# Centre for Distance & Online Education

## UNIVERSITY OF JAMMU

## JAMMU

## SELF LEARNING MATERIAL

## FOR

## BUSINESS LAW

**For the examination to be held in 2025 onwards**

**B.COM SEMESTER – IV** **Unit I – IV**

**COURSE NO. : BCG – 303** **LESSON NO. 1-20**


**COURSE CO-ORDINATOR:**

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**University of Jammu, Jammu**

**UNIVERSITY OF JAMMU**
**B.COM. THIRD SEMESTER**
**BUSINESS LAW**

**Course No.: BCG-303** **Max. Marks: 100**
**Internal Assessment: 20**
**External Exam: 80**

**OBJECTIVE:** The basic objective of this course is to provide knowledge about business laws.

**UNIT-I: LAW OF CONTRACT-I**

Contract - Definition and essential elements of a valid contract; kinds of Contract – void, voidable, valid, express, implied, executed executory, unilateral and bilateral contract;

Offer - Definition, legal rules as to offers;

Acceptance - Definition, legal rules as to acceptance;

Free consent - Definition, legal implications of coercion, undue influence, fraud, misrepresentation and mistake.

**UNIT-II: LAW OF CONTRACT-II**

Consideration - Definition, legal rules as to consideration.

Capacity to contract - Contract with minor, contract with persons of unsound mind, persons disqualified from contracting by law; Discharge of contract; Remedies for breach of contract.

**UNIT-III: SPECIAL CONTRACTS – I**

Bailment and pledge - Bailment definition, rights and duties of bailor and bailee, rights and obligation of finder of lost goods;

Pledge - Definition, rights and duties of pawnor and pawnee;

Indemnity & guarantee - Contract of indemnity, definition, rights of indemnity holder when sued and rights of indemnifier;

Contract of guarantee - Definition, features, rights and liability of surety;

**UNIT IV: SPECIAL CONTRACTS – II**

Sales of goods act - Contract of sales of goods, essentials of contract of sale, sale and agreement to sell, rights of an unpaid seller; Conditions and warranties - Difference between condition and warranty, implied conditions and warranties; Unpaid seller - Meaning and rights of unpaid seller against goods and buyer.

**BOOKS RECOMMENDED:**

1. Bulchandani, K.R.: Business Law for Management, Himalaya Pub. House, New Delhi.

2. Chawla and Garg: Business Law, Kalayani Publishers, New Delhi.

3. Kapoor N.D: Business Law, Sultan Chand & Sons, New Delhi.

4. Gulshan J.J: Business Law Including Company Law, New Age International Publisher.

5. Kuchhal M.C.: Business Law, Vikas Publication.

6. Singh Avtar: The Principles of Mercantile Law, Eastern Book Company, Lucknow.

7. Maheshwari & Maheshwari: Business Law, National Publishing House, Maheshwari New Delhi.

8. Chadha P.R.: Business Law, Galgotia Publishing Company, New Delhi.

9. Khergamwala J.S.: The Negotiable Instruments Act, N.M Tripathi Pvt, Ltd, Mumbai.

10. Bhushan Bharat, Abbi Rajni: Business & Industrial Law, Sultan Chand, Abbi Rajni New Delhi.

**NOTE FOR PAPER SETTER:**

Equal weightage shall be given to all the units of the syllabus. The external paper shall be of the two sections viz, A & B of three hours duration.

**Section-A:** This section shall contain four short answer questions selecting one from each unit. Each question shall carry 5 marks .A candidate shall be required to attempt all the four questions. Total weightage to this section shall be of 20 marks.

**Section-B:** This section shall contain eight long answer questions of 15 marks each. Two questions with internal choice shall be set from each unit. A candidate shall have to attempt any four questions selecting one from each unit. Total weightage to this section shall be of 60 marks.

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**MODEL QUESTION PAPER**

**BUSINESS LAW**

**Max Marks: 80** **Time Allowed: 3 hrs**

**Section A (20 Marks)**

**Attempt all the questions. Each question carries five marks.**

1. Define consideration. Give exception to the rule "No consideration no contract".

2. Define coercion. Discuss its elements?

3. What is meant by Contract of Indemnity and Guarantee?

4. Differentiate between sale and agreement to sell?

**Section B (60 Marks)**

**Attempt any four questions selecting one question from each unit. Each question carries 15 marks.**

1. Define contract. Discuss the essentials of a valid contract?

Or

Define offer. Explain legal rules as to offer.

2. What is meant by free consent? Differentiate between coercion and undue influence.

OR

Who is a minor? Explain the minor position in regard to contract.

3. Define bailment. Explain rights and duties of bailer.

Or

Differentiate between Indemnity and Guarantee?

4. Who is an unpaid seller? Discuss his rights?

Or

Discuss the main features of contract of sale?

## Dear Learner,

Welcome to the world of **Business Law**—where legal principles meet commercial realities.

In today's fast-paced and ever-evolving business environment, understanding the legal framework that governs commerce is not just an asset—it's a necessity. This course will equip you with the knowledge to navigate contracts, company law, consumer protection, dispute resolution, and other critical legal areas that shape business conduct.

As you embark on this journey, you are not just studying statutes and case law—you are learning to think critically, reason logically, and act ethically. These are the tools that will empower you to protect business interests, ensure compliance, and contribute to responsible and sustainable enterprise.

This subject encourages you to ask questions, analyze situations, and apply the law with clarity and confidence. The legal awareness you gain here will serve as a strong foundation for careers in business, entrepreneurship, management, or law.

Stay curious, stay informed—and remember: law is not just about rules, but about rights, responsibilities, and real-world impact.

Wishing you an insightful and enriching learning experience.

Warm regards,
**[CDOE]**

**C. No:- BCG-303** **UNIT I**

**SEMESTER: III** **LESSON: 1**

# LAW OF CONTRACT I

**STRUCTURE**



## 1.0. LEARNING OBJECTIVES AND OUTCOMES

**Learning Objectives**

- To explain the **definition of a contract** under the Indian Contract Act, 1872.
- To understand how **contracts are formed and executed.**
- To recognise the difference between an agreement and a contract.
- Identify and explain the **essential elements required for a valid contract**
- Explain the **importance of mutual consent and legal enforceability**.

**Learning Outcomes**

After Completing this lesson, learners will be able to:

- Define a contract and distinguish it from an agreement.
- Explain the legal meaning and importance of a contract.

- Explain what a contract is and the basic elements required to form one.
- Identify whether a given agreement qualifies as a legally enforceable contract.
- Develop the understanding to **evaluate the validity of a contract** based on its legal essentials.
- Recognize the **consequences of missing any essential element** in a contract.

## 1.1. INTRODUCTION

A contract is a key concept in legal and business transactions, forming the basis of many personal and professional relationships. A contract is a foundational element in the field of law and commerce, serving as a legally binding agreement between two or more parties. It establishes the terms and conditions under which parties commit to perform specific duties or refrain from certain actions. Understanding the meaning and definition of a contract is essential to grasp its legal significance and enforceability. For an agreement to be recognized as a valid contract, it must fulfil certain essential elements, without which it may be deemed void or unenforceable. These essentials include offer and acceptance, lawful consideration, capacity of parties, free consent, lawful object, and the intention to create legal relations. These elements together establish the foundation of a contract and determine its legal validity. These essentials ensure that the agreement is not only mutual but also legally enforceable, forming the basis for resolving disputes and promoting trust in personal and business relationships.

## 1.2. MEANING OF CONTRACT

Law is a basic necessity of every civilized society. Law is the bundle of rules and principles to be followed by the members of the society. When there is a law in a country, it brings uniformity and balance in human actions and provides justice to the aggrieved persons.

According to **Holland**, “Law is a rule of external human action enforced by the sovereign political authority.”

In the words of **Blackstone**,” Law is a rule of civil conduct, prescribed by the supreme power of state, commanding what is right and prohibiting what is wrong.”

**Law of Contract**

The law of contract is the foundation upon which the superstructure of modern business is built. It is that branch of law which determines the circumstances in which promises made by the parties. It is common knowledge that in business transactions quite often promises are made at one time and the performance follows later. In such a situation if either of the parties were free to go back on its promise without incurring any liability, there would be endless complications and it would be impossible to carry on trade and commerce. Hence, the law of contract was enacted which lays down the legal rules and regulations relating to promises – their formation, their performance and their enforceability and the condition under which the remedies are available. It is the most important branch of law.

A voluntary, deliberate and legally binding agreement between two or more competent parties. Contracts are usually written but may be spoken or implied, and generally have to do with employment, sale or lease, or tenancy.

A contractual relationship is evidenced by **(1) an offer, (2) acceptance of the offer, and a (3) valid (legal and valuable) consideration.** Each party to a contract acquires rights and duties relative to the rights and duties of the other parties. However, while all parties may expect a fair benefit from the contract (otherwise courts may set it aside as inequitable) it does not follow that each party will benefit to an equal extent.

The law of contract is applicable not only to the business community, but also to others. Every one of us enters into a number of contracts almost every day, and most of the time we do so without even realizing what we are doing from the point of law. A person seldom realises that when he entrusts his scooter to the mechanic for repairs, he is entering into a contract of bailment, or when he buys a packet of cigarettes, he is making a contract of the sale of the goods or again when he goes to the cinema to see a movie, he is making yet another contract and so on.

Besides, the law of contract furnishes the basis for the other branches of mercantile law. The enactments relating to sale of goods, negotiable instruments, insurance, partnership and insolvency are all founded upon the general principles of contract of law. That's why; the study of the law of contract precedes the study of all other subdivisions of mercantile law. The law of contract is India is governed by the Indian contract Act, 1872.

Explaining the object of law of contract **Sir William Anson** observes: "As the law relating to property had its origin in the attempt to ensure that what a man has lawfully acquired he shall retain, so the law

of contract is intended to ensure that what a man has been led to expect shall come to pass; that what has been promised to him shall be performed".

## 1.3. DEFINITION OF CONTRACT

Generally contract may be defined as an agreement which creates rights and obligations between the parties. These obligations and right s must be of such a nature that these can be claimed in the court of law.

**Salmond** says, "Contracts is an agreement creating and defining obligations between the parties".

**Halsbury** defines it as, "An agreement between two or more persons which is intended to be enforceable at law and is constituted by the acceptance by one party of an offer made to him by the other party to do or to abstain from doing some act".

**In the opinion of Sir William Anson**, "A legally binding agreement made between two or more persons by which rights are acquired by one or more to acts or forbearances on the part of other or others".

**Section 2(h)** of the Indian Contract Act defines a contract as, "An agreement enforceable by law".

**Sir Fredrick Pollock** says, "Every agreement and promise enforceable at law is a contract".

From the above definitions, we find that a contract essentially consists of two elements, an agreement and legal obligation.

**a.** **Agreement:** As per section 2 (e), "An agreement is defined as every promise and every set of promises, forming the consideration for each other, is an agreement". Thus, it is clear from definition that a promise is an agreement. What is a **Promise?** The answer to this question is contained in section 2(b) which defines the term as, "When the person to whom the proposal is made signifies his assent there to, the proposal is said to be accepted. A proposal when accepted becomes a promise". An agreement, therefore, comes in to existence only when one party makes a proposal of offer to the other party and that other party signifies his assent i.e. gives his acceptance thereto. In short, an agreement is the sum total of offer and acceptance.

**Agreement = Offer + Acceptance**

**For example**: X agrees to sell goods to Y on credit and Y agrees to pay X before the period of credit expires.

Thus, an agreement comes into existence, only after a proposal of offer made by one party is

accepted by other. On the analysing the above definitions, the following characteristics of an agreement becomes evident:

- **Plurality of persons:** There must be two or more persons to make an agreement because one person cannot enter into an agreement with himself.
- **Consensus ad idem:** Both the parties to an agreement must agree about the subject-matter of the agreement in the same sense and at the same time.

**b.** **Legal obligation:** An agreement to become a contract must give rise to a legal obligation i.e. duly enforceable by law. If an agreement is incapable of creating a duty enforceable by law, it is not a contract. Thus, an agreement is a wider term than a contract. All contracts are agreements but all agreements are not contracts because contract means agreement plus enforceability by law. agreement of moral, religious or social nature e.g. a promise to lunch together at a friend's house or to take a walk together are not contracts because they are not likely to create a walk together are not contracts because they are not likely to create a duty enforceable by law for the simple reason that the parties never intended that they should be attended by legal consequence.

In business agreements the presumption is usually that the parties intend to create legal relations. Thus, an agreement to buy certain specific goods at an agreed price e.g., 100 bags of wheat at Rs 230 per bag is a contract because it gives rise to a duty enforceable by law, and in case of default on the part of either party an action for breach of contract could be enforced through a court provided other essential elements of a valid contract as laid down in section 10 are present, namely, if the contract was made by free consent of the parties competent to contract, for a lawful consideration and with a lawful object. Thus, it may be concluded that the Act restricts the use of the word contract to only those agreements which give rise to legal obligations between the parties.

**A. CHECK YOUR PROGRESS**

- **Fill in the Blanks:**

1. All contracts are _____, but not all _____ are contracts.
   **Answer:** agreements, agreements
2. A contract is defined under Section _____ of the Indian Contract Act, 1872.
   **Answer:** 2(h)
3. The Indian Contract Act came into force in the year _____.
   **Answer:** 1872
4. For an agreement to become a contract, it must be _____ by law.
   **Answer:** enforceable
5. Agreements of a _____ nature are not contracts.
   **Answer:** social (or domestic)

## 1.4. ESSENTIAL ELEMENTS OF A VALID CONTRACT

All agreements are not contracts. An agreement to be enforced in the court has to satisfy certain conditions. On satisfying these, the agreements become a contract, and those conditions become essentials of a valid contract. The essential elements of a contract are contained in the definition of contract given in Sec. 10 of the contract Act. According to this Act, "all agreements are contracts if they are made by free consent of parties competent to contract for a lawful consideration and with a lawful object and are not hereby expressly declared to be void." The following are the essential elements of a valid contract:

### a. Offer and acceptance

In order to create a valid contract, there must be a lawful offer by one of the parties and the acceptance of the same by the other party. Offer and acceptance must be according to mode prescribed, rules and regulations and must be communicated to the offeror.

### b. Intention to create legal relationship

For forming a contract, the intention of the parties must be to create legal relationship between them. If there is no such intention on the part of the parties, there is no contract. Agreement of social or domestic nature, do not contemplate legal relations. For example, an agreement to have lunch at a friend's house is not an agreement intending to create legal relations. Agreements between husband and wife generally lack the intention to create legal relations. In commercial transactions, an intention to create legal obligation is presumed. If the parties expressly declare and resolve that their agreement is not intended to create legal relationship then even a business transaction will not amount to contract.

### c. Lawful consideration

The third essential element of a valid contract is the presence of consideration. The term consideration means something in return. Consideration has been defined as the price paid by one party for the promise of the other. An agreement is legally enforceable only when each of the parties to it gives something and gets something. The something given or obtained is the price for the promise and is called consideration. The consideration may be an act or forbearance or a promise to do or not to do something. It may be past, present or future. But only those considerations are valid which are lawful. The consideration is lawful, unless – it is forbidden by

law, or is of such a nature that, if permitted it would defeat the provisions of any law, or is fraudulent or involves or implies injury to the person or property of another, or is immoral or is opposed to public policy (Section 23).

**d. Capacities of parties**

The parties to an agreement must be competent to contract; otherwise it cannot be enforced by a court of law. In order to be competent to contract the parties must be:

(a) Of the age of majority

(b) Sound mind

(c) Must not be disqualified from any court of law to which they are subject (section 11).

If any of the parties to the agreement suffers from minority, lunacy, idiocy, drunkenness, etc., the agreement is not enforceable at law, except in some special cases, e.g., in the case of necessaries supplies to a minor or lunatic the supplier of goods is entitled to be reimbursed from their estate (section 68).

**e. Free consent**

Free consent of all the parties to an agreement is another essential element of a valid contract. Consent means that the parties must have agreed upon the same thing in the same sense (section 13). There is absence of free consent. If the agreement is induced by

(a) Coercion

(b) Undue influence

(c) Fraud

(d) Misrepresentation

(e) Mistake

or if the agreement is vitiated by any of the these factors, the contract would be voidable and cannot be enforced by the party guilty of coercion, undue influence, etc. the other party i.e. the aggrieved party can either reject the contract or accept it but subject to the rules laid down in the Act. If the agreement is induced by mutual mistake which is material to the agreement, it would be void (section 20).

**f. Lawful object**

For the formation of a valid contract, it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered in to must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of

another (section 23). If the object is unlawful for one or the other of the reasons mentioned above the agreement it void. Thus, when a landlord knowingly lets a house to a prostitute to carry on prostitutions, he cannot recover the rent through a court of law.

**g. Writing and registration**

According to the Indian Contract Act, 1872, a contract may be oral or in writing. But in certain special cases, it lays down that the agreement, to be valid, must be in writing or and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be in writing and registered (section25). Similarly, certain other acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration Act, 1940; and (ii) an agreement for the sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882 before they can be legally enforced.

**h. Certainty of meaning :**

According to section 29, "An Agreement the meaning of which is not certain or capable of being made certain and void".

The terms of the contract must be precise and certain. It cannot be left vague. A contract may be void on the ground of uncertainty. Thus, a purported acceptance of an offer to buy a lorry on hire purchase terms does not constitute a contract if the hire purchase terms are never agreed. Similarly, an agreement subject to war clause is too vague to be enforceable.

**i. Possibility of performance :**

Yet another essential element of a valid contract is that it must be capable of performance. Section 56 lays down that an agreement to do an act impossible in itself is void. If the act is impossible in itself, physically or legally, the agreement cannot be enforced at law. For example: Mr. Singh agrees with Mr. Gupta to discover treasure by magic. The agreement is not enforceable.

**j. Not declared to be void :**

The agreement must not have been expressly declared to be void under the Act, section 24-30 specify certain types of agreements which have been expressly declared to be void. For example, an agreement in restraint of marriage, an agreement in restraint of trade, and an agreement by way of wager have been expressly declared void under section 26, 27 and 30 respectively.

**B. CHECK YOUR PROGRESS.**

- **Multiple Choice Questions:**

1. Which of the following is *not* an essential element of a valid contract?
A. Offer and acceptance
B. Lawful consideration
C. Lawful object
D. Presence of a witness
**Answer:** D. Presence of a witness

2. A minor's agreement is:
A. Valid
B. Void
C. Voidable
D. Enforceable by minor only
**Answer:** B. Void

*3.* Lawful consideration means:
A. Any promise of value
B. Bribery or illegal payment
C. An act forbidden by law
D. A promise to commit a crime
**Answer:** A. Any promise of value

4. Which of the following is an essential element of a valid contract?
A. Moral duty
B. Social obligation
C. Free consent
D. Family arrangement
**Answer:** C. Free consent

5. Capacity to contract means:
A. Age above 21 only
B. Ability to read and write
C. Legal ability to enter into a contract
D. Physical strength
**Answer:** C. Legal ability to enter into a contract

**6. Consideration must be:**
A. Illegal
B. In cash only
C. Lawful and real
D. Always a service
**Answer:** C. Lawful and real

**7. Free consent means consent given:**
A. Under pressure
B. Voluntarily, without coercion or fraud
C. With some misunderstanding
D. Due to a mistake
**Answer:** B. Voluntarily, without coercion or fraud

**C. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. **Free consent is not required in a valid contract.**
   **False (***Free consent is a fundamental requirement of a valid contract.)*
2. **The object of a contract must be lawful.**
   **True (***If the object is illegal, the contract is void.)*
3. **All agreements are contracts.**
   **False** (*Only those agreements which are enforceable by law are contracts.)*
4. **A contract made under coercion is void.**
   **False** (*A contract under coercion is voidable, not void. The aggrieved party can choose to cancel it.)*
5. **An agreement made by a minor is valid.**
   **False** (*A minor's agreement is void ab initio – i.e., not valid from the beginning.)*
6. **The intention to create legal obligations is necessary in a valid contract.**
   **True** *(Without intention to create legal relations, a contract is not enforceable.)*

## 1.5. LET US SUM UP

A contract is a legally enforceable agreement between two or more parties that creates mutual obligations. According to the Indian Contract Act, 1872, a contract arises from an agreement that is enforceable by law. For an agreement to become a valid contract, it must fulfil certain essential elements: there must be a lawful offer and acceptance, intention to create legal relations, lawful consideration, capacity of parties, free consent, a lawful object, certainty of terms, possibility of performance, and the agreement must not be expressly declared void. Additionally, any legal formalities required by law, such as writing or registration, must be fulfilled. These essentials ensure that the contract is fair, clear, and enforceable, protecting the interests of all parties involved, and is within the framework of the law, making it enforceable in a court of law.

## 1.6. KEYWORDS

**Contract**: A legally binding agreement between two or more parties that is enforceable by law.

**Agreement**: An offer accepted by another party; all contracts are agreements, but not all agreements are contracts.

**Consideration***:* Something of value exchanged between parties, such as money, services, or goods, which makes the agreement legally binding.

**Enforceability**: The ability of a contract to be upheld in court if breached.

**Capacity to Contract**: The legal ability of the parties to enter into a contract — typically requiring parties to be of legal age and of sound mind.

**Lawful Object**: The purpose or consideration of the contract must not be illegal, immoral, or against public policy.

**Legal Relationship**: The intention of the parties to create legal obligations and be bound by the law.

**Void ab initio**: "Void from the beginning," implying something was never valid at any point.

## 1.7. SELF ASSESSMENT QUETIONS

1. Explain the **meaning and definition** of a contract with reference to legal provisions.

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2. “All contracts are agreements, but all agreements are not contracts.” Explain with suitable illustrations.

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3. Discuss the **essential elements** of a valid contract in detail.

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## 1.8. LESSON END EXERCISE

1. Not all agreements are enforceable by law. Comment.

2. Elaborate on the legal rules regarding the **capacity of parties** to enter into a contract.

3. Is invitation to make an offer the same thing as an offer?

## 1.9. SUGGESTED READINGS


- “Law of Contract" by Avtar Singh
- “The Law of Contracts" by G.C.V. Subba Rao
- "Business Law" by P.C. Tulsian
- "Elements of Mercantile Law" by N.D. Kapoor
- “Business Law” by K.C Garg, V.K Sareen & Mukesh Sharma.


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**C. No:- BCG-303** **UNIT I**

**SEMESTER: III** **LESSON: 2**

# LAW OF CONTRACT I

**STRUCTURE**



## 2.0 LEARNING OBJECTIVES AND OUTCOMES

**Learning Objectives**

- To explain the **difference between valid, void, voidable, and unenforceable contracts.**
- To explain the classification of different types of contract on the basis of validity, formation, performance, execution and obligation.
- To discuss how different types of contracts affect the rights and obligations of the parties involved.

**Learning Outcomes**

After Completing this lesson, learners will be able to:

- Describe the legal features that differentiate the types of contracts, such as enforceability, formation, and performance status.
- Explain the distinguishing features of each kind of contract with relevant examples.
- Evaluate differences and similarities between contract types to better understand their legal significance and practical use.
- Assess which contracts are legally binding and under what circumstances they may be enforced or deemed invalid.

## 2.1 INTRODUCTION

Contracts are fundamental to the functioning of modern society, serving as legally binding agreements that establish the rights and obligations of parties involved. Contracts play a vital role in both personal and business relationships by outlining the terms and conditions agreed upon by the involved parties. They help ensure clarity, accountability, and legal protection.

Contracts can be classified into various categories based on different legal criteria, each serving a distinct purpose in the realm of agreements and obligations. The classification of contracts helps in understanding their nature, enforceability, formation process, and the extent of performance expected from the parties involved. There are several kinds of contracts, each designed to suit different types of agreements and situations. These include express and implied contracts, unilateral and bilateral contracts, and more specialized forms such as void, voidable, and valid contracts. Understanding these different kinds of contracts is essential for anyone entering into a legal agreement, as it helps determine the contract's enforceability and the responsibilities of each party.

## 2.2. KINDS OF CONTRACT

Contracts may be classified on the basis of their;

(a) Validity

(b) Formation

(c) Performance

| **Validity or enforceability** | **Formation** | **Performance** |
|---|---|---|
| ○ Valid contracts<br>○ Void contracts<br>○ Void agreements<br>○ Voidable contracts<br>○ Unenforceable contracts<br>○ Illegal contracts | o Express contracts<br>o Implied contracts<br>o Quasi contracts | ○ Executed contracts<br>○ Executory contracts<br>i unilateral contracts<br>ii bilateral contracts |

### 2.2.1. Contract Classified According to Validity or Enforceability

1. **Valid contract:**

   An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract as laid down in section 10 are fulfilled.

