arbitral award will only be made where it is necessary for implementing or enforcing the award.

7. Applicability of Arbitration and Conciliation Act, 2015: The Bill clarifies that the 2015 Act shall only apply to arbitral proceedings which started on or after October 23, 2015. This overruled the position laid down by the Supreme Court in *BCCI v. Kochi Cricket Private Limited*[1] *(2018)*.

Q.2. "Approximate justice with finality by the way of arbitration is against the basic principle of administration of justice in the courts." Examine the statement in the light of latest developments of alternative dispute resolution systems in India. [15M]

Substantive v. Procedural Justice

There are two sets of laws that govern the lives of citizens– (i) Substantive laws: determine the rights and obligations of citizens (ii) Procedural laws: provide for the framework for enforcement Despite the fact that substantive laws are comparatively more important, but the efficacy of substantive laws is contingent upon the qualitative deliverance of procedural laws. The latter needs to be efficient, simple, expeditious and inexpensive, lest the substantive provisions fail in fulfilment of their purpose and object.

Justice Delivery in Courts

The formal justice system exists to provide predictable and rule based dispute resolution. But this process is often slow, technical and inaccessible. This led to the introduction of Additional Dispute Resolution mechanisms.

• India has an estimated 31 million cases pending in various courts. As of 31.12.2015 there were 59,272 cases pending in the Supreme Court of India, around 3.8 million cases pending in the High Courts and around 27 million pending before the subordinate judiciary.

• The dispute resolution process has a huge impact on the Indian economy and global perception on "doing business" in India. The above statistics reiterate the need for reforms not only in speeding up dispute resolution, but also having a strong in-country mechanism for out of court dispute resolution. Dispute Resolution in ADR ADR is a proceeding where the parties retain the right of determination over the dispute. It exists to create tailor-made solutions for one case instead of following an enshrined norm. ADR aims to facilitate a settlement. The advantages of a negotiated solution are many. It is faster and less

expensive; the end can be anticipated; delays are avoided; and transaction costs are reduced. There is even a possibility to preserve good relations.

Why do arbitral proceedings provide only approximate justice with finality?

1. Extra- judicial proceedings: Arbitration is a form of alternative dispute resolution, in which two parties agree on out of court settlement by hiring an arbitrator to hear both the sides. Thus, it bypasses the formal judicial proceedings.

2. Lacks formal evidence process: Quasi- Judicial nature: In arbitral proceedings, only skill and experience of the arbitrator is relied upon. No interrogatories or depositories are taken, and no discovery process is included in arbitration.

3. Limited judicial recourse against arbitral award:Not all awards can be appealed in courts as a matter of right.

Section 34 (prior to 2015 amendment) Section 34 of the 1996 act sets out the procedure and grounds for applying to set aside an arbitral award. Section 34(2)(a) provides certain grounds on which the courts can set aside an arbitral award, including that:

a. a party was under some incapacity;

b. the arbitration agreement is not valid in accordance with the law to which it was subjected by the parties to the agreement;

c. proper notice of the arbitrator's appointment or the proceedings was not given;

d. the dispute did not fall within the terms of those which could be submitted to arbitration or the award contains a decision beyond the scope of the arbitration; or

e. the tribunal was not composed in accordance with the parties' agreement

Under Section 34(2)(b) of the 1996 act, the courts may also set aside an award if:

i.the subject matter of the dispute cannot be settled by means of arbitration; or

ii.the arbitral award conflicts with the public policy of India.

The grounds in Section 34(2)(a) are precise, so the courts cannot widen their scope of interference with arbitral awards. The only open-ended expression which has left some ambiguity is Section 34(2)(b)'s 'public policy of India'. No other ground has been subject to such debate or the subject of so much judicial intervention.

Arbitration and Conciliation (Amendment) Act 2015

The Arbitration and Conciliation (Amendment) Act 2015 significantly amended the 1996 act (based on the Law Commission's reports) in order to reduce court intervention in arbitration. In particular, the scope of 'public policy', as provided for in Section 34, has been narrowed so that awards can be set aside only if they:

a. were induced or affected by fraud or corruption;

b. contravene the fundamental policy of India; or

c. Conflict with the most basic notions of morality or justice.