   **For example**: Ram offers to sell his motor bike for Rs 50,000 to his friend Shyam. Shyam agrees to buy it for the price of Rs 50,000. It is a valid contract. A contract to enter into a contract is, however, not a valid contract.

2. **Void contract:**

   An agreement which was legally enforceable when entered into but which has become void due to the supervening impossibilities of performance like war, government restrictions, etc.

   **Examples**: A contract between a citizen of Pakistan and India is a valid contract during peace but if war breaks out between the two countries, the agreement will become void contract.

   (ii) A valid contract to export goods becomes **void due to a government ban**.

3. **Void agreement:**

   According to section 2 (g), "An agreement which is not enforceable by law by either of the parties is void". No legal rights or obligations can arise out of a void agreement. It is void ab initio i.e. from its very inception. Such agreements never become a contract.

**Examples**: **(i)** Agreement with a **minor**.

**(ii)** Agreement to do an **illegal act** (e.g., drug trafficking).

**(iii)** Agreement **without consideration** (in most cases).

4. **Voidable contract:**

According to section 2 (i), "An agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others is a voidable contract". Note that the word used here is contract and not just agreement. This is so because the rights and duties are created and the contract is valid until the option to avoid it is exercised by the person whose consent to the agreement was not free but was obtained by coercion, undue influence, fraud or misrepresentation. The other party who induced the consent cannot take advantage of his own fraud because "He who comes into Equity (i.e. before law) must come with clean hands". The party entitled to repudiate the contract is not bound to repudiate it but may affirm it; in that case the other party remains bound to carry it on as agreed.

**Examples: (i)** A spiritual advisor induced his devotee to transfer property, claiming it would benefit the devotee's soul. The contract was declared voidable due to undue influence under Section 16 of the Indian Contract Act, 1872.

**(ii)** A person of weak intelligence made a gift of his entire property to B, who was in a position to dominate him. The gift having been obtained by undue influence is voidable at the option of A.

**(iii)** A husband threatened to commit suicide unless his wife and son signed a contract. The court held the contract voidable due to coercion under Section 15 of the Indian Contract Act, 1872.

5. **Unenforceable contracts:**

An unenforceable contract is one which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect such as absence of writing, registration, requisite stamp, etc., or time barred by the law of limitation.

**For example,** an oral arbitration agreement is unenforceable because the law requires an arbitration agreement to be in writing. Similarly, a bill of exchange or promissory note, though

valid in itself, becomes unenforceable after three years from the date the bill or note falls due, being time barred under the limitation act.

Such contracts must be sued by one or both of the parties. Such contracts cannot be proved in the court. Such contracts will not be enforced by the courts until and unless the defect is rectified.

6. **Illegal agreement:**

A contract which is either prohibited by law or otherwise against the policy of law is an illegal agreement. It is void ab intio. Thus, a contract to commit dacoity is an illegal contract and cannot be enforced at law. An illegal contract should be distinguished from a void contract. All illegal agreements are void but all void agreements or contracts are not necessarily illegal. Agreements with a minor are void but not illegal. Every void agreement is not illegal unless its object or consideration is immoral; opposed to public policy, etc. A void contract does not affect a collateral contract. An illegal agreement is like an infectious disease and is fatal not only to the main contract but to collateral contracts as well.

**For example:** X borrows Rs 50,000 from Y for the purpose of smuggling goods. Y knows of the purpose of the loan. The agreement between X and Y is collateral to the main agreement which is illegal. The collateral agreement is also illegal.

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### 2.2.2. Classification of Contracts According to the Formation

**1. Express contract :**

An express contract is one entered into by words which may be either spoken or written. Where the proposal and acceptance made in words, it is an express contract.

**2. Implied contract :**

Where the proposal or acceptance is made otherwise than in words, it is an implied contract. Implied contracts can be smelled out of the surrounding circumstances and the conduct of the parties who made them. So where a person employs another to do some work the law implies that the former agrees to pay for the work.

**3. Constructive or Quasi-Contract :**

It is a contract in which there is no intention on either side to make a contract, but the law imposes a contract. In such a contract, rights and obligations arise not by any agreement between the parties

but by operations of law. Thus, a finder of lost goods is under any obligation to find out the true owner and return the goods. Similarly, where certain books are delivered to a wrong addressee, the addressee is under an obligation either to pay for them or return them.

## A. CHECK YOUR PROGRESS

- **Multiple choice questions**

**1. A contract which is legally enforceable at the option of one or more parties but not at the option of the other or others is called a:**
a) Valid contract
b) Void contract
c) Voidable contract
d) Unenforceable contract
**Answer:** c) Voidable contract
**2. Which of the following is not a type of contract based on validity?**
a) Valid contract
b) Void contract
c) Executed contract
d) Voidable contract
**Answer:** c) Executed contract
**3. A contract that is not enforceable by law is called**:
a) Valid contract
b) Voidable contract
c) Void contract
d) Quasi-contract
**Answer:** c) Void contract
**4. Contracts can be classified on the basis of:**
a) Formation
b) Performance
c) Enforceability
d) All of the above
**Answer:** d) All of the above
**5. An agreement which is unenforceable by law because of the lack of intention of either party is known as:**
a) Voidable contract
b) Void contract
c) Valid contract
d) Illegal contract
**Answer:** c) Voidable contract
**6**. **Which of the following best defines an express contract?**
A) A contract created through conduct or actions
B) A contract created through written or spoken words
C) A contract imposed by law to prevent unjust enrichment
D) A contract without legal obligation
**Answer:** b) A contract created through written or spoken words

## 2.2.3. Classification on the basis of Performance or Extent of Execution

**1. Executed Contract:**

A contract is said to be executed when both the parties to a contract have completely performed their share of obligation and nothing remains to be done by either party under the contract.

**For example:**

**a.** When a book seller sells a book on cash payment, it is an executed contract because both the parties have done what they were to do under the contract. Where only one of the parties to a contract has performed his share of obligation and the other party is still to perform his share of obligations, and then also the contract is called executed contract.

**2. Executory Contract:** It is one in which both the obligations are outstanding one on either party to the contract, either wholly or in part, at the time of formation of the contract. In other words, a contract is said to be executory contract when either both the parties to contract have still to perform their share of obligation in to or there remains something to be done under the contract on both sides.

**For example:** Where T agrees to coach R, a pre-medical student, from first day of the next month and R in consideration promises to pay T Rs 300 per month, the contract is executory because it is yet to be carried out. Similarly, where M promises to sell his car to N for Rs 10,000 cash down, but N pays Rs 1,000 as earnest money and promises to pay the balance on next Sunday. On the other hand, M gives the possession of car to N and promises to execute a sale deed on receipt of the full amount. The contract between M and N is executory because there remains something to be done on both sides.

Executory contract are of two types:

**(i) Unilateral Contract:** A **unilateral contract** is a contract where **only one party makes a promise**. The other party is **not required to promise anything,** instead, they just need to **perform a task** to accept the offer.

**Example:** Reward offer: "I will pay $1,000 to anyone who finds and returns my lost dog."

**(ii) Bilateral Contract:** A **bilateral contract** is a two-sided agreement where **both parties make mutual promises** to do something in the future. **Both parties make promises** to each other. Each party is legally bound to perform their promise.

**Example: Car Sale Agreement:** *A agrees to sell a car to B for $10,000. B agrees to buy the car and pay $10,000.*

**B. CHECK YOUR PROGRESS**

- **Fill in the blanks:**

1. A contract that is created by the behavior or conduct of the parties rather than written or spoken words is called _____ contract.
2. A _____ contract is one that has all legal elements and is enforceable by law.
3. A _____ contract is not legally enforceable because it lacks one or more essential elements.
4. A contract in which one party makes a promise in exchange for the act of another is a _____ contract.
5. A _____ contract is formed when both parties exchange mutual promises.
6. A _____ contract is a legally enforceable agreement that has not yet been fully performed by one or both parties.
7. A contract that has been completely performed by all parties is known as an _____

**Answers: 1.Implied, 2.Valid, 3.Void**, **4.Unilateral, 5.Bilateral, 6.Executory, 7.Executed**

**C. CHECK YOUR PROGRESS**

- **True or False**

1. A unilateral contract involves promises from both parties.
2. An implied contract is always written.
3. A voidable contract is legally enforceable at the option of one party.
4. All valid contracts are necessarily executed.
5. An **executory contract** is one in which both parties have fully performed their obligations.
6. A **bilateral contract** involves a promise by one party and performance by another.
7. An **express contract** is one in which terms are clearly stated, either orally or in writing.
8. An **implied contract** is created through conduct or circumstances, not written or spoken words.
9. A **quasi-contract** is an actual contract formed through mutual agreement.
10. A **void contract** is one that has no legal effect from the beginning.

**Answers: 1. False 2. False 3. True 4. False 5. False 6. False 7. True 8. True 9. False 10. False**

## 2.3 LET US SUM UP

Kinds of contracts refer to the various categories that contracts fall into based on how they are created, performed, and enforced. These include **express contracts,** where the terms are clearly stated either verbally or in writing, and **implied contracts**, which are formed through the actions or conduct of the parties involved. Contracts can also be **bilateral**, involving promises exchanged between two parties, or **unilateral**, where one party promises something in exchange for the other party's performance. Additionally, contracts are classified by their legal status as **valid** (enforceable), **void** (not legally binding), **voidable** (can be legally cancelled by one party), or **unenforceable** (cannot be enforced due to legal technicalities). They may also be described as **executed** when fully performed, or **executory** when obligations are still pending. Understanding these kinds helps clarify the roles, responsibilities, and legal effects within contractual agreements.

## 2.4 KEYWORDS

- **Contract:** A legally enforceable agreement between two or more parties.
- **Valid Contract:** A contract that meets all legal requirements and is enforceable by law.
- **Void Contract:** A contract that is not legally enforceable from the beginning.
- **Voidable Contract:** A contract that is valid but can be cancelled by one party due to legal reasons like coercion or misrepresentation.
- **Illegal Contract:** A contract that involves unlawful activities and is not recognized by law.
- **Unenforceable Contract:** A contract that cannot be enforced due to some technical defect (e.g., not in writing when required).
- **Express Contract:** A contract where terms are clearly stated in spoken or written form.
- **Implied Contract:** A contract formed through actions or conduct rather than words.
- **Tacit Contract:** A type of implied contract recognized through silent actions or customary behavior.
- **Quasi-Contract:** A legal obligation created by the court to prevent unjust enrichment, even if no real contract exists.
- **E-Contract:** A contract made through electronic means such as emails, websites, or digital signatures.

- **Executed Contract:** A contract where all parties have completed their contractual obligations.
- **Executory Contract:** A contract where obligations are yet to be performed by one or both parties.
- **Unilateral Contract:** A contract in which only one party makes a promise, and the other accepts by performing an act.
- **Bilateral Contract:** A contract where both parties make mutual promises to each other.

## 2.5 SELF ASSESSMENT QUESTIONS

1. What is the difference between **express** and **implied** contracts?

2. With suitable examples, explain the difference between void agreements and void contracts.

3. Explain the term **quasi-contract**. When does it arise?

## 2.6. LESSON END EXERCISE

1. Explain the various kinds of contracts based on enforceability.

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2. What makes a contract **voidable,** and who can rescind it?

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3. Distinguish between **executory** and **executed** contracts with examples.

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## 2.7. SUGGESTED READINGS


- "Contract Law: Text, Cases, and Materials" by Ewan McKendrick
- **"Understanding Contract Law"** by Jeffrey Bell
- "The Law of Contract" by John D. McCamus
- **"Contract Law"** by Mindy Chen-Wishart
- "Business Law" by K.C Garg, V.K Sareen & Mukesh Sharma.


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**C. No:- BCG-303** **UNIT I**

**SEMESTER: III** **LESSON: 3**

# LAW OF CONTRACT I

**STRUCTURE**



## 3.0 LEARNING OBJECTIVES AND OUTCOMES

**Learning Objectives**

- To define the meaning of an offer in the context of contract law.
- To describe the essential elements of a valid offer, such as clear terms, communication, and intention to create legal relations.
- To explain in detail the legal rules governing a valid offer**.**
- To understand the difference between an offer and an invitation to offer.
- To understand the concept of revocation of an offer and the legal principles governing it.
- To explain the impact of revocation on the validity and enforceability of an offer**.**

**Learning Outcomes**

After Completing this lesson, learners will be able to:

- Define the concept of an offer and explain its role in contract formation.
- Understand the legal consequences of a valid offer.
- Explain the key rules that govern the validity of an offer, including communication, clarity, and intention.
- Describe the concept of revocation of an offer and explain the conditions under which an offer can be withdrawn.
- Apply legal principles related to offer and revocation to practical situations or case studies**.**
- Evaluate when revocation of an offer is effective and when it is invalid, particularly in cases involving unilateral offers or fixed time periods.

## 3.1 INTRODUCTION

In the realm of contract law, an **offer** serves as the foundation for the formation of a legally binding agreement. An offer is a clear and definite proposal made by one party to another, expressing a willingness to enter into a contract on certain terms. It represents a clear expression of willingness by one party to enter into a contract on specific terms, with the intention that it shall become binding as soon as it is accepted by the other party. It marks the beginning of the contractual process and sets the stage for mutual consent, which is essential for any valid and enforceable agreement. For an offer to be legally valid and enforceable, it must fulfil specific **essentials**, such as being communicated to the offeree, showing intent to create legal relations, containing definite terms and the offer being made with the willingness to be bound by it. Understanding these essentials is crucial, as any defect in them may render the offer invalid and prevent the formation of a valid contract. However, an offer does not remain open indefinitely; it can be terminated through various means, including **revocation,** which refers to the withdrawal of an offer by the offeror before it is accepted by the offeree. This principle plays a crucial role in determining when a contract is legally formed, as a valid revocation prevents the offer from being accepted. For a revocation to be effective, it must be communicated to the offeree before acceptance. Understanding the rules and timing related to revocation is essential to ensure clarity and fairness in contractual dealings.

## 3.2 MEANING OF OFFER

A contract is an agreement enforceable by law. An agreement is every promise and every set of promises forming the consideration for each other [Section 2 (e)]. Section 2 (6) defines a promise a follows: "A proposal, when accepted, becomes a promise." It means an agreement is an accepted proposal. Therefore, these must be proposal or offer by one party and its acceptance by the other party for making an agreement. Mr. A offer to sell his Matiz car to Mr. B for Rs. 3 lakhs. B accepts the offer. It will result into a contract. So, offer and its acceptance subsequently is the universally accepted process for creating a contract whether it is express or implied. Offer or proposal is the starting point in the formation of a contract.

Section 2 (a) defines proposal as *"When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence."*

The word proposal is synonymous with the English word 'Offer'. The person making the proposal is called the proposer or offeror and the person to whom the proposal is made is called the offeree.

**For example:** A offers to sell his motor cycle to B for Rs. 3,000. B agrees to pay A Rs. 3,000 for the motor cycle. Here A is called the offeror or promisor and B the offeree or promisee.

Thus, a proposal is an expression of will or intention. A person making the proposal expresses that he is willing to contract on the terms stated in it provided the other party to whom the proposal is made will likewise express his assent to the same terms.

Section 2*(a)* reveals 3 essential elements in an 'offer':

(a) Expression of willingness to do or not to do something,

(b) made to another pension i.e. a person cannot make an offer to himself,

(c) with the object of gaining the consent of the other person to such act or abstinence.

Thus, a casual enquiry, information, a statement of fact or statement of mere intention lacking the above mentioned three essentials are not offers.

## 3.3 KINDS OF OFFER

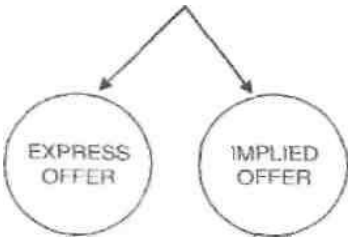
Offers or Proposals may be classified on the basis of:

(1) How an offer is made?

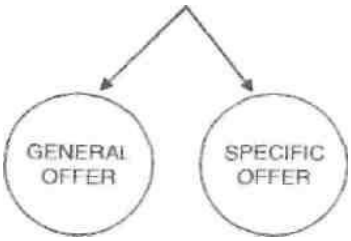
(2) To whom an offer is made?

**KINDS OF OFFER**

HOW MADE?




TO WHOM MADE?




1. **How an offer is made**: An offer may be either *express* or *implied* from the conduct of the parties. An **Express offer** is one which may be made by words spoken or written such as letter, telegram telex, fax message, email or through internet. Thus, where A offers to sell his pen to B for Rs. 20; it is an express offer. An **Implied offer** is one which may be gathered from the conduct of the party or the circumstances of the case. Thus, where a person goes to a doctor for treatment, his conduct implies an offer that if the treatment is given, the offer or will pay the usual charges. Similarly, stepping into a local bus, consuming eatables at a restaurant, shining shoes by a shoe shiner, without being asked to do so, etc. creates implied promises to pay for the benefits enjoyed.

2. **To whom an offer is made** An offer may be made to

   (a) A particular person,

   (b) A particular group or body of persons,

   (c) The public at large i.e. the whole world

An offer made to a definite person or body of persons is called a **Specific offer**. *A* specific offer can usually be accepted only by the person or persons to whom it is made. On the other hand, when an offer is addressed to the whole world, it is called a **General offer.** A general offer can be accepted by any one. Where A promises to give Rs. 100 to B if he brings back his missing dog, this is a specific offer and can only be accepted by B: but if A issues a public advertisement to the effect that he would give Rs. 500 to anyone who brings back his missing dog, such an advertisement amounts to a general offer and any member of the public can accept the said offer by searching for and bringing back A's missing dog. The leading case on this point is:

**CARLILL V. CARBOLIC SMOKE BALL CO. (1893)**

*In this case, the Carbolic Smoke Ball Co. offered by advertisement a reward of £ 100 to any person who should contract influenza after having used the Minoke ball three times daily for two weeks according to the printed directions. It also added that £100 was deposited in the bank showing its sincerity in the promise. The plaintiff Mrs. Carlill used the smoke-ball according of the directions to the company but contracted influenza. It was held that she could recover the reward because the advertisement was not a mere invitation to offer but an offer at large. Performance of the conditions is a sufficient acceptance without notification.*

- **An offer must be distinguished from:**

(a) ***A mere statement of intention****, e.g.,* an announcement of a forthcoming auction sale. Thus a person who attends the advertised place of auction could not sue for breach of contract if the sale were cancelled.

(b) ***An invitation to offer*** *e.g.* an advertisement in a newspaper, the display of goods in shop window with prices marked upon them; the display of priced goods in a self-service store.

(c) ***A mere communication of information*** in the course of negotiations *e.g.* statement of the lowest price made in answer to an enquiry as to the lowest price for sale.

*A catalogue of goods for sale e.g.* a book- seller's catalogue of books with prices stated.

(d) ***A casual enquiry*** *e.g.* "Do you intend to sell your computer?" is not an offer.

(e) A ***prospectus*** inviting the public to subscribe to the shares or debentures of a company.

(f) ***Advertisement for the tenders.***

## 3.4. Essentials of a Valid Offer or Rules Regarding Valid Offer

**1. Offer must be capable of creating legal relations**.

The offeror must intend the creation of legal relations. He must intend that if his offer is accepted a legally binding agreement shall result. A accepts an invitation to dine at B's place on a certain date but fails to turn up on the appointed date, A cannot be sued for breach of a contract, because in contracts regulating social or domestic arrangements the presumption is that parties do not intend legal consequences to follow from the breach of a contract. The essential element is that there must be an express or tacit reference to the legal relations of the consenting parties. The leading case is **BALFOUR VS. BALFOUR**.

**2. Offer must be certain, definite and not vague**.

No contract can come into existence if the terms of the offer are vague or loose and indefinite. Both the parties should be clear about the legal consequences arising out of contract. A vague offer does not convey what it exactly means. Thus, an offer by A to B to pay the latter a certain sum of money on the latter marrying A's daughter is no offer, because the amount to be paid is not certain. Similarly the words "P to receive a reasonable share of the profits" do not constitute a valid offer. The leading case on this point is: **TAYLOR V. PORTINGTON (1855)**: *A agreed to take B's house on rent for three years at the rent of £ 85 per annum provided the house was put into thorough repair and the drawing rooms were decorated "according to present style". It is a vague term, because the term "present style" may mean one thing to A and another to B. Hence the agreement was void on the ground that the terms of offer were vague and uncertain.*

**3. Offer must be communicated to the offeree.**

There can be no offer by a person to himself. It must always be communicated to the offeree. If there is no communication of an offer, there is no acceptance resulting in the contract. Thus, if A writes a letter to B offering to sell his watch for Rs. 200 but never posts the letter and keeps it in his pocket, it is not an offer and B can never accept it. Further a person cannot accept an offer about which he is not aware. If B finds A's lost dog, but has not seen the advertisement offering the reward and has proceeded to return the dog to A out of goodness of heart, B will not be able to

claim the reward, since he cannot be held to accept an offer of which he is unaware. The leading case on this point is: **LALMAN SHUKLA V GAURI DUTT (1913)**: *D sent his servant P to trace his missing nephew. D in the meantime announced a. reward for providing information about the missing boy. P, in ignorance of the announcement traced the boy and informed D. P later on came to know of the reward and he claimed it. His claim was dismissed on the ground that he was ignorant of the offer. It was further held that it was the duty of the servant to search for the boy.*

**4. Offer must be made with a view to obtaining the assent of the other party**.

An offer must be distinguished from mere expression of intention. The leading case on this point is: **Harris V. Nickerson (1873)**: *N advertised in the newspaper to effect sale of his goods on a particular day at a particular place. H travelled a long distance to bid for the things. On arrival, he found that the sale was cancelled. He sued N for breach of contract. It was held that advertisement was merely expression of an intention and not an offer which could be accepted by travelling to the place of intended sale.*

**5. An offer may be conditional.**

An offer can be made subject to a condition. In that case it can be accepted only subject to that condition. A conditional offer lapses when the condition is not accepted. Thus, a conditional offer by the management of company to the trade union to pay a certain amount lapses when the condition is not accepted. (Pipraich Sugar Mills Ltd. *vs.* P.S. Mills Mazdoor Union **AIR** 1957 SCC 95). If the offer contains certain conditions and the proposer has done what was reasonably sufficient to give the acceptor notice of the conditions, the person accepting the offer is presumed to have accepted it, with the conditions so attached.

> ***For example:*** *T, who could not read, took an excursion ticket on the railway. On the front of the ticket was printed 'for conditions see back'. One of the conditions was that the railway company would not be liable for personal injuries to passengers. T was injured by a railway accident. Held T was bound by the conditions and could not recover any damages.* ***[Thomson v. L.M. & S. Railway. (1930) I.K. B. 41].***
>
> Where a condition attached to an offer is against public policy, it will not be enforced merely because it had been impliedly accepted by the offeree. A contract formed on a conditional offer is valid. In recent times, however, the courts have adopted certain protective measures, for the aggrieved persons.

Conditional offers are invalid where the terms are unreasonable or the offeree is unaware of the

terms.

**6. Offer should not contain a term the non-compliance of which would amount to acceptance.**

One cannot say while making the offer that if the offer is not accepted before a certain date, it will be presumed to have been accepted.

***For example:*** *A writes to B, "1 offer to sell my house for Rs. 40,000. If I do not receive a reply by Monday next, I shall assume that you have accepted the offer." There will be no contract if B does not reply.*

**7. Lapse of an offer**.

An offer lapses:-

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

(b) If it is not accepted within (i) the specified time, or *(ii)* a reasonable time, if no time is specified. What is a reasonable time? It depends on the circumstances. Five months has been held to be an unreasonable delay in accepting an offer to buy shares in a company.

(c) If the offeree does not make a valid acceptance, for example makes a counter offer or conditional acceptance or if a particular manner of acceptance has been requested, he accepts in some other manner *for example* by sending a letter by mail when a reply by hand was requested. An offer can also lapse by revocation. A person who makes an offer can withdraw it at any time before acceptance. A proposal may be made for a fixed period. The offer will automatically expire if it has not been accepted till then. Where no time limit has been specified, the offer will lapse after a reasonable time.

**8. An invitation to offer is not an offer.**

An offer must be distinguished from an invitation to offer. In the case of an "invitation to offer" the aim is merely to circulate information of readiness to negotiate business with anybody who on such information comes to the person sending it. Such invitations are not offers in the eyes of law and do not become promises on acceptance.

The display of goods in a shop with price tags attached is an invitation to offer. Catalogues containing description of goods held for sale at the prices quoted are not offers. A price list is not

an offer to sell the goods at the listed prices. It is an attempt to induce offers and not an offer in itself. The display of goods on the shelves of a self-service shop is merely an invitation to offer and the customer makes an offer to buy when he carries the goods to the cashier. Similarly advertisement for sale or auction of goods, notice for tender, statement in the railway time table regarding the departure of certain train at a certain time is not an offer but only an invitation to offer.

The SC has held that a contract of employment is governed by the contract Act. Announcement of voluntary retirement scheme by a nationalised bank is not an offer. The employee offering to retire makes an offer. When the request is accepted it becomes effective. So he can withdraw the offer before it is accepted. [Bank of India vs. Swarankar (2003) S.C. 858]

**9. Standing or Open Offer**.

Where large quantities of goods are required by railways or other bodies from time to time, it is usual to call tenders for the supply of such goods. An advertisement inviting tenders is not an offer but a mere invitation to offer. It is the person who sends a tender for the supply of such goods is deemed to have made an offer. An offer for the continuous supply of a certain article at a certain rate over a definite period is called a standing offer. Such offers though accepted do not give rise to contract unless an actual order is placed. The offeror can withdraw his offer at any time before an order is placed with him A, by means of an offer agrees to supply coal to B at a particular rate for a period of two years. B accepts the tender. In this case B is not bound to place an order for all the coal which he requires, nor A is bound to keep that offer alive during the course of two years unless there is an extra-consideration.

**Krishnaveni Constructions vs. The X.E.N. Panchayat Raj Darsi (1995).** An offer containing the promise to keep the offer open for a specific period can be withdrawn unless it is supported by consideration.

**In Suraj Besan and Rice Mills vs. Food Corporation of India (1988).** The Delhi HC has held that a person can withdraw or modify tender before the communication of acceptance is complete as against him.

A mere agreement to agree, or an agreement to enter into a contract itself does not result into a contract. **[Punit Beriwala vs. Sura Sanyal, A.I.R. 1988 Cal. 44]**

If an authority which has invited tenders decides not to go ahead, the tenderers or even the highest tenderer cannot force it to accept. No right accrues to a tenderer until his tender has been accepted.

**[Gajendra Singh vs. Nagarpaliba Nigam, Gwalior AIR 1961 MP]**

A person inviting tenders may reserve a right to reject any tender or even the highest tender. A tenders has no cause of action if his tender is not accepted. **[B. Jayababu vs. Regional Manager, APS RTC, AIR 1996]**

**In LIC of India vs. R. Vasireddy (1984, SC 1014),** the deceased filed a proposal of insurance on his life for Rs. 50,000 on 27.12.1960 issuing two cheques which were encashed on 11.1.61. The person died on 12.1.61. In suit by widow of the deceased, LIC contended that the contract of insurance was not yet complete since proposal form had yet to be accepted by the Divisional Manager and amount of cheques had been deposited in suspense a/c and not credited to premium a/c. The SC upheld the contention of LIC and LIC was held not liable to pay the insurance claim.

**COUNTER OFFER:** A Counter offer is a rejection of the original offer and making a new offer. This new offer is a counter offer. A person who makes a counter offer and subsequently changes his mind and wishes to accept the original offer cannot do so as the first offer lapses and he cannot treat is as still open. The leading case on this point is

**HYDE V. WRENCH (1840)**: *A offered to sell a farm for £ 1,000. X said he would give £ 950. A refused and X then mid he would give £ 1,000, and when A declined to adhere to his original offer tried to obtain specific performance. Held there was no contract as X's offer to pay £ 950 was a refusal of the offer and a counter-offer; and that when he later said he would pay £ 1,000, was making a new offer, which would have to be accepted by A before a binding contract could come into existence.*

**Communication of special conditions:**

- When special terms and conditions are to be included in a contract, they must not be specifically stated but also communicated to the concerned party. It is the duty of the person who delivers a document to give adequate notice to the offeree of the terms and renditions contained in the document. When this is not done the acceptor will not be bound by such terms. The leading case on this point is:

**HENDERSON V. STEVENSON (1875)***: P bought a steamer ticket on the face of which was these words only, "Dublin to Whitehaven". On the back were printed certain conditions one of which excluded the liability of the company for loss, injury or delay to the passenger or his luggage. P had not seen the back of the ticket, nor was there any indication on the face about the conditions on the back. P's luggage was lost on the way due to the negligence of the company's servants. It was held that P was entitled to recover his loss from the company.*

The result in the above case would have been different if words like *"for conditions, see back"* had been printed on the face of the ticket to draw the passengers' attention to the place where the conditions were printed.

- If a person receives a document which he knows or ought to have known, contains the terms of the offer he is bound by the contents whether he has read it or not. The leading case on this point is

**PARKER V. SOUTH EASTERN RAILWAY CO. (1877)**: P deposited his bag at the cloak room at a railway station and received a ticket containing on its face the words "see back". On the back of the ticket there was a condition that, "the company will not be responsible for any package exceeding the value of £ 10". A notice to the same effect was hung up in the cloak room. P's bag was lost and he claimed the actual value of the lost bag, £ 24, 10 s. The claim was negatived and only £ 10 was awarded. That P did not read the conditions was his fault as the railway company had done what was reasonably expected of it.

- Where the acceptor does not know the language in which the ticket is printed, he will be bound unless he asks for a translation of it. The acceptor cannot plead that he was illiterate or blind, provided his attention was drawn to the conditions by suitable words on the document.

***For example:*** *(a) T, an illiterate lady, took a ticket for a journey from a railway company. On the face of the ticket were the words, "for conditions see back." One of the conditions absolved the railway company from liability for personal injuries to passenger. It was held that T could not recover damages for the injury received as she was bound by the condition limiting the company's liability.* ***[Thompson v. London, Midland and Scottish Railway Co. (1930) I.K.B. 41]***

- The document containing the terms should be an integral part of the original contract itself. If it is not a term of the contractual document, the latter cannot govern the contract. Moreover the terms should be brought to the notice of the offeree before the contract is concluded and not afterwards.

**For examples:**

(a) P and her husband hired a room at a hotel and paid a week's rent in advance.

When they went up to occupy the room there was a notice on one of the walls disclaiming the owners liability for damage, loss or theft of articles in the room. A thief entered the

room due to the negligence of the hotel servants. The owner of hotel was held liable since the notice was not a part of the agreement as it came to the knowledge of the client after the contract had been entered into. **[Olley** v. **Marlborough Court Ltd. (1949) 1 K.B. 532].**

(b) A transport carrier accepted the goods for transport without any conditions. Subsequently, he issued a circular to the owners of goods limiting his liability for the goods. As the special conditions were not communicated prior to the date of contract for transport, these were not binding on the owners of goods **[Raipur Transport Co v. Ghanshyam (1956) A. Nag 145].**

**Printed Contracts:** Many big organisations like Life Insurance Corporation of India, Indian Railways, etc. enter into thousands of contracts everyday. It would be difficult for such organisations to draw out a separate contract with every individual. They have, therefore, printed contracts, (or Standard Forms of Contracts). Such standardised contracts often contain a large number of terms and conditions which exclude liability under the contract. The individual is bound to sign them whether he likes the terms or not. The individual, therefore, deserves to be protected against the possibility of exploitation inherent in such contracts. In recent times, the courts have adopted various protective measures for the aggrieved persons, e.g. excluding unreasonable terms from the contract.

**For examples:**

(a) A laundry receipt containing a stipulation that the dry-cleaner would be liable only upto 15% of the market price or value of article was held to be unreasonable term and not binding on the plaintiff who had lost new sari at the laundry. **[Lilly White** vs. **Mannuswami (Air 1966 Mad. 13)]**

(b) Similarly, a printed clause limiting liability of the dry-cleaner to 20% of the dry-cleaning charges or 50% of the value of garment whichever is less, was held to be unreasonable term, arbitrary, opposed to public policy and hence void. **[R.S. Deboo v. M.V. HindelkarAIR 1995Mad 68]**

**Whether purchaser of a lottery ticket bound by the terms and conditions printed on the reverse of a lottery ticket?**

In a case, the plaintiff purchased one Rajasthan State lottery ticket for Rs. 1 which he lost. First prize of Rs. 2.5 lakh was declared on that lottery ticket. The defendants refused to pay the amount

contending that production of actual ticket was necessary to claim the amount as per printed conditions on the back of the ticket. The A.P. High court observed that unless the terms are arrived at after due negotiations, they cannot be held binding merely because a ticket is issued concerning the terms. Moreover, it was proved that the plaintiff had purchased the ticket and none else had claimed the prize amount. The court decided that plaintiff was not bound by terms printed on the reverse of ticket and was entitled to receive prize money without producing original ticket. **[Special Secretary, Govt, of Rajasthan vs. V.V. Seshaiyar AIR 1984 A.P. 5] Cross Offers.**

- When two parties make identical offers to each other, in ignorance of each other's offer, such offers are known as cross offers. They shall not constitute acceptance of one's offer by the other.

**For example:** D wrote to P on 28th November, 1971, offering to sell 800 tons of iron at Rs. 6900 per tonne. On the same day P wrote to D offering to buy 800 tons of iron Rs. 6900 per tonne. The two letters crossed in Post and neither of them knew anything about the offer to the other. P contended that there was a good contract. It was held that D was not bound as a result of the simultaneous offers, each being made in ignorance of the other.

## A. CHECK YOUR PROGRESS

### ➢ Application-Based Questions

1. **A offers to sell his bike to B for ₹20,000. B says he will think about it. Is there a valid acceptance?**
   **Answer:** No, saying "I will think about it" is not acceptance.
2. **X offers to sell goods to Y. Before Y accepts, X revokes the offer. Y later accepts. Is the contract valid?**
   **Answer:** No, because the offer was revoked before acceptance.
3. **P offers to sell a car and states the offer is open for 5 days. On the 3rd day, he revokes the offer. Can he do so?**
   **Answer:** Yes, unless consideration was given to keep the offer open (i.e., an option contract).
4. **What legal rule was established in** ***Carlill v. Carbolic Smoke Ball Co.*****?**
   **Answer:** A unilateral offer made to the public can be accepted by anyone who performs the conditions of the offer, creating a valid contract.
5. **Can an offer be revoked if the offeree has already posted their acceptance?**
   **Answer:** No, under the *postal rule*, the acceptance is effective once posted, and revocation after that is invalid.

## 3.5 MODES OF REVOCATION OF OFFER (Section 6)

According to Section 6 of the Act, a proposal may be revoked in any of the following ways.

**1. By notice of revocation**

Offer may be revoked by a communication of a notice of revocation by the offeror to the other party before acceptance is complete against the offeror himself. An offer made in writing may be revoked by words of mouth. The notice of revocation may not always be express. A notice of revocation to be effective must be communicated to the offeree.

**For example:** At an auction sale, A made the highest bid for B's goods. He withdrew the bid before the fall off the hammer. B knocked down the goods in favour of A. B sued A for the price of goods. It was held that A's bid was no more than offer and he was entitled to withdraw the same before it was accepted. **[Joravarmull Champa Lai vs. Jeygo- paldas Ghanshamdas AIR 1992 Mad 486].**

It may be noted that offer may be withdrawn at any time before it is accepted. After acceptance its character changes and then the offer cannot be withdrawn.

**2. By lapse of time**

A proposal will come to an end by the lapse of time prescribed in such proposal for its acceptance or, if no time is so prescribed by the lapse of reasonable time. What is a reasonable time is a question of fact depending upon the circumstances of each case. Where the subject matter of the contract is an article, like gold, the prices of which fluctuate daily in the market, very short period will be regarded as reasonable. Where person applied for shares of a company in June he cannot be bound by an allotment made late in November. **For example:**

> D offered to sell wool to H on Thrusday and agreed to give him three days time to accept. H accepted the offer on Monday, but by that time D had sold the wool. It was held that the offer had lapsed. **[Head v. Diggen (1828) 3M&R97].**

**3. By non-fulfilment of condition precedent**

A proposal is revoked when the acceptor fails to fulfil a condition precedent to the acceptance of the proposal which was conditional offer. Thus, X may offer to sell certain goods to Y on a condition that Y pays a certain amount before a certain date. The proposal is revoked if Y fails to pay the requested amount within given time.

**4. By death or insanity**

A proposal is revoked 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. Under English law death of the proposer revokes an offer even if acceptance is made in ignorance of the death. In addition to the four modes of revocation given above, an offer will also be revoked in the following cases.

**5. By Counter offer**

An offer comes to an end when the offeree makes a counter offer or rejects the offer. Where an offer is accepted with some modification in the terms of the offer or with some other condition not forming part of the offer, such qualified acceptance amounts to a counter offer. An offer once rejected cannot be revived.

**For example:** A offers to sell his house to B for Rs. 1,000. B replies offering to pay Rs.950. A refuses. Subsequently B writes accepting the original offer has lapsed.

**6. By the non-acceptance of the offer according to the prescribed or usual mode**

The offer will also stand revoked if it has not been accepted according to the mode prescribed.

**7. By subsequent illegality**

An offer lapses if it becomes illegal after it is made and before it is accepted. Thus, where an offer is made to sell 10 bags of wheat for Rs. 2500 and before it is accepted, a law prohibiting the sale of wheat by private individuals is enacted, the offer comes to an end.

**B. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. An invitation to treat is the same as an offer.
2. An offer must be certain, definite, and not vague.
3. A counter-offer is the same as acceptance.
4. Revocation of offer is effective once it is sent by the offeror.
5. Death of the offeror automatically terminates the offer.

**Answers: False, True, False, False, True**

## C. CHECK YOUR PROGRESS

- **Fill in the Blanks**

1. An _____ is a proposal made by one person to another to do or abstain from doing something.
2. An offer must be _____ to the offeree to be valid.
3. A _____ offer is made to the whole world and can be accepted by anyone who performs the conditions.
4. The _____ of an offer is the withdrawal of the offer before acceptance.
5. A _____ offer occurs when two parties make identical offers to each other at the same time.

**Answer: 1. Offer 2. Communicated 3. General 4. Revocation 5. Cross**

## 3.6. LET US SUM UP

An **offer** is a fundamental element in the formation of a contract, representing a proposal by one party (the offeror) to enter into a legally binding agreement with another party (the offeree). It indicates a willingness to do or refrain from doing something, provided the other party agrees. Offers can be classified into various **kinds**, including **express offers** (clearly stated in words, either oral or written), **implied offers** (inferred from conduct), **general offers** (made to the public at large), **specific offers** (made to a specific person or group), **cross offers** (two identical offers made by parties without knowledge of each other), and **counter-offers** (responses that alter the terms of the original offer). For an offer to be **valid**, it must satisfy certain **essentials**: it must be communicated clearly to the offeree; it should express a willingness to create legal relations; the terms must be definite and not vague; it should be made with the intention of obtaining assent; and it must not be made as a mere invitation to treat (such as advertisements or price lists). Additionally, the offer must be made with the genuine intention to be bound by it once accepted. **Revocation of an offer** refers to the withdrawal of the offer by the offeror before it is accepted. A revocation must be communicated to the offeree to be effective and must occur before acceptance. Once an offer is accepted, it cannot be revoked and a binding contract is formed.

## 3.7. KEYWORDS

- Offer – A proposal by one party to another to enter into a legally binding agreement.
- Offeror – The person who makes the offer.
- Offeree – The person to whom the offer is made.
- Valid **Offer** – An offer that fulfils all legal requirements and can lead to a valid contract upon acceptance.
- Express **Offer** – An offer stated clearly in words, either spoken or written.
- Implied **Offer** – An offer inferred from actions or conduct rather than words.
- Specific **Offer** – An offer made to a specific person or group that can be accepted only by them.
- General **Offer** – An offer made to the public at large, which anyone can accept.
- Counter **Offer** – A response to an offer in which the terms are changed; it acts as a rejection of the original offer.
- Cross **Offer** – When two parties make identical offers to each other without knowing about the other's offer.
- Invitation **to Offer (or Treat)** – An invitation for others to make offers (e.g., advertisements, display of goods); not an offer itself.
- Communication **of Offer** – The offer must be communicated to the offeree to be valid.
- Revocation **of Offer** – Withdrawal of the offer by the offeror before it is accepted.
- Lapse **of Offer** – An offer comes to an end due to expiration of time, death of a party, or rejection by the offeree.

## 3.8. SELF ASSESSMENT QUESTIONS

1. How is an offer different from an invitation to treat?

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2. Can an offer be revoked after the offeree has accepted it?

3. What is the effect of a counter-offer on the original offer?

4. Can silence amount to acceptance of an offer? Explain.

## 3.9 LESSON END EXERCISE

1. List and explain the essential elements of a valid offer.

2. Explain the various modes of revocation of an offer under contract law. When does a revocation become effective? Support your answer with relevant case laws.

3. Is it necessary to communicate revocation of an offer to the offeree?

4. Compare and contrast the legal consequences of revocation of an offer and rejection of an offer. How do both affect the possibility of a contract being formed?

## 3.10 SUGGESTED READINGS


- "Contract Law" by Ewan McKendrick.
- "Principles of Contract Law" by Stephen Graw.
- “Elements of Mercantile Law” by N.D. Kapoor.
- Pollock & Mulla: Indian Contract and Specific Relief Acts.
- “Business Law” by K.C Garg, V.K Sareen & Mukesh Sharma.


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**C. No:- BCG-303** **UNIT I**

**SEMESTER: III** **LESSON: 4**

# LAW OF CONTRACT I

**STRUCTURE**



## 4.0 LEARNING OBJECTIVES AND OUTCOMES

**Learning Objectives**

- To define the concept of acceptance in the context of contract law.
- To identify and describe the key essentials that make acceptance legally valid.
- To **e**xplain the rules of communication of acceptance and when it becomes legally effective.
- To explain when acceptance is deemed to be communicated effectively.
- To differentiate Between Valid and Invalid Acceptance.
- Understand major case laws that define or clarify acceptance.

**Learning Outcomes**

After Completing this lesson, learners will be able to:

- Understand what constitutes acceptance of an offer in legal terms in the context of forming a valid contract.
- **Explain** the **rules of communication** of acceptance and when it becomes legally effective.
- Understand how acceptance finalizes the agreement between parties.
- Recognize the importance of acceptance in the formation of a legally binding agreement.
- Differentiate between acceptance, counter-offer, rejection, and invitation to treat.
- Identify cases where acceptance is not valid, for e.g., conditional acceptance, late acceptance.

## 4.1 INTRODUCTION

In the realm of contract law, the concept of *acceptance of an offer* is a cornerstone of forming legally binding agreements. A contract is not complete without a clear and unequivocal acceptance of the offer made by one party to another. Acceptance occurs when the party to whom the offer is made agrees to the terms proposed by the offeror, thereby creating mutual consent between the parties. Without acceptance, an offer remains merely a proposal and no binding contract comes into existence. However, to be legally effective, acceptance must fulfil certain essential conditions such as being absolute, unconditional, communicated to the offeror, and made within the prescribed time. Understanding these essentials of acceptance is fundamental to ensure that agreements are clear, enforceable, and free from disputes. Any deviation or ambiguity can render a contract void or unenforceable. This topic explores the legal requirements of acceptance and its vital role in ensuring clarity, fairness, and mutual obligation in contractual relationships.

## 4.2. MEANING OF ACCEPTANCE

When the person to whom the proposal is made signifies his assent, it is an acceptance of the proposal. An accepted proposal is called a promise or an agreement. [(Section 2 (b)]. An application for the shares in a company is in the nature of offer while the allotment of the shares by the company is an acceptance resulting into a contract. An acceptance must be communicated

to the offeror in order to complete the acceptance. Mental acceptance is no acceptance. The acceptor should do something to signify his Intention to accept. A common example of an act amounting to acceptance is the fall of the hammer in the case of an auction sale. Except where a proposal prescribes a particular mode of acceptance, the acceptance may be made in several different ways.

**For example**: A offers to sell his horse to B for Rs. 500. B accepts the offer to purchase the horse for Rs. 500. This is acceptance.

**Acceptance may be express or implied**. When acceptance is made by words, spoken or written, it is an express acceptance. If it is accepted by conduct, it is an implied acceptance. Thus, where a person boards a train or bus, he impliedly accepts to pay the usual fare. Similarly, when a person goes to a hotel and eats some food, he impliedly accepts to pay for it.

**Who may accept?** An offer can be accepted only by the person to whom it is made. It means that the person to whom the offer is made can alone accept it. It cannot be accepted by another without the consent of the person making it. Thus, where offer is made by A to B, the acceptance by C would be inoperative.

The leading case on the point is **BOULTON VS. JONES (1857)**: *D sent an offer to a firm with whom he had accounts. P who had just taken over the said firm got the letter addressed to the old firm, accepted the offer and sent the goods. P sued for the price of the goods. The court held that there was no contract since the order was to the old firm and the acceptance was by the new firm.*

An offer may also be made to the world at large, as for instance, by an advertisement in the newspaper. In such a case only person or persons with notice of the offer can come forward and accept the offer. ***[Carlill v. Carbolic Smoke Ball Co. (1893) I. Q. B. 256].***

## 4.3. Essentials of a valid acceptance

1. **Acceptance must be absolute and unconditional.**

   An acceptance must be unconditional and unqualified. Accepting an offer with conditions, variations and reservations amount to counter offer and rejection of the original offer. The acceptor must comply with the terms of the offer. A variation or alteration, however, small of the offer, will make the acceptance invalid.

**For examples :** M offered to sell land to N at $ 280 N replied accepting the offer and enclosing $ 30 and promising to pay balance amount by monthly instalments of $ 50 each. Since N accepted, the offer subject to making payments in instalments, it was held that the acceptance was conditional and qualified **[Neele v. Mrritt (1930)].**

2. **Acceptance must be communicated to the offeror.**

If the offeree remains silent and does nothing to show that he has accepted the offer, no contract is formed. The acceptor should do something to signify his intention to accept. Thus, where a person accepts an offer but fails to post the letter of acceptance, it is no acceptance. Acceptance must be communicated to the offeror himself. A communication to any other person is as ineffectual as if no communication has been made.

The leading case on the point is **FELTHOUSE V. BINDLEY (1862)**: *F offered to buy his nephew's horse for £ 30-15s, adding, "If I hear no more, I shall consider the horse is mine at £30- 15s". The nephew did not reply, but told his auctioneer not to sell the horse, as it was sold to his uncle. But the auctioneer sold it by mistake to a third party. F sued him for conversion of his property. It was held that there was no communication of acceptance. Mental acceptance or uncommunicated assent does not result in a contract.*

**For examples:**

(a) The board of managers of a school resolved to appoint P as headmaster. One of the managers, in his individual capacity, informed P of the same. But there was no formal communication of the resolution by the board. The board later rescinded the resolution. It was held that in the absence of an authorised communication, there was no completed contract. **[Powell v. Lee. (1908) 99 L.T. 284].**

(b) The manager of a railway company received an offer by a letter relating to the supply of coal; he wrote on the letter 'accepted' and kept it in his drawer and forgot all about it. It was held that there was no contract as the acceptance had not been communicated. **[Brogden v. Metropolitan Rly. Co. (1877) A.C. 66].**

3. **Acceptance must be made within a reasonable time.**

Acceptance to be valid must be made within the time allowed by the offeror and if no time is specified, it must be made within a reasonable time. What is a reasonable time is a question of

fact depending on the particular circumstances. Acceptance may be made at any time till the offer is alive. Acceptance made after the offer has been withdrawn is invalid.

The leading case on this point is **RAMSGATE VICTORIA HOTEL CO. V. MONTEFIORE (1866):** A person applied for shares in a company in June. He cannot be bound by an allotment made late in November.

4. **Must be according to the mode prescribed or usual or reasonable mode.**

Acceptance has to be made in the manner prescribed or indicated by the offeror. Section 7(2) states that if the acceptance is not made in the manner prescribed, the proposer may within a reasonable time after the acceptance is communicated to him, insist that the acceptance must be made in the manner prescribed. Failure on the part of the offeror to do so, will imply that he has accepted the acceptance although it is not in the desired manner.

**For example:** An offer was made in the following terms. "I intend to sell my house for Rs. 1,000. If you are willing to have it write to F at his address". Instead of writing to F, the purchaser sent an agent to F and agreed to purchase. It was held that the seller was bound by the acceptance and there was no violation of section 7 when the purchaser, instead of writing to the particular person, met him personally to communicate his acceptance. **[Surendra Nath v. Kedar Nath A.I.R. 1936. Cal 87].**

It may be noted that law does not allow an offeror to prescribe 'silence' as the mode of acceptance. Thus a person cannot say that if within a certain time acceptance is not communicated, the offer would be considered as accepted. Where no mode of acceptance is prescribed, acceptance must be expressed in some Usual and reasonable manner. Acceptance by mail is a very reasonable manner in such cases.