Further, a new Section 2A was introduced, which states that an award may be set aside "if the Court finds that the award is vitiated by patent illegality appearing on the face of the award". In terms of this amended provision, an award cannot be set aside merely on the ground of erroneous application of the law or reappreciation of evidence. Thus, the amendment clearly demonstrates the legislature's intention for the public policy exception to be interpreted restrictively.

4. **Chapter VIII** (Finality and Enforcement of Arbitral Awards) [Sections 35-36]

- Finality of award**: S 35** Subject to this Part **an arbitral award shall be final and binding** on the parties and persons claiming under them respectively.
- Presumption that an arbitral award has a similar mandate of law to a judgment of a Court: **S 36** An arbitral award is enforceable similar to a decree of the court.

5. **Part IX (Appeals)** Limited grounds of appeal: S 37(1) Court is authorised by law to hear appeals from original decrees of the Court passing the order, namely:—

[(a) refusing to refer the parties to arbitration under section 8;

(b) granting or refusing to grant any measure under section 9;

(c) setting aside or refusing to set aside an arbitral award under section 34

S 37 (3) No second appeal shall lie from an order passed in appeal under this section, but nothing in this section shall affect or takeaway any right to appeal to the Supreme Court.

Basic principle of administration of Justice:

Courts should be able to correct serious failure to comply with the due process of arbitral proceedings. As discussed above, due to numerous reasons, it is evident that arbitral proceedings **bypass the judicial proceedings** and hence it is termed as ' approximate justice' and is criticized to be against the basic principle of administration of justice.

Approximation v. Accuracy

ADR's purpose is not exact justice but to approximate justice. This **trade off of speed for accuracy** is the hallmark of ADR mechanism. The administration of justice demands predictability and that equal cases should be treated equally (the principle of equality). This limits what it is possible to achieve in a court of law. In mediation, on the other hand, no obstacles are met in order to accommodate a solution for the individual case.

Lon Fuller sees **mediation as the antithesis** to the application of law, which is **rule based,** and is of the opinion that the application of law should be the principal rule.

Davis states that ADR risks **eroding the parties' right to demand a court decision** and that there is a risk that they will negotiate their way to a **poor settlement.** It is argued that ADR occurs in the s**hadow of the law** and can leave those with l**ess power vulnerable.** The counterargument is that the majority of civil cases are settled because the parties have the undisputed and absolute right to negotiate their way forward to a settlement.

Balancing ADR & Judicial Philosophies

Balance of interests is antithetical to the justice delivery mechanism. But we must also keep in mind that justice delayed is justice denied. With this in mind, the Arbitration & Conciliation Act, 1996 facilitates arbitration while at the same time securing common law principles of natural justice and arguments against public policy. Hence procedural and substantive safeguards exist in the interest of justice which check the use of absolute privatization of justice delivery mechanisms.

Highlight the important amendments made in the Arbitration and Conciliation Act, 1996 by the Arbitration and Conciliation (Amendment) Act, 2015 [15M]

TOPIC 12: Standard Form Contracts

Q.1. The Courts have found it very difficult to come to the rescue of the weaker party to a standard form contract and thus evolved certain modes to protect such weaker parties against the possibility of exploitation in such contracts. Explain the modes of protection available to weaker party in a standard form contract [20 M]

When a large number of contracts have got to be entered into by a person, from a practical point of view and for the sake of convenience, a standard form for the numerous contracts may be used. The contract with standard terms may be drafted by one party and on the same terms it may be made with numerous persons. For instance, an insurance company may prepare a draft of an insurance policy which forms the basis of a contract with a large number of insured persons.

One of the parties being in a greater bargaining position generally drafts the terms which suit him the most. In view of the unequal bargaining power of the two parties, the courts and the legislature have evolved certain rulers to protect the interest of the weaker party.