5. **The acceptor must be aware of the proposal at the time of the offer**

Acceptance follows offer. It the acceptor is not aware of the existence of the offer and conveys his acceptance, no contract comes into being. There must be a knowledge of the offer before anyone could consent to it. An act' done in ignorance of the offer of a reward cannot be called an acceptance. **The leading case is: LALMAN SHUKLA V. GAURI DUTT (1913).**

**For example:** A sold his business to his manager B without disclosing the fact to his

customer C, a customer, who had a running account with A, sent an order for the supply of goods to A by name. B received the order and executed the same. C refused to pay the price. It was held that there was no contract between B and C because C never made any offer to B and as such C was not liable to pay the price to B **[Boulton vs. Jones (1857) 157E.R. 232].**

**6. Acceptance must be given before the offer lapses or before the offer is revoked:**

It means that acceptance must be made while the offer is in force *i.e.* before the offer has been revoked or offer has lapsed.

A prospective resignation to quit a post is an offer and it can be withdrawn before the resignation is accepted by a competent authority. **[Union of India vs. Gopal Chandra, AIR 1978 See 694]**

**7. Acceptance cannot be implied from silence:**

No contract is formed if the offeree remains silent and does nothing to show that he has accepted the offer.

For example: Pankaj told Radha, 'I offer you my car for Rs. 50,000. If you don't reply in ten days, I shall assume that you accept the offer" Radha kept silent. Hence, there was no contract. *For further details see the discussion below.*

**Effect of silence on acceptance**

Generally speaking the person to whom the proposal is made need not reply. His silence cannot be regarded as an acceptance of the proposal. Proposal made to another cannot ripen into an agreement merely because the offeree makes no reply even though the proposal states that silence will be taken to amount to acceptance. Thus, mental acceptance is no acceptance.

**The leading case on this point is BROGDON V. METROPOLITAN RAILWAY CO. (1877)**: *A draft agreement relating to the supply of coal was sent to the manager of a railway company for his acceptance. The manager wrote the word 'approved' on the agreement but, by an oversight the document remained in his drawer. Held there was no contract as it was only mentally accepted and there was no expression of his mental determination. wrote the word 'approved' on the agreement but, by an oversight the document remained in his drawer. Held there was no contract as it was only mentally accepted and there was no expression of*

*his mental determination.*

- Acceptance of a proposal may sometimes be inferred from silence or inaction. As a rule silence does not imply acceptance**, but in the following cases silence may be indicative of assent to the proposal:**

(1) Where the offeree having reasonable opportunity to reject the offered goods or services takes the benefit of them, it will amount to acceptance.

**For example:** A landlord served a notice on the tenant demanding enhancement of rent. The tenant did not protest against it and continued to occupy the premises. The conduct of the tenant amounts to acceptance of the offer to pay the rent at a higher rate. **[Kashi Prasad v. Sajjadi Begam AIR. 1940, Oudh 287].**

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

- **Acceptance subject to contract**

When an offer or acceptance is made 'subject to contract' or by the use of words, "subject to approval by certain persons-such as solicitors etc.", no contract will arise till a formal contract is settled or consent of such person is obtained.

**A. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

**1.** Acceptance must be communicated to the offeror.

**2.** Silence is not considered acceptance unless agreed upon.

**3.** A counter-offer terminates the original offer.

**4.** An offer cannot be accepted after it has lapsed.

**5.** Acceptance must mirror the terms of the offer (mirror image rule).

**ANSWERS: 1.True 2. False 3.True 4. False 5. True**

**B. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

1. Which **of the following is NOT an essential of a valid acceptance?**
A) It must be absolute and unqualified
B) It must be communicated
C) It must be in writing
D) It must be made in response to the offer

2. **The "postal rule" states that acceptance is complete when:**
A) The letter is posted
B) The letter is received by the offeror
C) The offeror reads the letter
D) The letter is signed

3. **If an offeree changes the terms of the offer and sends it back, it is called:**
A) Valid acceptance
B) Revocation
C) Counter-offer
D) Consideration

4. **Which of the following will NOT terminate an offer?**
A) Counter-offer
B) Acceptance
C) Lapse of time
D) Silence

5. **Acceptance under Indian Contract Act becomes valid when:**
A) It is posted
B) It reaches the offeror
C) It is signed
D) It is prepared

**ANSWERS: 1. C 2. A 3. C 4. B 5. D**

C**. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS.**

1. Acceptance must be _____ and communicated to the offeror.0

2. A _____ acceptance is not considered a valid acceptance.

3. Acceptance must be made in the _____ prescribed by the offeror.

4. If no mode of acceptance is prescribed, it should be made in a _____ manner.

5. Acceptance must be communicated to the _____ or his authorized agent.

**ANSWERS: 1. absolute and unqualified, 2. conditional or qualified, 3. manner, 4. reasonable, 5. offeror.**

## 4.4. LET US SUM UP

**Acceptance** refers to the unqualified agreement to the terms of an offer, resulting in the formation of a binding contract. For acceptance to be valid, it must meet certain essential criteria. Firstly, it must be **absolute and unconditional**, matching the terms of the offer without modifications. Any variation constitutes a counter-offer rather than acceptance. Secondly, acceptance must be **communicated to the offeror,** unless the offer specifies that performance alone constitutes acceptance (as in unilateral contracts). Silence generally does not amount to acceptance. Additionally, acceptance must be **made in the manner prescribed** by the offeror, if any, or in a reasonable way if no mode is specified. Finally, it must be made **within the time stipulated**, or within a reasonable time if no time frame is given. These essentials ensure clarity and mutual consent, which are foundational to contract formation in legal systems.

## 4.5. KEYWORDS

- **Acceptance** – The expression of agreement to the terms of an offer, resulting in a binding contract.
- **Unconditional** – Acceptance must be without any changes or conditions; otherwise, it becomes a counter-offer.
- **Absolute** – Complete agreement with all terms of the offer without variation.
- **Consensus ad idem** – A Latin term meaning "meeting of the minds"; both parties must agree to the same thing in the same sense.
- **Mode of Acceptance** – The method by which acceptance is made; it should comply with the mode prescribed by the offeror.
- **Prescribed Manner** – If the offer specifies how acceptance must be made, it must be followed for the acceptance to be valid.
- **Timeframe** – Acceptance must be made within the time limit stated in the offer or within a reasonable time.

## 4.6. SELF-ASSESSMENT QUESTIONS

1. Can silence be considered acceptance? Why or why not?

2. What happens if an acceptance is made with a condition or modification?

## 4.7. LESSON END EXCERCISE

1. Discuss the concept of acceptance in contract law and explain its essential elements that make an acceptance valid and legally binding.

2. Explain the difference between a proposal (offer) and acceptance. Why acceptance is considered a crucial element in forming a valid contract?

3. Evaluate the doctrine of 'postal rule' in the communication of acceptance. Discuss its advantages and disadvantages in contract formation.

## 4.8. SUGGESTED READINGS


- "Law of Contract" by Avtar Singh.
- "Contract Law" by Anson.
- "Contract: Cases and Materials" by Ewan McKendrick.
- "Principles of the Law of Contract" by Sir Frederick Pollock.
- "The Indian Contract Act, 1872" – Bare Act with commentary.


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**C. No: - BCG-303** **UNIT I**

**SEMESTER: III** **LESSON: 5**

# LAW OF CONTRACT I

**STRUCTURE**



## 5.0 LEARNING OBJECTIVES AND OUTCOMES

**Learning Objectives**

- To explain the concept and importance of **free consent** in the formation of valid contracts.
- To define **coercion** under contract law and recognize the **elements of coercion** such as unlawful threats, committing or threatening to commit an act forbidden by law.
- To understand what constitutes **undue influence** and identify the **relationships** where undue influence is presumed.
- To define **fraud** in the context of contracts and list the **acts that constitute fraud**.

- To define **misrepresentation** and differentiate it from fraud.
- To explain the **legal effects** of entering a contract based on misrepresentation.
- To understand the concept of mistake of fact vs. mistake of law, differentiate between unilateral and bilateral mistake and recognize how certain mistakes can render a contract void or voidable.

**Learning Outcomes**

After Completing this lesson, learners will be able to:

- **Define** the concept of **free consent** and explain its significance in forming a valid contract.
- **Identify** and **differentiate** between situations where consent is vitiated by coercion, undue influence, fraud, misrepresentation, or mistake.
- **Explain** the legal meaning and elements of **coercion** and assess its effect on the validity of contracts.
- **Recognize** the circumstances under which **undue influence** occurs and how it affects contractual agreements.
- **Distinguish** between **fraud** and **misrepresentation**, and understand their implications on contracts.
- **Analyze** the concept of **mistake** in contracts, differentiating between types of mistakes and their consequences.
- **Evaluate** contractual scenarios to determine whether consent is free or vitiated and decide the legal consequences accordingly.

## 5.1 INTRODUCTION

In contract law, *free consent* is a vital requirement for the formation of a valid and enforceable agreement. Consent is said to be free when it is given voluntarily and without any external pressure or misleading circumstances. However, certain factors such as *coercion*, *fraud*, *undue influence*, *misrepresentation*, and *mistake* can affect the freedom of consent, thereby impacting the legitimacy of a contract. Coercion involves the use of threats or force, fraud includes intentional deception, undue influence arises from one party dominating the will of another, misrepresentation refers to

false statements made innocently, and mistake involves a misunderstanding by one or both parties regarding a fact essential to the agreement. Each of these elements can render a contract voidable or void, highlighting the importance of ensuring that consent is truly free and informed in all contractual dealings. Therefore, understanding the concept of free consent is crucial in legal and commercial dealings to protect the rights and interests of all parties involved.

## 5.2. FREE CONSENT

Free consent of all the parties to a contract is one of the essential elements of a valid contract as per requirements of section 10.

**Consent Defined**

Section 13 of the Contract Act defines the term consent and lays down that two or more persons are said to consent when they agree upon the same thing in the same sense. Thus consent involves identity of minds or consensus ad idem i.e., agreeing upon the same thing in the same sense. If, for whatever reason, there is no consensus ad idem among the contracting parties, there is no real consent and hence no valid contract.

**Free Consent Defined**

Section 14 lays down that consent is said to be free when it is not caused by-

1. Coercion, as defined in section 15, or
2. Undue influence as defined in section 16, or
3. Misrepresentation, as defined in section 18, or
4. Fraud as defined in section 17, or
5. Mistake subject to the provisions of sections 20, 21 and 22.

"Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, misrepresentation, fraud or mistake". (Section 14). This means that in order to bring a case within this section, the party, who alleges that this consent has been caused by any of the above elements which vitiate consent, must show that, but for the vitiating circumstances the agreement would not have been entered into.

**A. CHECK YOUR PROGRESS**

- **MATCH THE FOLLOWING:**

| CONCEPT | SECTION |
|---|---|
| 1. COERCION<br>2. UNDUE INFLUENCE<br>3. CONSENT<br>4. FRAUD<br>5. FREE CONSENT<br>6. BILATERAL MISTAKE<br>7. MISREPRESENTATION<br>8. UNILATERAL MISTAKE | a) SECTION 13<br>b) SECTION 14<br>c) SECTION 15<br>d) SECTION 16<br>e) SECTION 17<br>f) SECTION 18<br>g) SECTION 20<br>h) SECTION 22 |

**ANSWERS: 1-C, 2-D, 3-A, 4-E, 5-B, 6-G, 7-F, 8-H.**

## 5.3. COERCION

In simple words, coercion is threat or force used by one party against another for compelling him to enter into an agreement. Section 15 of Indian Contract Act defines coercion as, "the committing or threatening to commit any act forbidden by the Indian Panel Code or an unlawful detaining or threatening to detain, any property to the prejudice of any person with the intention of causing any person to enter into an agreement". It is immaterial whether the Indian Panel Code is or is not in force in the place where the coercion is employed.

**For example:** L threatens to shoot M, if he does not let out of his house to him. M agrees to let out his house to L. The consent of M has been induced by coercion.

Threats of imprisonment are included under the head coercion. For e.g. consent obtained at the point of piston or intimidation is also an act of coercion. Similarly, a threat to commit suicide with the intention of causing a person to enter into agreement is an act of coercion.

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

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

**Effects of Coercion:**

Section 19 provides that an agreement consent to which is obtained by coercion is voidable at the option of the party whose consent is so obtained.

A person to whom money had been paid or anything delivered under coercion must repay or return it (section 72).

**For example:** A railway company refuses to deliver certain goods to the consignee, except upon the payment of illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charges as was illegally excessive.

**Burden of proof:**

The burden of proving use of coercion lies on the party, who wants to set aside the contract on the plea of coercion.

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## 5.4. UNDUE INFLUENCE

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**Definition**

**Section 16(1)** defines the term undue influence as follows:-

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

The phrase in a position to dominate the will of the other" is clarified by the same section under sub-section (2), thus:

**Section 16(2),** A person is deemed to be in a position to dominate the will of another- Where he holds a real or apparent authority over the other , e.g., the relationship between master and the servant, police officer and the accused; or

(a) Where he stands in a fiduciary relation to the other. Fiduciary relation means a relation of mutual trust and confidence. Such a relationship is supposed to exist in the following cases: father and son, guardian and ward, solicitor and client, doctor and patient, guru and disciple, trustee and beneficiary, etc; 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, e.g., old illiterate persons.

It is to be observed that for proving the use of undue influence, both the elements mentioned above, namely, (i) the other party was in a position to dominate his will, and (ii) the transaction was an unfair one, must be established.

**Presumption of Undue Influence:**

Undue influence is presumed to exist under the circumstances mentioned above in sub- clauses (a), (b) and (c). in other words, for example, where the relationship between the contracting parties is that of master and servant, father and son, doctor and patient, solicitor and client, etc or where one of the parties to the contract is an old illiterate person, there is no need of proving the use of undue influence by the party whose consent was so caused. Merely, status of parties is enough to prove the existence of undue influence in these cases.

There is, however, no presumption of undue influence in the following cases:

(i) Husband and wife (In case of persons engaged to marry, the presumption of undue influence will arise).

(ii) Mother and daughter

(iii) Grandson and grandfather.

(iv) Landlord and tenant.

(v) Creditor and debtor

In these cases, undue influence shall have to be proved by the party alleging that undue influence existed.

**Burden of proof and rebutting the presumption:**

In cases where there is a presumption of undue influence the burden of proving that the person who was in a position to dominate the will of another, did not use his position to obtain an unfair

advantage, will lie upon the person who was in a position to dominate the will of the other [ section 16(3)]. He can rebut or oppose the presumption by arguing (i) that full disclosure of facts was made, (ii) that the price was adequate, and (iii) that the other party was in receipt of competence independent advice and his consent was free.

**Effects of Undue Influence:**

"When consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit there under, upon such terms and conditions as the court may seem just" (section 19-A).

**For example:**

1. 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.
2. A, a money lender, advances Rs.100 to B, an agriculturist, and by undue influence , induces B to executive a bond for Rs.200 with interest at 6% per month. The court may set the bond aside; ordering B to repay the Rs.100 with such interest as may seem just.

**Distinguish between Coercion and Undue Influence**

Both coercion and undue influence vitiate consent and make the consent of one of the parties to the contract unfree. But the following are the points of distinction between the two:

1. In coercion, the consent of the aggrieved party is obtained by committing or threating to commit an act forbidden by Indian Panel Code or detaining or threatening to detain some property unlawfully. While in undue influence, the consent of the aggrieved party is affected from the domination of the will of one person over another.

2. Coercion is mainly of a physical character involving mostly use of physical or violent force. Whereas undue influence is of moral character involving use of moral force or mental pressure.

3. While in the case of rescission of a contract procured by coercion, any benefit received by the aggrieved party has to be restored under section 64 of the Contract Act, in the case of rescission of a contract procured by undue influence, as per section 19 – A, the court has discretion to direct the aggrieved party for restoring the benefit whether in whole or in part or set aside the contract without any direction for refund of benefit.

## 5.5. Fraud

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

According to section 17, fraud means and includes any of the following acts done with intent to deceive or to induce a person to enter into a contract:

1. A false suggestion as to a fact known to be false or not believed to be true; or
2. the active concealment of a fact with knowledge or belief of the fact; or
3. a promise made without any intention of performing it; or
4. doing any other act fitted to deceive; or
5. doing any such act or making any such omission as the law specially declares to be fraudulent.

**Element of Fraud:**

**1.** The fraud must have been committed by a party to the contract or with his connivance or by his agent. Fraud by a stranger to contract does not affect its validity.

**For example:** The director of a company issued a prospectus containing false representation, on the faith of which Z agreed to buy some shares from the company. Z may avoid the contract because the directors are deemed to be the agents of the company. [Resse River Silver Mining Company Vs Smith].

**2.** There must be any one of the following ingredients in the act of fraud.

a) A suggestion as to a fact (suggestion falsi) which is not true by one who does not believe it to be true. A false statement made recklessly without inquiring whether, it is true or false would amount to fraud. But if a statement which turns out to be false is made in the honest belief that it is true there is no fraud. All that is necessary is that the statement must be made with knowledge of its falsehood or without belief in its truth by the person making it. Where for securing policy the insured gives willfully untrue answer, he commits fraud.

b) An active concealment of fact (suppression veri) by one having knowledge or belief of the fact. The concealment of suppression of material fact is falsehood and amounts to fraud. Concealment is as bad as a direct lie.

**For example:** A, horse dealer sold a mare to B. A know that the mare had a cracked hoof, which he filled up in such a way as to defy detection. The defect was subsequently discovered by B. I t was held that agreement could be avoided by B as his consent was obtained by fraud.

c) A promise made without any intention of performing it. The initial intention not to perform the promise that is being made is a necessary element to constitute fraud. Thus, where a person orders and obtains possession of goods with the intention of not paying for them, he commits fraud.

**For example:** A man and a woman went through a ceremony of marriage, the husband having no intention to regard it as a real marriage. It was held that the consent of the wife was obtained by fraud and that the marriage was just pretence (Shireen Mall Vs. John James Taylor).

d) Any other act fitted to deceive. This is a general clause and includes all cases not falling within any of the other clauses provided the act is fitted to deceive. The intention to deceive and the fitness of the act for deceit must be present.

e) Any such act or omission as the law specially declares to be fraudulent. It is fraudulent to conceive of any act that attempts to deceive law. Thus, where agreement is formed between the insolvent and the third party, it is nothing short of a fraud on insolvency law.

**3.** The act of fraud must have been committed with intent to deceive and must actually deceive. A deceit which does not deceive is not fraud. No cause of action arises where there is fraud without damage or damage without fraud.

**4.** The representation must have been aimed at the other party to the fraud. Such representation must have been made before the conclusion of the contract.

**Mere Silence is not Fraud**

Mere silence of a party as to certain facts does not generally amount to fraud. A party to the contract is under no obligation to disclose the whole truth to the other party. A vendor who sells an unsound horse but says nothing about its quantity commits no fraud. Caveat emptor i.e., let the buyer be aware is the rule applicable to contracts. There is in such cases no duty to speak and silence does not amount to fraud. Similarly, there is no duty to disclose facts which are within the knowledge of both the parties. Silence in such a case will not amount to fraud.

**Exceptions:**

However, there are two exceptions to the rule which are given in the explanation to section 17. These are –

i) Where circumstances create a duty on the part of the person keeping silence to speak, and

ii) Where silence in itself is equivalent to speech.

**Duty to Speak:**

Where there is duty or obligation to speak and a man in breach of that duty or obligation holds his tongue and does not say the thing he was bound to say, there is fraud. But there is no obligation to disclose things which are already known or which are within the power of the other party to know. Duty to speak arises where one party reposes a trust or confidence in the other. The word duty means a legal duty. In contracts uberrimae fidei (Contracts of utmost faith) there is duty to disclose all material facts which are in the knowledge of one party. All contracts of insurance are uberrimae fidei. Similarly, in case of contracts of marriage, family settlement and share allotment contracts, the parties are under duty to disclose all facts which are in the knowledge of the party.

**Effects of fraud:**

When consent to an agreement is caused by fraud, the agreement is a contract voidable at the option of the party whose consent was so caused. A party whose consent to an agreement was caused by fraud has two remedies, namely:

a) he may rescind the contract, or

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

Apart from the above, the person defrauded may obtain rescission, restitution or damage. The aforesaid

remedies are subject to an exception. A contract cannot be avoided on the ground of misrepresentation or silence amounting to fraud, if a party to whom an untrue or misleading statement has been made had the means of discovering the truth with reasonable diligence.

**B. CHECK YOUR PROGRESS**

- **SHORT ANSWER QUESTIONS.**

**1.** What is free consent?

Answer: As per Section 14, consent is free when it is not caused by:

a) Coercion (Section 15)
b) Undue Influence (Section 16)
c) Fraud (Section 17)
d) Misrepresentation (Section 18)
e) Mistake (Sections 20, 21, and 22)

**2.** What is Undue Influence? Give an example.

**Answer:** Undue Influence (Section 16) occurs when one party uses their dominant position to obtain an unfair advantage over the other.
**Example:** A doctor convinces an ill patient to sell property at an undervalued price.

**3.** How can undue influence be proven?

**Answer:** By showing:

- A relationship of trust (e.g., parent-child, lawyer-client)
- That one party dominated the other's will
- That the contract is **unfair** or one-sided

**4.** What is the effect of a contract entered into due to coercion?

**Answer:** A contract caused by coercion is voidable at the option of the aggrieved party whose consent is obtained by coercion (Section 19).

**5.** List any two acts that constitute fraud under Section 17.

Answer: The following acts that constitute fraud under Section 17

a. A false suggestion of a fact, made knowingly.
b. Active concealment of a fact by one having knowledge of it.

**6.** Is silence considered fraud?

**Answer:** Generally, No. Mere silence is not fraud unless:

- There is a duty to speak, or
- Silence is equivalent to speech under the circumstances (e.g., fiduciary relationships).

## 5.6. Misrepresentation

A representation means, statement of fact made by one party to the other, either before or at the time of contract, relating to some matter essential to the formation of the contract, with an intention to induce the other party to enter into the contract. It may be expressed by words spoken or written or implied from the facts or conducts of the parties for example, non – disclosure of a fact.

A representation when wrongly made, either innocently or intentionally, is termed as misrepresentation. To put it differently, misrepresentation may be either innocent or intentional or deliberate with intent to deceive the other party. In law, for the former kind, the term misrepresentation and for the latter the term fraud is used.

**Definition:**

According to section18 misrepresentation means and includes:

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

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

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

Thus, as per section 18, there is misrepresentation in the following three cases:

1. Positive assertion of unwarranted statements of material facts believing them to be true. If a person makes an explicit statement of fact not warranted by his information (i.e., without any reasonable ground), under an honest belief as to its truth though it not true, there is misrepresentation.

   **For example:** A says to B who intends to purchase his land, “My land produce 10 quintals of wheat per acre”. A, believes the statement to be true, although he did not have sufficient grounds for the belief. Later on, it transpires that the land produces only 7 quintals of wheat per acre, this is a misrepresentation.

2. Breach of duty which brings an advantage to the person committing it by misleading the other to his prejudice. This clause covers those cases where a statement when made was true but

subsequently, before it was acted upon, it became false to the knowledge of the person making it. In such a case, the person making the statement comes under an obligation to disclose the change in circumstances to the other party; otherwise he will be guilty of misrepresentation.

**For example:** A, before signing a contract with B for the sale of business, correctly states that the monthly sales are Rs.50, 000. Negotiations lasted for five months, when the contract of sale was signed. During this period the sales dwindled to Rs. 5,000 a month. A, unintentionally keeps quiet. It was held that there was misrepresentation and B was entitled to rescind the contract.[With Vs. O'Flangan,1936].

3. Causing mistake about subject matter innocently. If one of the parties induces the other, though innocently, to commit a mistake as to the quality or nature of the thing bargained, there is misrepresentation.

   **For example:** In a contract of sale of 500 bags of wheat, the seller made a representation that no sulphur has been used in the cultivation of wheat. Sulphur, however, had been used in the cultivation of wheat sulphur, however, and had been used in 5 out of 200 acres of land. The buyer would not have purchased the wheat but for the representation. This is misrepresentation.

**Effects of Misrepresentation:**

In case of misrepresentation, the aggrieved party has two alternative courses open to him –

i. He can rescind the contract, treating the contract as voidable or ii. He may affirm the contract and insist that he shall be put in the position in which he would have been, if the representation made had been true (sec.19). Misrepresentation does not entitle the aggrieved party to claim damages.

**For example:** A, innocently in good faith informs B that A's estate is free form encumbrance. B thereupon buys the estate. The estate is subject to a mortgage. B may either avoid the contract or may insist on its being carried out and the mortgage debt redeemed.

**Exception:**

The above remedy is lost, if the party whose consent was caused by misrepresentation, had the means of discovering the truth with ordinarily diligence. For example, A, by a misrepresentation, leads B erroneously to believe that 500 mounds of indigo are made annually at A's factory. B examines the accounts of the factory, which show that only 400 mounds of indigo have been made. After this B buys the factory. The contract is not voidable on account of A's misrepresentation.

**Difference between Misrepresentation and Fraud**

In both the cases, there is a misrepresentation of fact which induces the promisor to enter into a contract. Misrepresentation differs from fraud in the following respects:

1. A false statement made with an intention to deceive is fraud. A false statement without any intention to deceive would be misrepresentation.
2. In case of misrepresentation the fact that the other party had the means of discovering the truth is a good plea, but where consent to an agreement is caused by active fraud, the contract is voidable even though the party defrauded had the means of discovering the truth.
3. In case of fraud, the aggrieved party has the right to claim damages in addition to his right to avoid the contract. Misrepresentation merely goes to avoid the contract.
4. Fraud may amount to an offence of cheating. Fraud is a criminal act. Misrepresentation only gives a right to avoid a contract.

## 5.7. Mistake

Mistake may be defined as an erroneous belief concerning something. It means that parties intending to do one thing have by intentional error done something else.

Mistake may be of two types:

1. Mistake of law
2. Mistake of fact

**1. Mistake of Law:**

Mistake of law may be of three kinds:

a) Mistake of general law of the country.

b) Mistake of foreign law

c) Mistake of private rights of a party relating to property and goods etc.

**Mistake of general law of the country**

The contract is binding because everybody is supposed to know the law of the country. The maximum ignorantia juris non excusat (ignorance of law is no excuse) is applicable and the party cannot be allowed any relief on the ground. According to section 21, “A contract is not voidable

because it was caused by a mistake as to any law in force in India".

**For example:**

1. A and B make a contract under the impression that a particular debt is barred by law of limitation. The contract is valid.

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

**Mistake of foreign law and private rights of a party relating to property and goods,** etc. are treated as mistake of fact. The contract is not voidable.

**2. Mistake of Fact**

Mistake of fact may be either bilateral or mistake of only one party i.e., unilateral mistake.

**Bilateral Mistake:**

A mistake of fact in the minds of both parties negatives consent and the contract become void. Section 20 provides that, "Where both the parties to an agreement are under a mistake as to a matter of fact, essential to the agreement, the agreement is void". Here there is no real correspondence of offer and acceptance, each party understanding the contract in a different way. In reality there is no agreement at all, there being total absence of consent.

Four conditions must be fulfilled before a contract can be avoided on the ground of mistake.

a) There must be a mistake as to the formation of contract.
b) The mistake must be of both the parties, i.e., bilateral and not unilateral.
c) It must be mistake of fact and not of law.
d) It must be about a fact essential to the agreement.

**For example:** A man and a woman made a separation deed under which the man agreed to pay a weekly allowance to the woman under a mistaken assumption that they were lawfully married. It was held that the agreement was void as there was common mistake on a point of fact which was material to the existence of the agreement. (Galloway V. Galloway, 1914).

However, an erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not deemed to be a mistake as to a matter of fact.

**For example:** M buys a painting believing it to be worth Rs.2, 000 while actually it is worth Rs. 200 only.

The cases falling under bilateral mistakes are discussed below:

1. **Mistake as to the subject matter:**

   Mistake as to the subject-matter falls into six heads, namely-existence, identity title, price quantity and quality.

2. **Mistake as to the existence of the subject matter:**

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

   **For example:** A agrees to sell 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 carrying the cargo had been cast away and the goods lost. Neither party was aware of the fact. The agreement is void.

3. **Mistake as to the identity of the subject matter:**

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

   **For example:** A agreed to buy B 125 bales of cotton, "to arrive ex-pear less from Bombay". There were two ships of that name sailing from Bombay. One of which was in the mind of A and the other in the mind of B. It was held that there was a bilateral mistake and there was no contract [Raffles V Wichellaus].

4. **Mistake as to the title of the subject matter:**

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

   **For example:** A agreed to take a lease of fishery from B, through contrary to the belief of both parties at that time, A was already tenant for life by inheritance of the fishery and B had no title at all. It was held, the lease agreement was void [cooper V Phibbas].

5. **Mistake as to the price of the subject-matter :**

   Where there is genuine mistake in the price of an article for sale, the contract is void.

   **For example:** A seller, within the knowledge of B, the buyer, makes a mistake in the figure

1250. The agreement is void. [Webster V Cecil].

6. **Mistake as to the quantity of the subject-matter :**

There is no contract between the quantity sold and purchased. Thus, where a broker gave two invoices differed as to quantity sold and purchased, there was no enforceable contract.

7. **Mistake as to the quality of the subject matter:**

Mistake as to the quality of the thing does not affect consent unless it is their mistake of both the parties, and it is to the existence of some quality which makes the things without the quality essentially different from the thing as it was believed to be. But if the mistake is fundamental it is void. A contract for the sale of a horse believed to be a race horse would be void if it turns out to be a cart horse.

8. **Mistake as to the possibility of performing the contract.**

**a. Physical impossibility :**

A contract for the hiring of a room for witnessing the coronation procession was held to be void because unknown to the parties the procession had already been cancelled [Grifft V.Brymer].

**b. Legal impossibility :**

An agreement is void if it provides that something should be done which cannot legally be done. Thus, a person cannot take lease of his own land.

**Unilateral Mistake:**

Section 22 provides that if one party alone is under a mistake of fact, the contract is rendered voidable. In other words, while bilateral mistakes render a contract void, unilateral mistake is of no account. When the contract is clear, mistake of one parties cannot affect it. If a man due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must face the consequences.

Where the unilateral mistake is fundamental and affects the character of the contract, the innocent party is freed from liability. In the following even though the mistake is unilateral, the agreement would be void.

**a) Mistake as to nature of the contract :**

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

**b) Mistake as to the identity of the person contracted with :**

Mistake as to the identity of a person may also avoid a contract. Where A intends to contracts only with B, but enters into a contract with C believing him to be B, contract is vitiated.

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

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

**C. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. Misrepresentation is defined under Section ___ of the Indian Contract Act, 1872.
2. Misrepresentation is a _____ statement made without intent to deceive.
3. A contract induced by misrepresentation is _____ at the option of the aggrieved party.
4. If the aggrieved party had the means to discover the truth with _____ diligence, the contract is not voidable.
5. Mistake is defined under Sections ___ to ___ of the Indian Contract Act.
6. A _____ mistake occurs when both parties are under a wrong belief about a material fact.
7. A bilateral mistake makes the agreement _____.
8. A unilateral mistake generally makes the agreement _____.
9. Mistake of _____ refers to an error regarding facts essential to the agreement.
10. Mistake of law of the country does not make a contract _____.
11. Misrepresentation affects the _____ of the contract.
12. A mistake as to the _____ of the subject matter makes the agreement void.
13. A false statement made innocently and believed to be true is called _____.
14. A contract based on a bilateral mistake of fact is _____ in nature.
15. A mistake of foreign law is treated as a mistake of _____.

**ANSWERS:** 1.**18,** 2.**False,** 3.**Voidable,** 4.**Reasonable / ordinary,** 5.**20 to 22,** 6.**Bilateral,** 7.**Void,** 8.**Valid, 9.Fact,** 10.**Void, 11.Free consent,** 12.**Existence / identity / quality,** 13. **Misrepresentation,** 14.**Void,** 15.**Fact**

## 5.8. LET US SUM UP

Under the Indian Contract Act, 1872, a valid contract requires **free consent** of the parties involved. As per **Section 13**, consent means that both parties agree upon the same thing in the same sense (*consensus ad idem*). According to **Section 14**, consent is said to be "free" when it is not caused by **coercion** (Section 15), **undue influence** (Section 16), **fraud** (Section 17), **misrepresentation** (Section 18), or **mistake** (Sections 20–22). If consent is obtained through any of these means, the contract becomes **voidable** at the option of the party whose consent was not freely given. Coercion involves using threats or unlawful acts to force someone into a contract, while undue influence occurs when one party uses their dominant position to obtain an unfair advantage. Fraud refers to intentional deception, and misrepresentation involves an innocent false statement that induces the other party to enter into the contract. Mistakes may be of fact or law, and a mutual mistake of fact makes the contract void. Free consent is essential for the enforceability of a contract, and its absence may render the agreement void or voidable, depending on the circumstances.

## 5.9. KEYWORDS

**1. Consent** – It means when two or more parties agree upon the same thing in the same sense. Defined under Section 13.

**2. Free Consent** – Consent is free when it is not caused by coercion, undue influence, fraud, misrepresentation, or mistake. Defined under Section 14.

**3. Coercion** – The act of compelling a person to enter into a contract through threats or unlawful acts. Defined in Section 15.

**4. Undue Influence** – When one party uses its dominant position to influence the will of another unfairly. Defined under Section 16.

**5. Fraud** – An intentional act of deception to induce another party into a contract. Defined under Section 17.

**6. Misrepresentation** – A false statement made innocently without the intention to deceive, but which induces the other party to contract. Defined in Section 18.

**7. Mistake of Fact** – When both or one party enters into a contract under a wrong understanding of a material fact. Covered under Section 20.

**8. Voidable Contract** – A contract that is valid, but can be canceled by one party if free consent is missing.

**9. Void Contract** – A contract that is not legally enforceable, often due to mutual mistake of fact.

**10. Consensus ad idem** – Latin term meaning "meeting of the minds"; both parties must agree to the same thing in the same sense.

**11. Dominant Position** – A position where one party has the power to influence the will of another, often seen in cases of undue influence.

**12. Bilateral Mistake** – A situation where both parties are mistaken about a fundamental fact. Such contracts are void.

**13. Unilateral Mistake** – A mistake made by only one party. Usually, it does not affect the validity of the contract.

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## 5.10. SELF ASSESSMENT QUESTIONS

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1. Define 'Free Consent' as per the Indian Contract Act.

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2. Differentiate between Fraud and Misrepresentation.

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3. Write a critical note on the impact of absence of free consent on the enforceability of a contract.

## 5.11. LESSON END EXCERCISE

1. What are the different factors that affect free consent under the Indian Contract Act, 1872? Explain each with relevant sections and examples.

2. Discuss the concept of mistake under the Indian Contract Act. Differentiate between bilateral and unilateral mistake. What is the effect of mistake on the validity of a contract?

3. Analyse the legal remedies available to a party whose consent has not been freely given in a contract.

## 5.12. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT II**

**SEMESTER: III** **LESSON: 6**

# LAW OF CONTRACT II

**STRUCTURE**



## 6.0. Learning Objectives and Outcomes

**Learning Objectives**

- To explain the meaning of "consideration" in the context of contract law.
- To understand its role as one of the essential elements for a valid contract.
- To describe the essential elements that make consideration valid.
- To understand which types of consideration are legally valid and under what circumstances.
- To understand the exceptions to the principle of no consideration, no contract
- Explain how consideration relates to the concept of privity of contract.

**Learning Outcomes:**

After Completing this lesson, learners will be able to:

- Clearly articulate what consideration means in legal terms and why it is fundamental in forming a valid contract.
- List and explain the legal requirements that make consideration valid
- Identify whether a given contract includes valid consideration.
- Demonstrate understanding of how consideration supports mutual obligations in a binding contract.
- Identify the situations in which the principle of no consideration, no contract is an exception.
- Explain how consideration affects third-party rights and the limitations placed by privity of contract.

## 6.1. INTRODUCTION

In the field of contract law, consideration plays a pivotal role in determining the validity and enforceability of agreements between parties. It refers to something of value given by both parties to a contract that induces them to enter into the agreement to exchange mutual promises. Consideration may take the form of money, goods, services, an act, or a forbearance from doing something. The presence of consideration indicates that the parties have entered into the contract willingly and with the intent to create legal obligations. It ensures a quid pro quo—meaning "something for something"—which is essential in distinguishing enforceable contracts from mere social or moral arrangements.

For a contract to be valid, consideration must fulfil certain legal requirements. It must move at the desire of the promisor, may move from the promisee or any other person, must be real and not illusory, and must not be unlawful or opposed to public policy. Additionally, while the adequacy of consideration is generally not questioned by courts, it must still have some legal value. This topic examines the legal meaning of consideration, its essential elements, the types recognized under the law, and the exceptions to the rule that "a contract without consideration is void."

## 6.2. MEANING OF CONSIDERATION

Consideration is the foundation of every contract. The law enforces only those promises which are made for consideration. Where one party promises to do something, it must get something in exchange. This something in return is called consideration. Consideration is the life blood of every contract. In

the absence of consideration a promise or undertaking is purely gratuitous. However, sacred and binding in honour, it creates no legal obligation.

**Consideration has been defined in many ways.**

According to **Pollock,** "Consideration is the price for which the promise of other is bought and the promise thus given for value is enforceable."

It is something which is of value in the eyes of law. It may be some benefit to the plaintiff or some detriment to the defendant. It is also used in the sense of quid pro quo i.e. something in return. A most commonly accepted definition of the consideration is given in the famous English case **Currie V.Misa** as, "Some right, interest, profit or benefit accruing to one party or some forbearance, detriment, loss, or responsibility , given , suffered or undertaken by the other".

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

Consideration is something of value which the promisee has given, gives or promises to give in return for the promise. It does not mean payment of money only. Forbearance to sue is good consideration. A promise can be a consideration for another promise.

**For examples:**

a. A agrees to sell his horse to B for Rs.1,000. Here A's promise to sell his horse is for B's consideration to pay Rs. 1,000.Similarly, B's promise to pay Rs.1,000 is for A's consideration to sell his horse to B.

b. A agrees to give Rs. 1,000 to B as a voluntary donation for a temple building. This promise is not binding on A because there is no reciprocal consideration for his promise. However, if B has undertaken any liability on the faith of A's promise, the contract is binding.

c. Promises to maintain B's child and B promises to pay Rs. 20,000 yearly for this purpose. Here the promise of each party is the consideration for the promise of the other party.

## 6.3. ESSENTIALS OF CONSIDERATION

**1. Move at the desire of the promisor:**

The first essential characteristics of consideration are that the act or abstinence must have been

done at the desire of the promisor. It follows that any act performed at the desire of a third party cannot be consideration. The desire of the promisor may be express or implied. A gratuitous service rendered by the promisee without any request of the promisor is not consideration enforceable at law. But it is not necessary that what is done by promisee by way of consideration should benefit the promisor. Any benefit conferred by B on C at the request of A would be good consideration for A's promise.

**For example:**

a) A sees B drowning and saves his life. A cannot demand payment for his services as it is a voluntary act on his part and B never asked him to do so.

b) B had built, at his own expense, a market at the request of the collector of the district. The shopkeepers in the market promised to pay B a commission on the articles sold by them in the market. When B sued the shopkeepers for commission, it was held that the promise to pay commission did not amount to a contract for want of consideration, because B (the promisee) had constructed the market not at the desire of the shopkeeper (the promisors) but at the desire of the collector to please him (Durga Prased Vs.Baldeo).

A promise to subscribe to a public or a charitable object is unenforceable because there is no benefit to the promisor, but where the other party has undertaken a liability on the faith of the promise made by the promisor, it is enforceable.

**2. Must move from the promisee or any other person:**

As long as there is a consideration for a promise, it is immaterial who has given it. It may move from the promisee, or if the promisor has no objection, from any other person. This is wider than the concept in England, where consideration can move only from the promisee. Consideration move from a stranger but it must flow at the desire of the promisor.

The leading case is **Chinnayya Vs. Ramayya,** an old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed writing in favour of the brother agreeing to pay the annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter.

**Example:** X, Y and Z enter into an agreement under which x pays Rs. 4,00,000 to Y and Y agreed to build a house for Z. Here Z is a party to the contract but stranger to

consideration and can enforce the contract.

**3. Consideration may be past, present or future:**

The words "has done or abstained from doing, does or abstains from doing: or promises to do or to abstain from doing" indicate that consideration may be past, present or future.

**Past Consideration:**

When the consideration for a present promise was given before the date of the promise, it is said to be past consideration. A past consideration, if given at the request of the promisor will support a subsequent promise. A past consideration is as good as present or future consideration.

**For Example:**

i. A teaches the son of B at B's request in the month of January and in February B promises to pay A a sum of Rs.200 for his services. The services of A will be past consideration.

ii. A lawyer gave up his practice and served as manager of a landlord at the latter's request in lieu of which the landlord subsequently promised a pension. It was held that there was good past consideration (Shiv Saran Vs. Kesho Prasad).

**Present Consideration:**

When consideration for a promise is given simultaneously with the promise it is called present consideration. A present consideration consists in doing or abstaining from doing something. A promise to give time to a debtor is good consideration.

**For example:** X sells computer to Y for Rs. 50,000 any Y in return gives Rs.50,000 to X. In this case, the performance by both the parties (seller and buyer) is simultaneous.

**Future Consideration:**

A future or executory consideration is a promise to do or give something in return in future for the promise then made. it also called a promise for the promise. Mutual promise to marry, a promise to do work in return for promise of payment is examples of future consideration.

**4. It need not be adequate:**

It is nowhere laid down that consideration should be adequate to the promise. Adequacy is for the parties to decide at the time of making the agreement. Inadequacy is for the parties to decide at the time of making the agreement. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence of fraud. It should be of some value in the

eyes of law. Even a smallest consideration is sufficient provided it has some value.

**For example:** A agrees to sell his house worth Rs.10 lakhs to B for Rs.10,000. As consent to the agreement was freely given, the agreement is a contract notwithstanding the inadequacy of consideration.

Where consideration is shockingly inadequate and one party alleges that his consent was not free the court will take inadequacy of consideration as evidence in support of such allegation.

**5. Consideration must be real:**

Though consideration need not be adequate, yet it must be real and illusory. Thus, a promise to do that which a person is by law bound to do, does not amount to consideration. Consideration has also to be competent. If it is physically impossible, vague or legally impossible, the contract cannot be forced. Thus, a promise by a man to make two parallel lines meet is no good consideration.

A promise to sue for a reasonable time is a good consideration. Similarly, if a person compromises and agrees to accept a smaller sum in settlement of his claim, this would be sufficient consideration for the opposite party's promise to pay sum.

**For example:** A's husband did not give maintenance allowance to her which he had promised to pay. When she was about to sue her husband for this, husband requested her not to sue and promised her to pay monthly maintenance allowance. It was held that A's forbearance to sue is a consideration for husband's agreement for payment of maintenance allowance [Indira Bai Vs.Markand].

**6. Consideration must be lawful:**

The consideration for an agreement must be lawful. An agreement is void, if it is based on unlawful consideration. The consideration of an agreement is lawful unless:-

a) It is forbidden by law; or
b) Is of such a nature that if permitted it would defeat the provisions of any law; or
c) Is fraudulent; or
d) Involves or implies injury to the person or property of another; or
e) The court regards it as immoral or opposed to public policy.

**For example:** A promise to obtain for B an employment in the public service and B promises to pay Rs.1,000 to A. The agreement is void as the consideration for it is unlawful.

**7. It must be something which the promisor is not already bound to do:**

A promise to do what one is already bound to do, either by general law or under an existing contract, is not a good consideration for a new promise. There will be no detriment to the promisee or benefit to the promisor over and above their existing rights or obligation.

**For example:**

a) A promised to pay money to a police officer to investigate into a crime. The agreement was held to be invalid because, "the officer is already under the duty to do so by law" [Collins Vs. Godfrey].

However, where a person agrees to do more than his official duty, this will be a good consideration for the promise.

b) A police constable provided information leading to the conviction of a criminal. He sued for the reward offered for giving such information. It was held that he had rendered services outside the scope of his official duty and he was entitled to recover the reward" [England Vs. Davison]

**A. CHECK YOUR PROGRESS**

- **True or False**

1. Consideration must always be monetary in nature.
2. Consideration must move at the desire of the promisor.
3. A gift given voluntarily qualifies as consideration.
4. A promise to pay a time-barred debt is enforceable even without consideration.
5. Consideration must always come from the promisee only under Indian law.
6. A Building given as a consideration is not valid as per the Indian contract act.

**ANSWERS: 1. FALSE 2.TRUE 3. FALSE 4. TRUE 5. FALSE 6. FALSE**

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**B. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS:**

1. **Which of the following is *not* an essential element of valid consideration?**
   A. It must be real and not illusory
   B. It must move at the desire of the promisor
   C. It must be illegal
   D. It must have some value in the eyes of the law
   **Answer:** C. It must be illegal
2. **Consideration must move at the desire of the _____.**
   A. Promisee
   B. Promisor
   C. Third party
   D. None of the above
   **Answer:** B. Promisor
3. **Which section of the Indian Contract Act defines consideration?**
   A. Section 2(b)
   B. Section 2(e)
   C. Section 2(d)
   D. Section 10
   **Answer:** C. Section 2(d)
4. **Which of the following is a correct statement?**
   A. Consideration must always be in cash only
   B. Consideration must be past only
   C. Consideration can be past, present or future
   D. Consideration must always be from a third party
   **Answer:** C. Consideration can be past, present or future
5. **"No consideration, no contract" – Which of the following is an exception to this rule?**
   A. Contracts made under coercion
   B. Contracts made without mutual consent
   C. Promise to compensate for past voluntary services
   D. Promise made without intention to create legal relationship
   **Answer:** C. Promise to compensate for past voluntary services

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## 6.4. No Consideration No Contract – Exceptions

Every agreement to be enforceable at law must be supported by valid consideration .An agreement made without consideration is void and is unenforceable except in certain cases. Section 25 specifies the case where an agreement though made without consideration will be valid. These are as follows:

**1. Natural love and affection [section 25(1)] :**

An agreement though made without consideration will be valid if it is in writing and registered and

is made on account of natural love and affection between parties standing in a near relation to each other. An agreement without consideration will be valid provided:-

a) it is expressed in writing;
b) it is registered under the law for the time being in force;
c) it is made on account of natural love and affection;
d) it is between parties standing in a near relation to each other.

All these essentials must be present to enforce an agreement made without consideration. The presence of only one or some of them will not suffice.

**For example:** A for natural love and affection, promises to give his son B, for Rs.1,000.A puts his promise to B into writing and registers it .This is a contract.

It should, however, be noted that mere existence of near relation between the parties does not necessarily import natural love and affection. Thus, where a Hindu husband, after referring to quarrels and disagreement between him and his wife, executed a registered document in favour of his wife, agreeing to pay for separate residence and maintenance, it was held that the agreement was void for want of consideration because it was not made out of natural love and affection [Rajlakhi Devi Vs.Bhootnath].

**2. Compensation for services rendered [section 25(2)] :**

An agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promise or something which the promisor was legally compellable to do. To apply this rule, the following essentials must exist:

i) the act must have been made voluntarily;
ii) for the promisor or it must be something which was the legal obligation of the promisor;
iii) the promisor must be in existence at the time when the act was done;
iv) the promisor must agree now to compensate the promise.

A promise to pay for past services voluntarily rendered would be enforceable under this rule. If, however, something has not done voluntarily, this clause will not apply.

**3. Time barred debt [section 25 (3)]:**

A promise to pay a time-barred debt is also enforceable .But the promise must be in writing and be

signed by the promisor or his agent authorized in that behalf .The promise may be to pay the whole or part of the debt. An oral promise to pay a time barred debt is unenforceable.

4. **Completed gifts [Except 1-section 25]:**

   Explanation 1 to section25 provides that the rule 'No consideration, No contract' shall not affect validity of any gifts actually made between the donor and the donee. Thus, if a person gives certain properties to another according to the provisions of the Transfer of property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

5. **Agency [Section 85]:**

   There is one more exception to the general rule. It is given in section 185 which says that no consideration is needed to create an agency.

6. **Guarantee [Section 127]:**

   A contract of guarantee is made without consideration.

7. **Remission [Section 63]:**

   No consideration is required for an agreement to receive less than what is due. This is called remission in the law.

**C. CHECK YOUR PROGRESS.**

- **ONE LINER QUESTIONS**

1. **Which section of the Indian Contract Act defines consideration?**
   → *Section 2(d)*
2. **Consideration must move at whose desire?**
   → *At the desire of the promisor*
3. **Can consideration be past, present, or future?**
   → *Yes*
4. **Is consideration necessary for a valid contract?**
   → *Yes, unless it's an exception under Section 25*
5. **Can a stranger to consideration sue on a contract in Indian law?**
   → *Yes*
6. **Is performance of an existing duty a valid consideration?**
   → *No, unless there is something extra promised*
7. **Can natural love and affection be a valid consideration without registration?**
   → *No*
8. **Is adequacy of consideration required in Indian contract law?**
   → *No*
9. **Does consideration need to be lawful?**
   → *Yes*
10. **Is forbearance (not doing something) a valid form of consideration?**
    → *Yes*

## 6.5. LET US SUM UP

Consideration is a key element in contract law that refers to something of value exchanged between parties to make a contract legally enforceable. It is the benefit or detriment each party receives or agrees to, forming the basis of a mutual agreement. For consideration to be valid, several essential conditions must be met. Firstly, it must move at the desire of the promisor, meaning it should be given in response to the promisor's request. Secondly, it can move from the promisee or any third party, which is especially recognized under Indian law. Thirdly, consideration may be past, present, or future, allowing flexibility in when the value is provided. Additionally, it must be something of legal value, though not necessarily of market value. It must also be lawful and not go against public policy or involve illegal acts. Lastly, consideration must be real and not illusory or impossible to perform. Without valid consideration, a contract generally lacks enforceability, making this concept essential to the formation of binding agreements.