1. There should be a contractual document: In *Chapelton v Barry Urban District Council,* it was held that if the document is a mere receipt and does not create a contract, the terms contained therein are not binding. In this case the P hired a chair from the D to sit on a beach. As he sat down he fell through the canvas and suffered personal injuries. It was held that the ticket was a mere receipt and the D could not claim exemption.
2. There should be no misrepresentation: In *curtis v Chemical Cleaning and Dyeing Co* Mrs Curtis delivered her wedding dress for cleaning. She was orally told that the D did not undertake any responsibility for damage to beads and sequins. There was also a clause in the receipt but that was not disclosed to the plaintiff. The duress was badly stained. It was held by the Court of Appeal that there was misrepresentation as to the contractual terms.
3. There should be a reasonable notice of the contractual terms: In *Parker South Eastern Railway Co* the P deposited a bag in a cloakroom managed by the D at a railway station. In return he got a ticket which stated that the liability of the D for any package was limited to 10 pounds. P's bag which was valued more than that was lost, for which he brought an action against the D. It was held that the D had made reasonably sufficient efforts to draw the attention of the P to the terms and therefore the terms were binding.
4. Notice should be contemporaneous with the contract: In *Olley v Marlborough Court Ltd* the P and her husband hired a room in the D hotel and paid for one week's boarding and lodging in advance. A notice in the room displayed that there was no responsibility for the loss of items. Due to the negligence of the hotel staff, their property was stolen. It was held that the notice in the room did not form part of the contract.

5. The terms of the contract should be reasonable: In *Central Inland Water Transport Corporation Ltd v Brojo Nath* one of the clauses in a contract provided that the employer could terminate the service of a permanent employee by giving him a 3 months' notice or 3 months' salary. Accordingly, the services were terminated immediately. It was held that such a clause was wholly unreasonable and against public policy and was therefore void under Section 23 of the Contract Act.
6. Strict implementation of the exemption clause: In *Wallis v Pratt* there was a sale by sample of the seeds described as 'English Sainfoin' by the R to the appellants. The Contract was made subject to an exemption clause slaying: 'The sellers give no warranty, express or implied as to growth description or any other matters.' The R supplied an inferior quality of seeds known as 'giant sainfoin'. The fact could be known only after the seeds were sown and the crop was ready. It was noted that the exemption clause had excluded liability for breach of warranty and not a breach of conditions and in this case there was breach of conditions.
7. Fundamental Breach of contract: In *Davies v Collins* an Army Officer delivered his uniform to the cleaners for cleaning and some repairs. The cleaners gave the same to the subcontractors for doing the job and it was lost. IT was held that the cleaners were liable as there was a fundamental breach of contract on their part as they did not exercise reasonable care by getting the job done from the servants under their control.
8. Non-contractual liability: In *White v John Warrick and Co Ltd,* the P hired a cycle front eh D stipulating that nothing in the agreement would render the owners liable for any personal injury. While the P was riding the cycle, he was thrown and injured. IT was held that the exemption clause only excluded contractual liability whereas they still remained liable for negligence under the law of torts.
9. Liability towards third parties: In *Morris v CW Martin and Sons Ltd,* the P gave a fur garment to a furrier for cleaning. Since the furrier himself could not do the job, he gave this garment to the D for claiming with the consent of the P. The D's servant stole the garment. The D was not allowed exemption and they were held liable.
10. Statutory protection

Misrepresentation Act 1967 permits compensation even for innocent misrepresentation **(Section 2).** Prior to this Act a party to a contract could claim compensation under law of torts only in case of fraud.

Road Traffic Act 1960 makes any contract for the conveyance of passengers in a public service vehicle which restricts or excludes liability for injury to a passenger void

Transport Act 1962 debars Transport Boards for excluding or restricting their liability towards the passengers traveling on tickets, for death or injury caused to them.

The Sale of Goods Act 1979 imposes restrictions on the right of the seller to exclude liability for implied conditions and warranties.