## 6.6. KEYWORDS

- **Consideration** – Something of value exchanged between parties in a contract; a key element that makes an agreement enforceable by law.
- **Promisor** – The person who makes the promise in a contract.
- **Promisee** – The person to whom the promise is made.
- **Past Consideration** – A benefit or act that has already been given or done before the promise was made.
- **Present Consideration** – Something exchanged at the same time the contract is formed.
- **Future Consideration** – A promise to do something or give something in the future.
- **Lawful Consideration** – Consideration must not involve illegal or immoral acts and must comply with the law.
- **Desire of the Promisor** – Consideration must be given at the request of the promisor, not voluntarily or randomly.
- **Third-party Consideration** – Consideration can come from someone other than the promisee (recognized in Indian law).

- **Mutual Exchange** – Both parties must give and receive something of value.
- **Benefit and Detriment** – One party gains something (benefit), and the other loses something or assumes an obligation (detriment).
- **Real and Not Illusory** – Consideration must be actual and possible to perform; it cannot be vague or imaginary.
- **Doctrine of Privity of Consideration** – In Indian law, even a third party can provide consideration, unlike in English law.

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## 6.7. SELF-ASSESSMENT QUESTIONS

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1. "Consideration must move at the desire of the promisor." Explain this statement with relevant case law.

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2. Discuss the different types of consideration (past, present, and future). How are they recognized in Indian and English law?

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3. "There is a fine line between adequate and sufficient consideration." Discuss this distinction with relevant illustrations and case references.

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## 6.8. LESSON END EXERCISE

1. Define consideration. Discuss its importance in the formation of a valid contract.

2. What are the essential elements of valid consideration? Explain each with suitable examples.

3. Explain the doctrine of privity of consideration. How is it treated under Indian contract law as compared to English law?

4. A contract without consideration is void." Discuss this statement and state the exceptions to this rule under Indian law.

## 6.9. SUGGESTED READING


- Garg, Sareen, Sharma & Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No :- BCG-303** **UNIT II**

**SEMESTER: III** **LESSON: 7**

# LAW OF CONTRACT II

**STRUCTURE**



## 7.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and purpose of consideration in contract law.
- To identify and explain the essential legal rules governing valid consideration.
- To Develop critical thinking about whether the doctrine of consideration remains necessary in modern contract law.

**Learning Outcomes:**

After Completing this lesson, learners will be able to:

- Define the concept of consideration and explain its role in contract formation.
- Identify the essential legal rules governing valid consideration.
- Distinguish between different types of consideration (executed, executory, and past).
- Explain why consideration must be sufficient but need not be adequate.

- Recognize situations where consideration is invalid, such as when it is past or unlawful.
- Apply the legal rules of consideration to real or hypothetical contract scenarios.

## 7.1. INTRODUCTION

In contract law, consideration is a fundamental element required for the formation of a legally binding agreement. It refers to the value exchanged between parties, which can be in the form of a benefit to one party or a detriment to the other. The doctrine of consideration ensures that promises are not made gratuitously and that each party to a contract has provided something of value in return for the promise they receive. For a contract to be enforceable, the consideration must meet specific legal requirements. These include rules such as: consideration must move from the promisee, must be sufficient but need not be adequate, and must not be past. The legal rules surrounding consideration help distinguish enforceable contracts from mere social or moral obligations. This topic explores these core principles, supported by case law, and examines exceptions such as promissory estoppel and contracts made by deed, which can alter the usual requirements.

## 7.2. LEGAL RULES AS TO CONSIDERATION

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

Section 23 of the contract act speaks of three things.

i) Consideration for the agreement ;

ii) Object for the agreement ;and

iii) Agreement

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

**1. If it is forbidden by law:**

If the agreement or object for a promise is such as is forbidden by law, the agreement is void. It is forbidden by law, if the legislature penalizes it or prohibits it. It is illegal and cannot become valid even if the parties act according to such agreement. Section 26, 27, 28 and 30 of the contract act deal with cases where the consideration or object of an agreement is considered unlawful.

An act or an undertaking is forbidden by law:

**a)** When it is punishable by criminal law of the country, or

**b)** When it is prohibited by special legislation or regulations made by a competent authority under powers derived from the legislature.

**For example:** An agreement to pay consideration to a tenant to induce him to vacate premises governed by the Rent Restriction Act is illegal and cannot be enforced because such an act is forbidden by the said act [Mohan Chand VS. Manindra]

**2. If it is of such a nature that, if permitted, it would defeat the provision of any law:**

If the object or consideration of an agreement is of such a nature that if permitted it would defeat the provisions of any law, the agreement is void. An agreement to give an annual allowance to the parents of an adopted Hindu boy in order to induce them to consent to the adoption is void.

**For example:**

a) A's estate is sold for arrears of revenue under the provision of an act of the legislature by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect a purchase by the defaulter and would so defeat the object of the law. [Mohan Lal V. Udai Narain].

b) An agreement between husband and wife to live separately is invalid as being opposed to Hindu Law.

**3. If it is fraudulent:**

An agreement, whose object or consideration is to defraud others, is unlawful and hence void.

**For examples:**

**a)** A, promises to pay Rs.200 to B, if B would commit fraud on C. B agreeing to defraud is unlawful consideration for A's promise to pay. Hence the agreement is illegal and void.

**b)** A, B and C enter in to an agreement for the division among them of gains acquired, or to be acquired by them by fraud. The agreement is void, as its object is unlawful.

**c)** A, being agent for a landed proprietor, agrees for money without the knowledge of his principal, to obtain for B a lease of land belonging to his principal. The agreement between A and B is void as it implies a fraud by concealment by A on his principal.

**4. If it involves or implies injury to the person or property of another:**

The object or consideration of an agreement will be unlawful if it tends to injure the person or property of another. Thus, an agreement to pull down another's house is unlawful. The word injury means criminal or wrongful harm.

**For example:**

**a)** An agreement to commit an assault or to beat a man has been unlawful and void

**b)** An agreement to put certain property to fire is unlawful and void under this clause.

**c)** An agreement involving the publication of a libel (defamatory article against someone) has been held unlawful and void.

**5. If the court regards it as immoral:**

An agreement whose object or consideration is immoral, illegal and therefore void. The scope of the word immoral here extends to the following:

i) **Sexual immorality** e.g., illicit cohabitation or concubinage or prostitution.

**For example:**

a. A, agrees to let her daughter to hire to B for concubinage. The agreement is void because it is immoral, though the letting may not be punishable under the Indian Penal Code.
b. A gift deed executed in consideration of illicit intercourse has been held void as its object was immoral. It may be noted that an agreement to pay for past or future illicit cohabitation is also void, as being immoral.

ii) **Furtherance of sexual immorality**:

**For example:** A prostitute was sued for the hire money of a carriage in which she used to go every evening in order to make a display of her beauty and thus to attract customers. The suit

was dismissed on the ground that the plaintiff contributed towards the performance of an immoral and illegal act and hence he was liable to suffer [Pearce V.Brooks].

iii) **Interference with marital relations:**

**For example:** Money advance to a married woman to enable her to procure a divorce and to marry the plaintiff could not be recovered back as the object of the agreement was held immoral (Bai Vijli V. Nansa Nagar).

iv) **Such acts which are against good public morals:**

**For example:** An agreement for future marriage, after the death of first wife is against good morals and hence would be void. [Wilson V. Carnley].

An agreement is unlawful if the court regards it as opposed to public policy. It is not possible to give a precise or exact definition of the term public policy. It is rather an elastic term and its connotation may vary with the social structure of a state. It is interesting to note that opposed to public policy and immoral, both are very much similar in nature because what is immoral must be opposed to public policy and reverse is also true in most cases.

**6. If the court regards it as opposed to public policy:**

On the basis of decided cases on the subject the following agreements have been held to be against public policy:

**a) Trading with an alien enemy:**

It is now fully established that trading with an alien enemy (i.e., a citizen of the other country at war with the state) is against public policy in so far as it tends to aid the economy of the enemy country. Such agreements are therefore illegal, unless made with the special permission of the government. It is to be noted that an agreement to promote hostile action in a friendly state is also illegal and void as being opposed to public policy.

**b) Agreements interfering with the course of justice :**

In an agreement the object of which is to interfere with the course of justice, e.g., an agreement not to disclose misconduct to the other party or an agreement to influence a judge to induce him to decide the case in a party's favour, is obviously opposed to public policy and is void. But an agreement to refer present or future disputes to arbitration is a valid agreement.

**c) Agreements for stifling criminal prosecution :**

It is well settled law that if a person has committed a crime, he must be punished. Hence any agreement which seeks to prevent the prosecution of a guilty party is opposed to public polity and is void. For "No one can be allowed to make a trade of a felony". Where, therefore, A promises B to drop a prosecution which he has instituted against B for robbery and B promise to restore the value of the thing taken, the agreement is void, as its object is unlawful.

**d) Maintenance and champerty :**

Maintenance may be defined as an agreement whereby a stranger promises to help another person by money or otherwise in litigation in which that person has himself no legal interest. Champerty is an agreement whereby a person agrees to assist another in litigation in exchange of a promise to hand over a portion of the proceeds of the action.

The principles of English law on maintenance and champerty are not applicable in India. In England both kinds of agreements are illegal and unenforceable. In India, agreements to share the subject matter of litigation if recovered are not in themselves opposed to public policy unless they are extortionate and unconscious able. Thus, an agreement by a chartered accountant with his client to charge fees on the basis of percentage of the benefit received by the cline in income tax proceedings is void.

The agreement for supplying funds by way of maintenance or champerty is valid, unless:

i) it is unreasonable so as to be unjust to the other party ;or

ii) it is made by a malicious motive like that of gambling in litigation or oppressing other party by encouraging unrighteous suits, and not with the bonafide object of assisting a claim believed to be just.

**e) Traffic in public offices :**

Agreement for sale or transfer of public offices or for appointments to public offices in consideration of money is illegal, being opposed to public policy. Such agreements, if enforced, would lead to inefficiency and corruption in public life.

**For example:** A, promises to obtain for B an employment in the public service, and B promises to pay Rs.1,000 to A. The agreement is void as the consideration for it is unlawful.

**f) Agreements creating an interest opposed to duty :**

An agreement which tends to create a conflict between interest and duty is illegal and void on

ground that it is opposed to public policy.

**For example:**A, agrees to pay B, the lieutenant colonel in the army, Rs.50,000 if he will assist her brother to desert the army. The object of the agreement is opposed to public policy and hence the agreement is void and illegal.

**g) Agreements restraining personal liberty :**

Agreements which unduly restrict personal freedom have been held to be void and illegal as being against public policy.

**h) Agreements interfering with parental duties :**

A father, and in his absence, the mother, is the legal guardian of his/her minor child. The authority of a guardian is to be exercised in the best interest of the child, in accordance with good public morals. If, therefore, the right of guardianship is bartered away by an agreement which is inconsistent with the duties arising out of such custody, such an agreement shall be void on the group of public policy.

**For example:** For monetary consideration, A agreed to place his daughter at the disposal of B to be married as B likes. The agreement is illegal and void as it would interfere with A's parental duty to select a husband in the best interest of the girl [Atma Ram V.Banku Mal].

**i) Marriage brokerage agreement :**

These are agreements for the payment of money in consideration of procuring for another in marriage a husband or a wife. Such agreements are illegal and void as being contrary to public policy. Thus, when a prohit was promised Rs.200 in consideration of procuring a wife for the defendant, the agreement was held invalid and the money could not be recovered. [Pitamber V.Jagjiwan].

Similarly, an agreement of dowry, i.e., to pay money to the parents of the bride or the bridegroom in consideration of their agreeing to the contract of marriage is also illegal and cannot be enforced. But such an agreement is illegal in respect of payment only; the validity of marriage is not affected.

**j) Miscellaneous Cases:**

The following agreements have also been held to be against public policy.

a) Agreements tending to create monopolies are illegal and void.

b) Agreements to defraud revenue authorities are void and illegal

c) Agreements whereby money is given to induce persons to give evidence in a civil court are void because everyone is expected to perform his legal duty.

**A. CHECK YOUR PROGRESS**

- **Fill in the Blanks**

1. Under Section 23, an agreement with unlawful _____ or _____ is void.
   ➤ **Answer: consideration, object**
2. An agreement to commit fraud is _____ and hence void.
   ➤ **Answer: unlawful**
3. An agreement involving publication of a defamatory article is considered _____.
   ➤ **Answer: unlawful**
4. Trading with an _____ enemy is opposed to public policy.
   ➤ **Answer: alien**
5. A _____ agreement involves providing financial assistance in litigation in return for a share in proceeds.
   ➤ **Answer: champerty**

**B. CHECK YOUR PROGRESS**

- **True or False**

1. An agreement with a lawful consideration but unlawful object is still valid.
   ➤ **False**
2. Sexual immorality can make an agreement void under Section 23.
   ➤ **True**
3. Agreements to defeat the provisions of any law are enforceable if both parties agree.
   ➤ **False**
4. A marriage brokerage agreement is not enforceable under Indian law.
   ➤ **True**
5. An agreement to promote fair arbitration is void under public policy.
   ➤ **False**

## C. CHECK YOUR PROGRESS

- **Multiple Choice Questions (MCQs)**

**1. According to Section 23, an agreement is void if:**
A. The object alone is unlawful
B. The consideration alone is unlawful
C. Either object or consideration is unlawful
D. None of the above
**Answer: C. Either object or consideration is unlawful**

**2. An agreement to defeat the provisions of any law is:**
A. Valid
B. Enforceable
C. Void
D. Executed
**Answer: C. Void**

**3. Which of the following is *not* considered immoral under Indian Contract Law?**
A. Agreement for illicit cohabitation
B. Agreement to publish a book
C. Agreement to aid concubinage
D. Agreement to promote sexual immorality
**Answer: B. Agreement to publish a book**

**4. Maintenance and Champerty agreements in India are:**
A. Always void
B. Always valid
C. Valid unless extortionate or made with malice
D. Valid only in criminal cases
**Answer: C. Valid unless extortionate or made with malice**

**5. Which of the following agreements is not opposed to public policy?**
A. Agreement to bribe a public official
B. Agreement to promote a fair arbitration
C. Agreement to influence a judge
D. Agreement for marriage brokerage
**Answer: B. Agreement to promote a fair arbitration**

**6. "No consideration, no contract" is a general rule. Which section of the Indian Contract Act contains exceptions to this rule?**
A. Section 11
B. Section 25
C. Section 10
D. Section 19

**Answer: B. Section 25**

## 7.3. LET US SUM UP

The legal rule as to consideration is a fundamental principle in contract law, requiring that each party to a contract must provide something of value, known as consideration, for the agreement to be legally enforceable. Consideration can be in the form of a promise, an act, or forbearance (refraining from doing something one is legally entitled to do). The rule ensures that there is a mutual exchange between the parties. Traditionally, consideration must move from the promisee, be sufficient (have some value in the eyes of the law), but need not be adequate (equal in value to what is received). Past consideration—something given or done before a promise is made—is generally not valid. Moreover, performing an existing contractual or public duty is not sufficient consideration unless something extra is provided. This rule helps distinguish enforceable agreements from mere social or moral obligations.

## 7.4. KEYWORDS

 **Consideration** – Something of value exchanged between parties to make a contract legally binding.

 **Promisee** – The person who receives the promise in a contract.

 **Promisor** – The person who makes the promise in a contract.

 **Sufficient Consideration** – Consideration that has legal value, even if it is not of equal value.

 **Adequate Consideration** – Consideration that is equal or fair in value (not required for validity).

 **Past Consideration** – An act done before a promise is made; generally not valid as consideration.

 **Executory Consideration** – A promise to do something in the future; the act has not yet been performed.

 **Executed Consideration** – A completed act given in exchange for a promise.

 **Illusory Consideration** – A promise that is too vague or uncertain to be legally binding.

 **Legal Duty** – A duty already imposed by law; doing this is not valid consideration.

 **Contractual Duty** – An obligation already agreed upon in a previous contract; repeating it is not valid consideration unless something extra is added.

 **Promissory Estoppel** – A legal principle that can enforce a promise without consideration if one party relied on it to their detriment.

 **Mutuality** – Both parties must exchange something of value for the contract to be enforceable.

 **Bargain Theory** – The idea that a contract must involve a mutual exchange or bargain.

 **Doctrine of Consideration** – The legal rule that a promise is not enforceable unless it is supported by consideration.

## 7.5. SELF-ASSESSMENT QUESTIONS

1. Discuss any five instances where an agreement is opposed to public policy under Indian law. Illustrate with case law.

2. Distinguish between consideration and object. Explain how each must be lawful under Section 23.

## 7.6. LESSON END EXERCISE

1. Discuss the legality of immoral and public policy-based agreements. How do courts determine what is immoral or opposed to public policy?

2. Explain the concept of unlawful consideration and object under Section 23 of the Indian Contract Act. Give examples.

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## 7.7. SUGGESTED READING


- Garg, Sareen, Sharma & Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT II**

**SEMESTER: III** **LESSON: 8**

# LAW OF CONTRACT II

**STRUCTURE**



## 8.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and legal importance of capacity to contract.
- To identify the criteria required for a person to have capacity to contract.
- To explain the legal status and consequences of contracts entered into by minors.
- To analyze the validity of contracts with persons of unsound mind and how the law protects them.
- To recognize the categories of persons disqualified by law from entering into contracts.
- To understand the effects and enforceability of contracts involving disqualified persons.

- To learn the exceptions and special provisions related to contracts with minors and unsound persons.

**Learning Outcomes:**

After Completing this lesson, learners will be able to:

- Define and explain the concept of capacity to contract in legal terms.
- Identify who has the legal capacity to enter into a contract.
- Distinguish between valid, void, and voidable contracts involving minors.
- Analyze the impact of unsound mind on the validity of contracts.
- Recognize persons who are disqualified by law from contracting and explain why.
- Evaluate the enforceability of contracts involving persons lacking capacity.
- Apply legal principles to determine the validity of contracts involving minors, unsound persons, or disqualified persons.
- Explain the legal consequences of contracting without proper capacity.

## 8.1. INTRODUCTION

The capacity to contract is a foundational concept in contract law, referring to the legal ability of an individual or entity to enter into a binding agreement. For a contract to be valid and enforceable, all parties involved must possess the capacity to understand the nature and consequences of the contract. However, certain groups of individuals are considered to have limited or no capacity to contract due to their age, mental condition, or legal status. These include **minors, persons of unsound mind**, and others who are **disqualified by law** from entering into contracts. Minors, typically individuals below the age of majority, are generally restricted from contracting because they may lack the maturity and judgment necessary to make informed decisions. Similarly, persons of unsound mind—those who are mentally incapacitated or unable to comprehend the contract's implications—are protected by law to prevent exploitation. Additionally, certain persons disqualified by law, such as convicts or bankrupt individuals, are restricted from contracting to uphold legal and social policies. This topic delves into the principles governing contractual capacity, the special rules applicable to contracts involving these groups, and the legal consequences that arise when contracts are made without proper capacity.

Understanding these distinctions is essential to ensuring fairness and legality in contractual relationships.

## 8.2. CAPACITY OF PARTIES

For a valid contract, the parties to a contract must have capacity i.e. competence to enter into a contract. Every person is presumed to have capacity to contract but there are certain persons whose age, condition or status renders them incapable of binding themselves by a contract. Incapacity must be proved by the party claiming the benefit of it and until proved the ordinary presumption remains.

**Section 11** of the Contract Act deals with the competency of parties and provides that "every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject."

It follows that the following persons are incompetent to contract.

*(a)* minor

(6) person of unsound mind, and

(c) Persons disqualified by any law to which they are subject.

Contracts entered into by persons mentioned above are void.

## 8.3. CONTRACT WITH MINOR

An infant or a minor is a person who is not a major. According to the Indian Majority Act, 1875, a minor is one who has not completed his or her $18^{th}$ year of age. A person attains majority on completing his $18^{th}$ year in India. In the following two cases, a person continues to be a minor until he completes the age of 21 years.

a) where a guardian of a minor person or property has been appointed under the Guardians and Wards Act.1890; or

b) where the superintendence of a minor's property is assumed by a Court of Wards.

**Rules regarding minor's agreement**

A minor's agreement being void is wholly devoid of all effects. When there is no contract there should be no contractual obligation on either side. The various rules regarding minor's agreement are

discussed as follows:

1. **Agreement void ab initio :**

Section 10 of the contract act requires that the parties to a contract must be competent and section 11 says that a minor is not competent. But neither section makes it clear whether the contract entered in to by a minor is void or voidable. Till 1903, courts in India were not unanimous on this point. The Privy Council made it perfectly clear that a minor is not competent to contract and that a contract by minor is void ab initio.

**For example:** In order to pay off the promissory note and the mortgage debt of his father, the minor son and his mother sold a piece of land to the holders of the promissory note in satisfaction of the note and mortgage debt. Later the minor brought an action to recover back the land. The action was reflected on the ground that the sale of the land in question was valid as it was done by the mother for her minor son and on his behalf. [Sriakulam Subra Manyam V.Kurra Subha Rao. ILR 1949 Mad.141PC].

2. **No ratification**

An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent to authorize an act cannot give it validity by ratifying it. But if on becoming major, minor makes a new promise for fresh consideration, then this new promise will be binding.

**For example:** A minor borrowed a sum of money executing a simple bond for it, and after attaining majority executed a second bond in respect of the original loan and interest. It was held that suit upon the second bond was not maintainable. [Arumugan V.Durgaisinga, 1914]

3. **Minor can be a promise or beneficiary**

If a contract is beneficial to a minor, it ca be enforced by him. There is no restriction on a minor from being a beneficiary, for example, being a payee or a promise in a contract. Thus, a minor is capable of purchasing immovable property and he may sue to recover the possession of the property upon tender of the purchasing money. Similarly, a minor in whose favour a promissory note has been executed can enforce it.

4. **No estoppel against a minor**

Where a minor by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor. It means he is not estoppel from pleading his infancy in order to avoid a contract. The court may direct minor to restore property. No doubt, minor has got protection but he has no liberty to cheat man.

**5. No specific performance except in certain cases**

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

But a contract entered into by the guardian or manager on minor's behalf can be specifically enforced if

(I) The contract is within the authority of the guardian or manager.

(II) It is for the benefit of the minor.

A bond was executed by widow acting as guardian of her minor son for the payment of her deceased husband's debts, the minor's estate can be held liable for the payment as per the bond [Lalchand V.Narhar 89IC 896].

**6. Liability for torts.**

A tort is a civil wrong. A minor is liable in tort unless the tort in reality a breach of contract. Thus, where a minor borrowed a horse for riding only he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend.

**7. No insolvency**

A minor cannot be declared insolvent as he is incapable of contracting debts and dues are payable from the personal properties of minor and he is not personally liable.

**8. Joint contract by minor and adult**

In such a case, the adult will be liable on the contract and not the minor. In Saln Das V. Ram Chand, where there was a joint purchase by two purchasers, one of them was a minor; it was

held that the vendor could enforce the contract against the major purchaser and not the minor.

**9. Partnership**

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

**10. Minor can be an agent.**

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

**11. Minor cannot bind parent or guardian**

In the absence of authority, express or implied, an infant is not capable of binding his parent or guardian, even for necessaries. The parents will be held liable only when the child is acting as an agent for parents.

**12. Surety for a minor**

In a contract of guarantee when an adult stands surety for a minor then adult is liable to third party as there is direct contract between the surety and the third party.

**A. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. According to Section ___ of the Indian Contract Act, 1872, every person is competent to contract who is of the age of majority, is of sound mind, and is not disqualified from contracting by any law.
2. A contract with a minor is considered ___ in the eyes of law.
3. A minor's contract is void ab initio, which means it is void from the ___.
4. A minor can act as a ___ in a contract but not as a ___.
5. A minor is not personally liable for a contract, but he may be liable for ___ supplied to him.
6. A minor cannot ___ a contract upon attaining the age of majority.
7. Under certain circumstances, a contract entered into by a guardian on behalf of a minor is ___, provided it is for the benefit of the minor.

**ANSWERS: 1. 11 2. Void 3. Beginning 4. Beneficiary, promisor 5. Necessaries 6. Ratify 7. Valid**

## 8.4. Contract with person of unsound mind

As explained earlier, as per section 11 of Contract Act, for a valid contract each party to the contract must have a sound mind. Contracts made by persons of unsound mind are void. The reason is that a contract requires assent of two minds but a person of unsound mind has nothing which the law recognises as a mind.

**Section 12** deals with the question as to what is a sound mind for the purpose of entering into a contract. It lays down that, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it he is capable of understanding it and of forming a rational judgement as to its effect upon his interests."

This section further states that:

(a) A person who is usually of unsound mind but occasionally of sound mind may make a contract when he is of sound mind. Thus a patient in a lunatic asylum, who is at intervals of sound mind may make a contract during those intervals.

(b) A person who is usually of sound mind but occasionally of unsound mind is not considered competent to make a contract when he is of unsound mind. Thus a sane man who is so drunk that he cannot understand the terms of a contract or form a rational judgement as to its effect on his interests is incompetent to make a contract, whilst such drunkenness lasts.

The question whether a party to contract is of sound mind or not has to be decided by the courts. If the unsoundness of mind is cited as ground for incompetency to enter into a contract, he must prove that he was of unsound mind at the time of entering into contract.

Unsoundness of mind does not mean weakness of mind or loss of memory. It means not only lack of capacity to understand the terms of the contract but also lack of understanding to realise the effect of the terms of the contract. There is always a presumption in favour of sanity. Persons who are idiots, drunk or lunatic cannot enter into contracts. All these persons stand on the same footing as minors and their contracts are void.

**Unsoundness of mind may arise from:**

***(i)*** **Idiocy.**

An Idiot is a person with no intervals of saneness. He is incapable. His mental powers of understanding even ordinary matters are" absent because of lack of development of brain. The agreement with an idiot is void.

**Example**: A property worth about Rs. 25,000 was agreed to be sold by a person for Rs. 7,000 only. His mother proved that he was a congenital idiot, incapable of understanding the transaction. The sale was held to be void. **(INDER SINGH V. PARMESHWARDHARI SINGH [1957]).**

***(ii)*** **Lunacy or Insanity.**

It is a disease of the brain. A lunatic loses the use of his reason due to some mental strain or disease. He may have lucid Intervals of sanity. He can enter into contract during that period when he is of sound mind.

***(iii)*** **Drunkenness.**

It produces temporary incapacity till the man is under the effect of intoxication creating impotence of mind. He stands on the same footing as a lunatic.

**Example:** Mr. X meets Mr. Y at a party. Mr. X is heavily intoxicated and unable to understand or reason due to his drunken state. Mr. Y takes advantage of the situation and gets Mr. X to sign a contract agreeing to sell his expensive watch for just ₹1,000. The next morning, when Mr. X is sober, he realizes the unfair transaction and refuses to deliver the watch.

***(iv)*** **Hypnotism.**

It also produces temporary incapacity till the person is under the impact of artificially induced sleep.

**Example:** *A person, Mr. A, is placed under hypnosis by Mr. B for entertainment purposes. While under hypnosis, Mr. B convinces Mr. A to sell his car for ₹5,000, far below its market value. Mr. A, in that hypnotized state, agrees and signs the contract. Later, when Mr. A regains normal consciousness, he realizes what happened and challenges the contract.*

***(v)*** **Mental decay/**

It is on account of old age etc.

So, an agreement with person of unsound mind is void. But under section 68, the property of such person is always liable for necessaries supplied to him or to anyone whom lie is legally bound to support.

**B. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

1. Which section of the Indian Contract Act defines the capacity to contract?
a) Section 2(d)
b) Section 10
c) Section 11
d) Section 20
**Answer: c) Section 11**

2. Who among the following is **not** competent to contract?
a) A person of sound mind
b) A person who is 25 years old
c) A minor
d) A business owner
**Answer: c)**

3. A contract by a person of unsound mind is:
a) Valid
b) Voidable
c) Void ab initio
d) Illegal
**Answer: c)**

**4.** Which of the following is **not** an example of unsound mind?
a) Idiot
b) Lunatic
c) Drunkard
d) A healthy adult
**Answer: d)**

5. When does a contract with a mentally unsound person become enforceable?
a) When registered
b) If done with a witness
c) During lucid intervals
d) If approved by court
**Answer: c)**

## 8.5. Persons disqualified from contracting by any other law

It refers to statutory disqualifications imposed on certain persons in respect of their rapacity to contract.

1. **Alien enemies.** An alien is competent to contract with citizens of India living in India. He can maintain an action on a contract entered into by him during peace time. But, if a war is declared, an alien enemy cannot enter into any contract with an Indian citizen. Contracts entered into before the declaration of war are either stayed or terminated but contracts entered into during the war are unenforceable.

2. **Foreign sovereigns and amy minors.** These persons are immune from the jurisdiction of local courts, unless they voluntarily submit to its jurisdiction. These persons have a right to contract but can claim the privilege of not being sued. The rules hoarding suits by or against foreign sovereigns are laid down in sections 84 to 87 of Civil Procedure Code.

3. **Insolvents.** An insolvent cannot enter into a contract as his property vests in the official receiver or official assignee. This disqualification of an insolvent is removed after he is discharged.

4. **Convict.** A convict while undergoing imprisonment is incapable of entering into a contract. But this disability comes to an end on the expiry of the sentence.

5. **Corporations.** A corporation is an artificial person recognised by law. It exists only in the eyes of law. It is competent to enter into a contract only through its agents.

6. **Married women.** A woman is competent to enter into a contract. Marriage does not affect the contractual capacity of a woman. She can even bind her husband in cases of pressing necessity. A married woman may sue or be sued in her own name in respect of her separate property.

7. **Professional persons.** Doctors and advocates are included in this class. In England barristers are prohibited by the etiquettes of their profession from suing for their fees. So are members of the Royal College of Physicians. In India these personal disqualifications do not exist. According to the Bar Council Act 1927 an advocate of the High Court can enter into a contract with his client and can also bring a suit against him for his fees.

**C. CHECK YOUR PROGRESS**

- True/False

1. A minor is disqualified from entering into a valid contract. → **True**
2. An undischarged insolvent can enter into all types of contracts freely. → **False**
3. A foreign sovereign can enter into a contract in India with prior government permission. → **True**
4. A convict cannot enter into a contract during the period of his sentence. → **True**
5. Public officers can make contracts related to their official duties for personal gain. → **False**
6. A corporation can never enter into a contract. → **False**
7. A person disqualified by law is not competent to enter into a legally binding agreement. → **True**
8. A minor can ratify a contract after attaining majority. → **False**
9. A judge is allowed to contract in matters that relate to his judicial role. → **False**
10. Persons of unsound mind are permanently disqualified from contracting. → **False** *(They may contract during lucid intervals)*

## 8.6. LET US SUM UP

The **capacity to contract** refers to the legal ability of a person to enter into a binding agreement. Under contract law, not everyone is considered competent to contract. The law identifies certain groups of people who lack the capacity to contract, and any agreement entered into by such individuals is generally void or voidable. One such group includes **minors**, i.e., individuals below the age of majority (usually 18 years). Contracts with minors are generally void ab initio (from the beginning), although minors can enforce contracts that are for their benefit, such as those for essential goods or services (necessaries). Another category is **persons of unsound mind**, which includes individuals who, due to mental illness or temporary incapacity, cannot understand the nature and consequences of the contract. Contracts made during periods of unsoundness are void. However, contracts entered into when the person is of sound mind are valid. Additionally, certain individuals are **disqualified from contracting**

by law, such as alien enemies, convicts, insolvents, and in some jurisdictions, corporations or persons holding certain public offices. These disqualifications exist to protect public interest or due to legal incapacity. In all such cases, contracts made without legal capacity are either void or voidable, depending on the circumstances.

## 8.7. KEYWORDS

- **Capacity to Contract**: Legal ability to enter into a valid contract.
- **Competent Parties**: Individuals who are legally eligible to contract (major, sound mind, not disqualified).
- **Void Contract**: A contract that has no legal effect from the beginning.
- **Minor**: A person under the age of majority (usually under 18 years).
- **Void Ab Initio**: A minor's contract is invalid from the start.
- **Necessaries**: Essential goods/services (e.g., food, clothing) for which a minor can be held liable.
- **Beneficial Contract**: A contract that benefits the minor and may be enforceable.
- **Unsound Mind**: A mental state where a person cannot understand the nature of a contract.
- **Sound Mind**: The ability to understand and make decisions regarding the contract.
- **Voidable Contract**: A contract that can be cancelled by the person of unsound mind if they were incapable at the time of agreement.
- **Disqualified Persons**: Individuals legally barred from entering contracts (e.g., alien enemies, convicts, insolvents).
- **Alien Enemy**: A citizen of a country at war with the home country; barred from contracting.
- **Convict**: A person serving a prison sentence; restricted from certain contracts.
- **Insolvent**: A person declared bankrupt; limited in contractual capacity.
- **Legal Disability**: A legal restriction preventing someone from entering into a contract.

## 8.8. SELF-ASSESSMENT QUESTIONS

1. Explain the legal position of a contract entered into by a minor.

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2. What are lucid intervals? How do they impact a contract?

3. Mention any three categories of persons disqualified by law from entering into a contract.

## 8.9. LESSON END EXERCISE

1. Discuss the legal consequences of entering into a contract with a minor. Are there any exceptions to this rule?

2. Explain the concept of sound mind in contract law. Under what circumstances can a person of unsound mind make a valid contract?

3. Who are the persons disqualified by law from entering into contracts? Explain with suitable examples.

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## 8.10. SUGGESTED READING


- Garg, Sareen, Sharma & Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No :- BCG-303** **UNIT II**

**SEMESTER: III** **LESSON: 9**

# LAW OF CONTRACT II

**STRUCTURE**



## 9.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and concept of discharge of contract.
- To identify the various modes through which a contract can be discharged.
- To examine the legal effects of discharge of contract.

**Learning Outcomes:**

After Completing this lesson, learners will be able to:

- Define what is meant by the discharge of a contract.
- Identify and explain different ways a contract can be discharged.
- Demonstrate understanding of discharge by performance and agreement.
- Analyze situations leading to discharge by frustration or breach.
- Recognize the legal consequences when a contract is discharged.

## 9.1. INTRODUCTION

Discharge of contract refers to the termination or ending of the contractual obligations between parties, meaning that the parties are released from further duties under the contract. It marks the conclusion of the contract's life cycle when the terms have been fulfilled or when certain conditions make continued performance impossible or unnecessary. A contract can be discharged in various ways, including by performance, agreement, breach, frustration, or operation of law. Discharge by performance occurs when both parties complete their contractual duties as agreed. Sometimes, parties mutually agree to end the contract before performance is complete, which is discharge by agreement. Discharge by breach happens when one party fails to fulfil their obligations, allowing the other party to terminate the contract. Frustration arises when unforeseen events make the contract impossible to perform. Understanding the discharge of contracts is crucial in contract law as it determines when legal obligations end and what remedies may be available if the contract is terminated prematurely.

## 9.2. DISCHARGE OF CONTRACT

When the rights and obligations arising out of a contract are extinguished, the contract is said to be discharged or terminated. A contract may be discharged in any of the following ways:

1. By performance –actual or attempted.
2. But mutual consent or agreement.
3. By subsequent or supervening impossibility or illegality.
4. By lapse of time.
5. By operation of law.
6. By breach of contract.

### 1. Discharge by performance:

Performance of a contract is one of the most usual ways of discharge of a contract. The performance of a contract lies in doing or causing to be done what the promisor has promised to do. On the performance of the obligation undertaken by the parties, the contract is automatically discharged. Where a party has done what he undertook to do

there is nothing left for his to do. The contract is terminated when both parties completely perform the exact thing each has agreed to do. If one party only performs his promise, he alone is discharged and he acquires a right of action against the other who is guilty of breach.

Where a party has not performed his promise, but offered to perform the said promise in favour of the promisee, he will be deemed to have performed the promise. An adequate offer of performance amounts, in law to performance itself, and in case of non-performance by the promise, the promisor would be discharged from his obligation to perform.

**2. By mutual consent or agreement :**

Since a contract is created by means of an agreement, it mat also be discharged by another agreement between the same parties. Sections 62 and 63 deals only with this subject and provide for the following methods of discharging a contract by mutual agreement.

**a) Novation :**

"Novation occurs when new contract is substituted for a existing contract either between the same parties or between different parties the consideration mutually being the discharge of the old contract". If the parties are not changed then the nature of the obligation (i.e. material terms of the contract) must be altered substantially in the new substituted contrat,for,a mere variation of some of the terms of the contract, while the parties remain the same, is not 'novation' and 'alteration'. When the parties to a contract agree for 'novation', the original contract is discharged and need not be performed.

**For example:**

A owes B Rs.10,000. A enters into an agreement with B and gives B a mortgage of his estate (A) for Rs. 5,000 in place of the debt of Rs.10,000.

This is a new contract and extinguishes the old.

**b) Alteration :**

Alteration of a contract means change in one or more of, the material terms of a contract. If a material alteration in a written contract is done by mutual consent, the original contract is discharged by alteration and the new contract in its altered form takes its place. A material alteration is one which alters the legal effect of the contract, e.g., a change in the amount of money to be paid, the rate of interest or the names of the parties. Immaterial

alteration, e.g., correcting a clerical error in figures or the spelling of a name, has no effect on the validity of the contract and does not amount to alteration in the technical sense.

The difference between 'novation' and 'alteration' may be noted .In case of novation , there may be a change of parties also while in case of alteration parties remain the same, only the terms of a contract are altered.

**For example:** A enters into contract with B for the supply of 100 bales of cotton at his godown No. 1 by the first of the next month. A and B may vary the terms of the contract by mutual agreement.

**c) Rescission:**

A contract may be discharged, before the date of performance, by agreement between the parties to the effect that it shall no longer bind them. Such an agreement amounts to 'rescission' or cancellation of the contract, the consideration for mutual promises being the abandonment by the respective parties of their rights under the contract. An agreement of rescission releases the parties from their obligations arising out of the contract. Such agreements are to be distinguished from 'agreements in restraint of legal proceedings' which are void as per section 28. Law cannot force the parties to take a legal action for breach of contract and therefore, if they consent to treat non-performance or part performance of a contract equivalent to full performance or discharge of the contract, it is perfectly alright.

**For example:** A promises to deliver goods to B on a certain date. Before, the date of performance. A and B mutually agree that the contract will not be performed. The contract stands discharged by rescission. There may also be an implied rescission of a contract, e.g., where there is non-performance of a contract by both the parties for a long period, without complaint, it amounts to an implied by rescission.

**d) Remission:**

Remission may be defined, "as the acceptance and lays down that a promisee may remit or give up wholly or in part, the performance of the promise made to him, and a promise to do so is binding even though there is no consideration for it .The section further provides that an agreement to extend time for the performance of a promise also does not require consideration to support it on the ground that it is a partial remission of performance.

**For example:** A owes B Rs.5,000 and is also indebted to other creditors. A makes an

agreement with his creditors, including B, to pay them a composition of eight annas (fifty paisa) in the rupee upon their respective demands. Payment to B of Rs.2,500 is a discharge of B's demand.

**e) Waiver:**

Waiver means the deliberate abandonment or giving up of a right which a party is entitled to under a contract, whereupon the other party to the contract is released from his obligation. Strictly, speaking there is no need of an agreement for a waiver but because we are discussing it as a method of discharge under 'mutual consent, we presume that the other party consents to it. Thus, where A promises to tailor a shirt for B and B afterwards forbids him to do so to which A consents, the contract is terminated by waiver.

**A. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. A contract is said to be discharged when the obligations under it are fulfilled.
2. Partial performance of a contract always discharges the contract.
3. Performance must always be exact and complete to discharge the contract.
4. If time is not of the essence in a contract, delay in performance may not lead to discharge.
5. **Waiver** means **voluntary relinquishment or giving up of a right or claim by one party** to a contract.
6. A contract can be discharged if both parties agree to end it before performance.
7. Rescission is the cancellation of a contract by mutual agreement.
8. Novation involves replacing an existing contract with a new one involving the same or different parties.
9. A contract once formed cannot be modified or cancelled by mutual consent.
10. In novation, the original contract continues alongside the new contract.

**ANSWERS: 1.T, 2. F, 3. T, 4. T, 5. T, 6.T, 7.T, 8. T, 9.F, 10. F**

**3. Discharge by subsequent or supervening impossibility or illegality impossibility at the time of contract:**

There is no question of discharge of a contract which is entered into to perform something that is obviously impossible, e.g., an agreement to discover treasure by magic, because, in such a

case there is no contract to terminate, it being an agreement void ab initio by virtue of section 56, Para 1, which provides, "an agreement to do an act impossible in itself is void".

**Subsequent Impossibility:**

In fact it is this case, where the impossibility supervenes after the contract has been made, which is material to our study of discharge of contracts. In this connection, section 56, Para 2, declares that, "A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

In order that the section would apply the following conditions must be fulfilled:

(1) that the act should have become impossible;

(2) that impossibility should be by reason of some event which the promisor could not prevent; and

(3) thus the impossibility should not be self-induced by the promisor or due to his negligence. Further, the word, "impossible" should be construed here in its practical sense and not in a physical or literal sense.

A contract will be discharged on the ground of subsequent or supervening impossibility in the following cases:

**(i) Destruction of subject-matter :**

When the subject-matter of a contract, subsequent to its formation, is destroyed, without the fault of the promisor or promisee, the contract is discharged. Note that it is so only when specific property or goods are destroyed which cannot be regained.

**For example:**If a factory premises on which a machinery is to be installed are destroyed by fire, or a ship under a charter party is seized by a foreign government, the contract is discharged [Tatem,Ltd. V.Gamboa].

**(ii) Failure of ultimate purpose:**

Where the ultimate purpose for which the contract was entered into fails, the contract is discharged, although there is no destruction of any property affected by the contract and the performance of the contract remains possible.

**(iii) Death or personal incapacity of promisor:**

Where the performance of a contract depends upon the personal skill or qualification or the existence of a given person, the contract is discharged on the illness or incapacity or the death of that person.

**For example:** An artist undertook to paint a picture for a certain price, but before he could do so, he met with an accident and lost his right arm. Held, the artist was discharged due to disablement.

**(iv) Change of law:**

A subsequent change in law may render the contract illegal and in such cases the contract is deemed discharged. The law may actually forbid the doing of some act undertaken in the contract, or it may take from the control of the promisor something in respect of which he has contracted to act or not to act in a certain way.

**For example:** There was a contract for the sale of the trees of a forest. Subsequently by an act of legislature, the forest was acquired by the state government. The contract was discharged because it had become impossible of performance.

**(v) Outbreak of war:**

All contracts entered into with an alien enemy during war an illegal and void ab initio. Contracts entered into before the outbreak of war are suspended during the war and may be revived after the war is over if the nature of the contract so permits.

**Exceptions**

Some of the circumstances in which contract is not discharged on the ground of supervening impossibility are as follows:

**(a) Difficulty of performance :**

A contract is not discharged by reason of the fact that the performance is more difficult, more expensive or more burdensome or less profitable than the parties anticipated.

**For example:** D agreed to supply coal within certain time. Due to government restrictions on the transport of coal from collieries there was a failure of delivery in time. But since coal was available in the open market from where D could have obtained it, it was not a case of impossibility of performance.[Keshav Lal V.Dewan Chand].

**(b) Commercial impossibility :**

When in a transaction profits dwindle to a very low level or actual loss becomes certain, it is said that the performance of the contract has become commercially impossible. Such a situation may arise on account of higher price of the raw material or increase in the wages bill, etc. Commercial impossibility also does not discharge a contract [Sachindra V.Gopal].

**(c) Impossibility due to the default of a third person:**

The doctrine of supervening impossibility does not cover cases where the contract could not be performed because of the impossibility created by the failure of a third person on whose work the promisor relied.

**For example:** A, agreed to sell to B 61 bales of cloth to be manufactured by the New Victoria Mills, Kanpur, "as soon as they are supplied to him by the said mill". In a suit for damages for non-delivery of goods, the defendant (A) pleaded impossibility on the ground that the goods were not supplied to him by the Mills held the words, "as soon as they are supplied to him by the Mill", simply indicates that the process of delivery and did not convey the meaning that delivery was contingent on their being supplied by the Mill. Hence, the case did not fall within the provisions of section 32 and 56 as the default was due to the fault of the defendant. B is therefore, entitled to recover damages from A. [Ganga Saran V.Ram Charan Ram Gopal].

**(d) Strikes and lock-outs:**

A strike by the workmen or a lock-out by the employer also does notexcuse performance because the former is manageable (as the labour is available otherwise) and the latter is self-induced. Where the impossibility is not absolute or where it is due to the default of the promisor himself section 56 would not apply. As such these events also do not discharge a contract.

**(e) Failure of one of the object:**

When a contract is entered into for several objects, the failure of one of them does not discharge the contract.

**For example:** A company agreed to let out a boat to H, (a) for viewing a naval reviewon the occasion of the coronation of King Edward VII, and (b) to sail round the fleet. Due to illness of the King, the naval review was later cancelled but the fleet was assembled. Held, the contract was not discharged because the holding of the review was not the sole basis of the contract. To sail round the fleet, which formed on equally basic object of the contract was still capable of

attainment. [H.B.Steamboat Co.V.Hatlon].

**B. CHECK YOUR PROGRESS**

- One-liner Q&A

1. **Q:** What is supervening impossibility in contract law?
   **A:** It refers to an event after contract formation that makes performance impossible.
2. **Q:** Does supervening illegality discharge a contract?
   **A:** Yes, if an act becomes illegal after contract formation, it discharges the contract.
3. **Q:** What happens if performance becomes physically impossible due to unforeseen events?
   **A:** The contract is discharged due to impossibility.
4. **Q:** Is a contract void if the subject matter is destroyed?
   **A:** Yes, destruction of subject matter makes the contract void due to impossibility.
5. **Q:** Does a change in law that makes the contract illegal result in discharge?
   **A:** Yes, it results in discharge by supervening illegality.
6. **Q:** What is the legal term for events that frustrate contract performance?
   **A:** Doctrine of frustration.
7. **Q:** Can personal incapacity lead to discharge of contract?
   **A:** Yes, if personal skill is essential and the person is incapacitated.
8. **Q:** What is impossibility at the time of contract formation called?
   **A:** Initial impossibility.
9. **Q:** Is a contract valid if performance was impossible at the time of agreement?
   **A:** No, it is void ab initio (from the beginning).
10. **Q:** Does commercial hardship qualify as impossibility?
    **A:** No, mere difficulty or increased cost doesn't discharge the contract.

**4. Discharge by lapse of time:**

The limitation act lays down that in case of breach of contract legal action should be taken within a specified period, called the period of limitation, otherwise the promise is debarred from instituting a

suit in a court of law and the contract stands discharged. Thus, in some circumstances lapse of time may also discharge a contract. For example, the period of limitation for simple contracts is three years under the limitation act, and therefore, on default by a debtor if the creditor does not file a suit of recovery against him within three years of default, the debt becomes time-barred on the expiry of three years and the creditor will be deprived of his remedy at law. This is effect implies discharge of contract. Again, where "time is of essence in a contract", if the court is not performed at the fixed time, the contract comes to an end, and the party not at fault need not perform his obligation and may sue the other party for damages.

**5. Discharge by operation of law:**

A contract terminates by operation of law in the following cases:

a. **Death:** Where the contract is of a personal nature, the death of the promisor discharges the contract. In other contracts, the rights and liabilities of the deceased person pass on to the legal representatives of the dead man.

b. **Insolvency:** Contract is discharged by the insolvency of one of the parties to it when on insolvency court passes an, "order of discharger" exonerating the insolvent from liabilities on debts, incurred prior to his adjudication.

c. **Merger:** Where an inferior right contract merges into a superior right contract, the former stands discharged automatically.

   **For example:** Where a man holding property under a contract of tenancy buys the property, his rights as a tenant are merged into the rights of ownership and the contract of tenancy stands discharged by operation of law.

d. **Unauthorized material alteration:** Material alteration made in a written document or contract by one party without the consent of the other, will make the whole contract void. Thus, where the amount of money to be received is altered, or an additional signature is forged, on a promissory note by the creditor, he cannot bring a suit on it and the promoter cannot be enforced against the debtor even in its original shape. The effect of making such an alternation is exactly the same as that of cancelling the contract.

**6. Discharge by breach of contract:**

Breach of contract by a party there to is also a method of discharge of contract, because

"breach" also brings to an end the obligations created by contract on the part of each of the parties. Of course, the aggrieved party i.e., the party not at fault can sue for damages for breach of contract as per law; but the contract as such stands terminated.