Unfair Contract Terms Act 1977 severely limits the rights of the contracting parties to exclude or limit their liability though exemption clauses in their agreements. Liability for death or personal injury cannot

be excluded. The manufacturer and distributor cannot exclude their liability arising out of defective goods or for their negligence as regards goods supplied for private use or consumption.

The Consumer Safety Act 1978 requires the provision of safe goods to the consumers. Breach of safety regulations is punishable as an offence. There is also a provision for a civil action when damage is caused by breach of safety regulation.

The Supreme Court has directed the grant of disability pension to a member of the Territorial Army by rejecting the reliance placed by the Union of India on a document signed by the appellant at the time of enrollment in the Territorial Army, whereby he had apparently waived his right to get enhanced pension. *Pani Ram v Union of India 2021*

The **Law Commission of India in its 103rd Report (1984)** on Unfair Terms in Contract, has recommended the insertion of a new **Chapter IV-A** consisting of **Section 67A** in the Indian contract Act. According to this recommendation where the Court on the terms of the contract or evidence adduced, comes to the conclusion that the contract is unconscionable, it may refuse to enforce that part. A contract is considered to be unconscionable if it exempts any party thereto from either the liability for wilful breach of contract, or the consequences of negligence.

Government Contract

. In the modern era of a welfare state, government's economic activities are expanding and the government is increasingly assuming the role of the dispenser of a large number of benefits

The Constitution of India recognizes the contractual liability of the Central and state governments. Article 298 of the Constitution clearly lays down the power of the Central and state governments to carry out any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose. It is the executive power of the Union and the states. Similarly, the following Article, that is Article 299 prescribes the mode and manner of such contracts.

Thus according to Article 299 the requirements of valid government contracts which need to be fulfilled are:

1. All the contracts must be expressed to be made by the President in the case of the Central Government and the Governor in the case of state governments.
2. All the government contracts must be executed on behalf of the President of India or the Governor of the states, depending on the situation.
3. All the contracts must be executed by the President or the Governor depending on the situation.

Government Contracts	Ordinary Contracts
According to Article 299, a government contract must be expressed. That is the words, 'expressed to be made' clearly mention that a government contract must always be in writing.	Whereas ordinary contracts which are formed under the Indian Contract Act, 1872 which states that a valid contract can be expressed or implied.
A government contract must always be executed by an authorised person in order to hold the government in contractual liability. A contract between the government and the other party would be invalid if it is not executed by the authorised person duly appointed by the President or the Governor, as the case may be.	An ordinary contract does not require to be executed by an authorised person.
A government contract must follow all the provisions stated under Article 299 of the Constitution.	An ordinary contract is bound by the provisions mentioned in the Indian Contract Act, 1872.

In the case of *K.P. Chowdhary v. State of Madhya Pradesh (1966)*, the appellant gave the highest bids for two forest contracts at an auction. One of the terms of the auction was, that if the bidder failed to comply with the terms then his earnest money would be forfeited, and any deficiency occurring was to be recoverable from him as arrears of land revenue. Meanwhile, a dispute arose between the bidder and the forest department and since the dispute was not settled to the satisfaction of the bidder he refused to comply with the terms of the contract. The admitted position was that a contract complying with Article 299(1) has never been signed. The Supreme Court held that under Article 299 the words 'mandatory terms' mean there should be no implied contract between the parties. As laid down in Article 299 a government contract must be written and thus failure to follow the provisions indicates that the contract between the bidder and the state government was void.

Position in Britain

According to Common Law, before 1947, the Crown could not be sued in a court on a contract. This privilege was traceable to the days of feudalism when a lord could not be sued in his own courts. Another maxim which was pressed into service was that the 'King can do no wrong'. A subject could, however, seek redress against the Crown through a petition of right in which he set out his claim, and if the royal fiat was granted, the action could then be tried in the court. The royal fiat was granted as a matter of course and not as a matter of right, and there was no remedy if the fiat was refused.

The Crown Proceedings Act,1947, abolished this procedure and permitted suits being brought against the Crown in the ordinary courts to enforce contractual liability, a few types of contracts being, however, excepted.[