Breach of contract may be of two kinds:

a. **Anticipatory breach**: An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. It may take place in two ways:
   - Expressly by words spoken or written.
   - Impliedly by the conduct of one of the parties.

b. **Actual breach:** Actual breach may also discharge a contract. It occurs when a party fails to perform his obligation upon the date fixed for performance by the contract, as for example, where on the appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery. It is important to note that there can be no actual breach of contract by reason of non-performance so long as the time for performance has not yet arrived. Actual breach entitles the party not in default to elect to treat the contract as discharged and to sue the party at default for damages for breach of contract.

**C. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. A contract is said to be _____ when the parties to it are no longer legally bound by its terms.
2. Discharge of a contract by _____ occurs when the period prescribed for performing the contract has expired.
3. According to the _____ Act, if a contract is not performed within the limitation period, it becomes unenforceable.
4. Discharge by _____ happens without any act by either party but due to legal reasons like death, insolvency, or unauthorized alteration of the contract.
5. When a contract is discharged by _____, it means one of the parties has failed to perform their obligations.
6. If a party refuses to perform their part of the contract before the due date, it is called _____ breach.
7. A _____ breach occurs when a party fails to perform their obligations on the due date.
8. In case of _____, the aggrieved party may treat the contract as discharged and claim damages.
9. The _____ of a party may discharge the contract if personal performance was required.
10. If one party makes unauthorized _____ to the terms of a written contract, it leads to discharge by operation of law.

**ANSWERS: 1. Discharged 2. Lapse of time 3. Limitation 4. Operation of law 5. Breach 6. Anticipatory breach. 7. Actual 8. Breach 9. Death 10. Alterations**

## 9.3. LET US SUM UP

Discharge of contract refers to the termination of contractual obligations, meaning the parties involved are no longer bound by the terms of the agreement. A contract may be discharged in several ways: by performance, where both parties fulfil their contractual duties; by agreement, where the parties mutually consent to end the contract; by frustration, when unforeseen events make performance impossible; by breach, where one party fails to meet their obligations, giving the other the right to terminate the contract; and by operation of law, such as in cases of bankruptcy or death. Once discharged, the contract is considered legally completed, and the parties are released from further responsibilities.

## 9.4. KEYWORDS

 **Discharge of Contract** – Termination of contractual obligations, freeing parties from further duties.

 **Performance** – Completion of contractual duties by all parties as agreed.

 **Mutual Agreement** – Discharge by consent of all parties to end or modify the contract.

 **Frustration** – When unforeseen events make contract performance impossible or illegal.

 **Breach of Contract** – Failure of a party to perform their obligations, allowing the other party to terminate the contract.

 **Operation of Law** – Automatic discharge due to legal reasons such as death, insolvency, or alteration of the contract.

 **Novation** – Replacement of an old contract with a new one, with consent of all parties involved.

 **Rescission** – Cancellation of the contract, restoring parties to their original positions.

 **Accord and Satisfaction** – An agreement to accept different performance than originally agreed, discharging the original obligation.

 **Anticipatory Breach** – When one party indicates in advance that they will not perform their obligations.

 **Actual Breach** – Occurs when a party fails to perform on the due date or during performance.

 **Impossibility of Performance** – When it becomes physically or legally impossible to fulfil contract terms.

 **Force Majeure** – A clause that frees parties from liability or obligation when extraordinary events prevent performance.

## 9.5. SELF-ASSESSMENT QUESTIONS

1. Explain the significance of mutual consent in discharging a contract. How does novation differ from rescission and alteration?

2. Compare and contrast discharge of contract by frustration and by breach. How do courts determine which applies in a given case?

3. Examine the doctrine of frustration and its impact on the discharge of a contract. Under what circumstances can frustration be invoked?

## 2.10 LESSON END EXERCISE

1. Explain the various modes through which a contract can be discharged. Illustrate with suitable examples.

2. What is discharge of contract by agreement? Explain the different ways in which this can be achieved.

3. How does impossibility of performance affect a contract? Critically evaluate with reference to relevant case laws.

4. Discuss the discharge of contract by operation of law. Provide examples of situations where this might apply.

## 2.11 SUGGESTED READING


- Garg, Sareen, Sharma & Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharms, Commercial Law


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**C. No: - BCG-303** **UNIT II**

**SEMESTER: III** **LESSON: 10**

# LAW OF CONTRACT II

**STRUCTURE**



## 10.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the concept of breach of contract and its legal implications.
- To identify different types of breaches (e.g., actual breach, anticipatory breach).
- To explore the various remedies available for breach of contract.
- To distinguish between legal remedies (damages) and equitable remedies (specific performance, injunction).
- To understand the concept of mitigation of damages and its importance.
- To learn about restitution and its role in contract breaches.
- To examine the conditions under which specific performance is granted.

**Learning Outcomes:**

After Completing this lesson, learners will be able to:

- Define what constitutes a breach of contract and identify the different types of breaches (actual, anticipatory).
- Understand the purpose of remedies in contract law and explain the various remedies available for breach of contract.
- Differentiate between legal remedies (damages) and equitable remedies (specific performance, injunction).
- Learn how damages are calculated and awarded, understand the principle of mitigation of damages, explore when specific performance is an appropriate remedy, and recognize the role of injunctions in contract disputes.
- Analyze case examples involving breach of contract remedies.

## 10.1. INTRODUCTION

A contract is a legally binding agreement between parties that creates mutual obligations. When one party fails to perform their contractual duties as agreed, it results in a breach of contract. This breach can be actual or anticipatory. When the other party has actually failed to fulfil the obligation it is said to be actual breach whereas when one party assumes that the other party may default in the performance of his contractual duties, then that is a case of anticipatory breach. Such breaches can disrupt business transactions and cause losses, making it essential to have clear remedies to address these violations. Remedies for breach of contract are legal tools designed to compensate the injured party or to enforce the agreement's terms. These remedies generally fall into two main categories: legal remedies, primarily in the form of monetary damages, and equitable remedies, such as specific performance or injunctions, which compel parties to act or refrain from certain actions. The choice of remedy depends on the nature of the breach and the circumstances of the case. Understanding these remedies is crucial for protecting contractual rights and ensuring fairness in commercial and personal agreements. This topic explores the types, purposes, and applications of remedies available for breaches of contract.

## 10.2. BREACH OF CONTRACT

Breach of contract by a party there to is also a method of discharge of contract, because "breach" also brings to an end the obligations created by contract on the part of each of the parties. Of course, the aggrieved party i.e., the party not at fault can sue for damages for breach of contract as per law; but the contract as such stands terminated.

**Breach of contract may be of two kinds:**

1. **Anticipatory breach :**

   An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. It may take place in two ways.

   a **Expressly by words spoken or written:**

   Here a party to the contract communicates to the other party, before due date of performance, his intention not to perform it.

   b **Impliedly by the conduct of one of the parties:**

   Here a party by his own voluntary act disables himself from performing the contract. For example, person contracts to sell a particular horse to another on 1st June and before that date, he sells the horse to somebody else. In the above cases, there occurs an anticipatory breach of contract brought about by the conduct of one of the parties.

   **Effect of an Anticipatory Breach:**

   When there is an anticipatory breach of contract, the promisee is executed from performance or from further performance. Further, it gives an opinion to the promise whereby:

   a) He may either treat the contract as rescinded and sue the other party for damages for breach of contract immediately without waiting the due date of performance, or
   b) He may elect not to rescind but to treat the contract as still operative and wait for the time of performance and then hold the other party responsible for the consequences of non-performance.

2. **Actual breach:**

   Actual breach may also discharge a contract. It occurs when a party fails to perform his obligation upon the date fixed for performance by the contract, as for example, where on the

appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery. It is important to note that there can be no actual breach of contract by reason of non-performance so long as the time for performance has not yet arrived. Actual breach entitles the party not in default to elect to treat the contract as discharged and to sue the party at default for damages for breach of contract.

## 10.3. REMEDIES FOR BREACH OF CONTRACT

Whenever there is breach of a contract, the injured party becomes entitled to any of one or more of the following remedies against the guilty party:

1. Rescission of the contract
2. Suit for damages.
3. Suit upon quantum meruit.
4. Suit for specific performance of the contract.
5. Suit for an injunction.

**1. Rescission of the contract:**

Where there is a breach of contract by one party, the other may rescind the contract and need not perform his part of obligation under the contract and sit quietly at home if he decides not to take any legal action against the guilty party. But in case the aggrieved party intends to sue the guilty party for damages for breach of contract, he has to file a suit for rescission of the contract. When the court grants rescission, the aggrieved party is freed from all his obligation under the contract; and becomes entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract (section 75).

**For example:** A contracts to supply 100 kg of tea leaves for Rs.15,000 to B on 15$^{th}$ April. If A does not supply the tea leaves on the appointed day need not pay the price. B may treat the contract as rescinded and may sit quietly at home. B may also file a 'suit' for rescission and claim damages.

Thus, applying to the court for 'rescission of the contract' is usually necessary for claiming damages for breach for breach or for availing any other remedy. In practice a suit for

rescission is accompanied by a 'suit for damages', etc. in the same plaint.

It is worth noting that damages can also be claimed even without a suit for 'rescission' of the contract in certain cases, as for example, in case of rescission of voidable contract, no suit need be filled. On the other hand, a suit for 'rescission of the contract 'may be filed when no damages are to be claimed in case of pledge of movable goods, say gold ornaments.

**2. Suit for damages:**

Damages are a monetary compensation allowed to the injured party for the loss or injury suffered by him or a result of the breach of contract. The fundamental principle underlying damages is not punishment but compensation. By awarding damages the court aims to put the injured party into the position in which he would have been, had there been performance and not breach, and not punish the defaulter party. As a general rule, "compensation must be commensurate with the injury or loss sustained, arising naturally from the breach". "If actual loss is not proved, no damages will be awarded".

**Damages are of four types:**

**a) General or ordinary damages :** General damages are those which arise naturally in the usual course of things for the breach of contract. These include damages which are the natural and probable consequences of the breach of contract. General damages are such damages which the law presumes from the breach of contract. They are awarded with a view to compensate the injured party and not with a view to punish the party at fault. General damages are usually assessed on the basis of actual loss suffered.

**For example:** A contract to sell and deliver 50 mounds of salt 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 mounds of salt of like quality at the time when the salt ought to have been delivered.

**b) Special damages:** Special damages are those which are the result of unusual circumstances affecting the plaintiff. These are the damages which the parties knew, when they made the

contract, as likely to arise from the breach of the contract. The notice of special circumstances involved in a contract must be known to the party against whom special damages are claimed for breach of a contract. If he had no knowledge, he is not answerable. Knowledge of the special circumstances must be on the date of the contract. Subsequent knowledge of special circumstances will not create any special liability. Special damages being exceptional in character do not follow ordinary course.

**For example:** A, a builder contracts to erect and finish a house by the 1st of January, in order that B may give possession of it at that time to C, to whom B has contracted to let it .A is informed of the contract between B and C. A builds the house so badly that, before 1st January, if falls down and has to be rebuilt by B, who in consequence loses the rent which he was to have received from C and is obliged to make compensation to C for the breach of contract .A must make compensation to B for the cost of rebuilding the house for rent lost and for the compensation made to C.

**c)** **Exemplary or vindictive damages:** They are awarded with a view to punish the wrongdoer and not primarily with the idea of awarding compensation to the injured party. The conduct of the dependent cannot be adequately punished only by awarding proportionate financial loss actually suffered .it should be sufficiently exemplary or vindictive. Generally vindictive damages are not awarded for breach of contract, but are as a rule awarded in actions or tort. But there are two exceptions to this rule namely, (1) Breach of contract to marry; and (2) Breach of contract by a banker having sufficient funds of the customers at the disposal, to honour his cheque.

The amount of damages claimed by the customer for the loss of his reputation is not determined by the amount of cheque. In fact, the reverse holds true i.e., the smaller the amount of the cheque wrongfully dishonoured, the greater is the damage caused to the reputation of the trade and the larger would be the amount of compensation he would be entitled to.

**For example:** The bank disobeyed the customer's order to stop payment of a particular cheque and as a consequence another cheque for £ 315$8d was dishonoured as a result of inadequate funds. The court awarded £ 250 as damages to the plaintiff.

**d)Nominal damages:** Nominal damages are awarded where the injured party has sustained damages of a short but not of a substantial nature to be reckoned with, e.g.

i) Where the breach is technical and injured party has no intention of performing his part of the contract;

ii) Where the injured party has not suffered any actual damages or fails to prove that he has;

iii) Where though damage has been caused, it was more due to the fault of the injured party than that of the defendant.

**Rules regarding the measure of damages**

The principles governing the measure of damages discussed above may be summarized as under:

a. The damages are awarded by way of compensation for the loss suffered by the aggrieved party and not for purpose of punishing the guilty party for the breach.

b. The injured party is to be placed in the same position, so far as money can do, as if the contract has been performed.

c. The aggrieved party can recover by way of compensation only the actual loss suffered by him, arising naturally in the usual course of things from the breach itself.

d. Special or remote damages, i.e., damages which are not the natural and probable consequence of the breach are usually not allowed until they are in the knowledge of both the parties at the time of entering into the contract.

e. The fact that damages are difficult to assess does not prevent the injured party from recovering them.

f. When no real loss arises from the breach of contract, only nominal damages are awarded.

g. If the parties fix up in advance the sum payable as damages in case of breach of contract, the court will allow only reasonable compensation so as to cover the actual loss sustained, not exceeding the amount so named in the contract.

h. Exemplary damages cannot be awarded for breach of contract except in case of breach of contract of marriage or wrongful refusal by the bank to honour the customer's cheque.

i. It is duty of the injured party to minimize the damage suffered.

j. The injured party is entitled to get the costs of getting the decree for damages from the defaulter party.

**3. Suit upon quantum meruit:**

The third remedy for a breach of contract available to an injured party against the guilty party is to file a suit upon quantum meruit. The phrase quantum meruit literally means "as

much as is earned" or "in proportion to the work done". Thus, remedy may be availed of either without claiming damages i.e., claiming reasonable compensation only for the work done or in addition to claiming damages for breach i.e., claiming reasonable compensation for part performance and damages for the remaining unperformed part.

The aggrieved party may file a suit upon quantum meruit and may claim payment in proportion to work done or goods supplied in the following cases:

(1) Where work has been done in pursuance of a contract, which has been discharged by the default of the defendant.

(2) Where work has been done in pursuance of a contract which is 'discovered void or become void'.

(3) When a person enjoys benefit of non-gratuitous act although there exists no express agreement between the parties. One of such cases is provided in section 70 which lays down that when services are rendered or goods are supplied by a person,(a) without any intention of doing so gratuitously and (b) the benefit of the same is enjoyed by the other party, the latter must compensate the former or restore the thing so delivered.

(4) A party who is quilt of breach of contract may also sue on a quantum meruit provided the following conditions are satisfied:

a) the contract must be divisible, and

b) the other party must have enjoyed the benefit of the past which has been performed , although he had an option of declining it.

**4. Suit for specific performance of the contract:**

Specific performance means the actual carrying out of the contract as agreed. Under certain circumstances an aggrieved party may file a suit for specific performance, i.e., for a decree by the court directing the defendant to actually perform the promise that he has made. Such a suit may be filed either instead of or in addition to a suit for damages.

A decree for specific performance is not granted for contracts of every description. It is only where it is just and equitable so to do, i.e., where the legal remedy is inadequate or defective; the courts issue a decree for specific performance. It is usually granted in contracts connected with land, building, rare articles and unique goods having some special value to the party suing because of family association.

Specific performance is not granted, as a rule, in the following cases:

(i) Where monetary compensation is an adequate relief.

(ii) Where the court cannot supervise the actual execution of the contract

(iii) Where the contract is for personal services, e.g., a contract to marry or to paint a picture.

(iv) Where the contract is not enforceable by either party against the other, that is, where one of the parties does not possess competency to contract.

**5. Suit for injunction**

'Injunction' is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of the negative terms of the contract. To put if differently, where a party is in breach of negative terms of the contract (i.e., where he is doing something which he promised not to do), the court may, by issuing an injunction, restrain him from doing, what he promised not to do. Thus, "injunction" is a preventive relief. It is particularly appropriate in cases of 'anticipatory breach of contract' where damages would not be an adequate relief.

**For example:** N, a film actress to act exclusively for Warner Bros. for one year. During the year she contracted to act for X. It was held that she could be restrained by an injunction for acting for X. [Warner Bros. V. Nelson].

**A. CHECK YOUR PROGRESS**

- **True / False**

1. **A party can claim damages even if no actual loss has been suffered.**
   **True** (Nominal damages can be awarded)
2. **Specific performance is not granted in contracts for personal services.**
   **True**
3. **Punitive damages are frequently awarded in contract law.**
   **False** (They are rare in contract cases)
4. **An anticipatory breach allows the non-breaching party to terminate the contract immediately.**
   **True**
5. **General damages are awarded only when special circumstances are known to both parties.**
   **False** (That applies to special damages)
6. **Quantum meruit is applicable when there is no contract but services are rendered.**
   **True**
7. **Rescission means continuing with the contract despite the breach.**
   **False** (It means canceling the contract)
8. **In all cases of breach, the court must grant specific performance.**
   **False**

**B. CHECK YOUR PROGRESS**

## ➢ Multiple Choice Questions (MCQs)

1. **A breach of contract occurs when:**
   a) A party fulfils its obligations
   b) The contract is signed
   c) A party fails to perform as promised
   d) Both parties agree to terminate the contract
   **Answer:** c) A party fails to perform as promised
2. **Which of the following is a type of breach where one party refuses to perform the contract before performance is due?**
   a) Implied breach
   b) Anticipatory breach
   c) Constructive breach
   d) Actual breach
   **Answer:** b) Anticipatory breach
3. **Which of the following is a legal remedy that involves a monetary award?**
   a) Specific performance
   b) Damages
   c) Injunction
   d) Rescission
   **Answer:** b) Damages
4. **Which remedy involves the court ordering a party to fulfil their part of the contract?**
   a) Injunction
   b) Rescission
   c) Specific performance
   d) Quantum meruit
   **Answer:** c) Specific performance
5. **Quantum meruit is awarded when:**
   a) A contract is fully performed
   b) No loss has occurred
   c) A party has partially performed and seeks compensation
   d) The contract is illegal
   **Answer:** c) A party has partially performed and seeks compensation
6. **Which of the following is not a typical remedy for breach of contract?**
   a) Injunction
   b) Specific performance
   c) Damages
   d) Arbitration
   **Answer:** d) Arbitration
7. **Special damages are awarded when:**
   a) The damages arise naturally from the breach
   b) The damages are speculative
   c) The special circumstances are known to both parties
   d) The contract is void
   **Answer:** c) The special circumstances are known to both parties
8. **Injunction is:**
   a) A form of monetary compensation
   b) An order to do or not to do something
   c) A substitute for damages
   d) A method of terminating a contract
   **Answer:** b) An order to do or not to do something

**C. CHECK YOUR PROGRESS**

- **MATCH THE COLUMN**

| COLUMN A | COLUMN B |
|---|---|
| A. Actual Breach<br>B. Anticipatory Breach<br>C. Damages<br>D. Specific Performance<br>E. Quantum Meruit<br>F. Injunction<br>G. Rescission<br>H. Special Damages | 1. Remedy involving court-ordered performance<br>2. Breach on the date of performance<br>3. Declaring intention not to perform before due date<br>4. Monetary compensation for loss due to breach<br>5. Compensation for value of services rendered<br>6. Court order to stop or prevent an act<br>7. Cancellation of the contract<br>8. Compensation for loss from specific known circumstances |

ANSWERS: **A – 2, B – 3, C – 4, D – 1, E – 5, F – 6, G – 7, H – 8**

## 10.4. LET US SUM UP

A **breach of contract** occurs when one party fails to fulfil their obligations under a legally binding agreement without a valid legal excuse. Breaches can be classified as either **actual,** where the failure to perform occurs on the due date, or **anticipatory,** where one party declares in advance that they will not perform their part of the contract. When a breach occurs, the injured party is entitled to legal remedies to compensate for the loss or enforce performance. The primary **remedies for breach of contract** include **damages**, which are monetary compensations aimed at placing the injured party in the position they would have been in if the contract had been performed. Damages may be general (direct losses) or special (losses arising from specific circumstances communicated to the breaching party). Other remedies include **specific performance**, where the court orders the breaching party to fulfil their contractual duties, typically used in cases involving unique goods or property; **injunction**,

which is a court order to do or refrain from doing something; and **quantum meruit**, which allows a party to recover the value of work or services provided when the contract is partially performed. Courts generally assess these remedies based on the nature of the contract, the extent of the breach, and the actual harm suffered by the aggrieved party.

## 10.5. KEYWORDS

- **Breach of Contract**: The failure to perform any term of a contract without a legitimate legal excuse.
- **Actual Breach**: A breach that occurs when one party fails to perform their obligation on the due date or during performance.
- **Anticipatory Breach**: A situation where one party declares before the performance is due that they will not fulfil their contractual duties.
- **Damages**: Monetary compensation awarded to the injured party for the loss suffered due to breach.
- **General Damages**: Compensation for losses that naturally arise from the breach (direct losses).
- **Special Damages**: Compensation for losses arising from special circumstances known to both parties at the time of contract formation.
- **Nominal Damages**: A small amount awarded when a breach occurred, but no actual financial loss was suffered.
- **Punitive Damages**: Damages meant to punish the breaching party; rarely awarded in contract cases.
- **Liquidated Damages**: Pre-determined damages agreed upon in the contract, enforceable if reasonable and not a penalty.
- **Specific Performance**: A court order requiring the breaching party to perform the contract as agreed, often used in cases involving unique goods or property.
- **Injunction**: A court order restraining a party from doing something that breaches the contract.
- **Quantum Meruit**: A claim for payment for work or services done when there is no valid contract or when a contract is partially performed.
- **Mitigation of Damages**: The legal duty of the injured party to reduce or minimize the losses resulting from a breach.

- **Rescission**: Cancellation of the contract, returning the parties to their original positions as if the contract never existed.

## 10.6. SELF-ASSESSMENT QUESTIONS

1. Differentiate between actual breach and anticipatory breach of contract.

2. Can an aggrieved party claim both damages and specific performance? Discuss with reasons.

3. What is an injunction? In what kinds of breach of contract cases is it most commonly used?

## 10.7. LESSON END EXERCISE

1. Discuss the various remedies available to an aggrieved party in the event of a breach of contract.

2. Explain the doctrine of mitigation of damages. What happens if the plaintiff fails to mitigate losses?

3. What are the different types of damages in contract law? Explain each with an example.

## 10.8. SUGGESTED READING


- Garg, Sareen, Sharma & Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharms, Commercial Law


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**C. No: - BCG-303** **UNIT III**

**SEMESTER: III** **LESSON: 11**

# SPECIAL CONTRACT I

**STRUCTURE**



## 11.0. Learning Objectives and Outcomes

**Learning Objectives**

- To describe the meaning of bailment.
- To understand the legal concept of bailment under the law of contracts.
- To learn the essentials required to form a valid contract of bailment.
- To analyze the different types of bailment based on purpose and consideration.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Gain a clear understanding of the concept of bailment in contract law.
- Identify the essential elements required to create a valid bailment.
- Distinguish between ownership and possession in the context of bailment.

- Recognize the different types of bailment based on purpose and consideration.

## 11.1. INTRODUCTION

Bailment is a significant concept under the law of contracts that involves the delivery of goods by one person (the bailor) to another (the bailee) for a specific purpose, under the condition that the goods will be returned once the purpose is fulfilled or otherwise disposed of as per the instructions of the bailor. It is based on the transfer of possession, not ownership, and plays a crucial role in both personal and commercial transactions, such as warehousing, transportation, and repairs. To constitute a valid bailment, certain essential elements must be present, including delivery of goods, consent, and a lawful purpose. Bailments can be classified into various types, such as gratuitous bailment and bailment for reward, depending on whether consideration is involved. Understanding the essentials and types of bailment helps in identifying the rights, duties, and liabilities of the parties involved, making it an important topic in legal studies and commercial law.

## 11.2. MEANING OF BAILMENT

Bailment means a delivery of goods on condition to re-deliver the goods when the condition is satisfied. Delivery or transfer of possession must not be accompanied by transfer of ownership, as on a sale of exchange. Delivery of goods to the bailee must be for some purpose. When that purpose is achieved the identical goods are to be returned. Common examples of bailment are giving cloth to the tailor to make a coat, delivering a car for repairs, delivering goods to a railway company for carriage from one place to another, something left with a friend for use or to be looked after, etc.

**For example**: Ram deposited money with a bank. Here the relation between Ram and banker is that of a lender and borrower and not that of a bailor and bailee for there is no question of returning the identical money deposited.

## 11.3. Essentials of Bailment

The essential features of bailment as stated in section 148 of the contract act are as follows:

1. **Delivery of goods:** The first important feature of bailment is the delivery of goods from one person to another. Delivery involves change of possession from one person to another and not a change of ownership. Mere custody without possession does not create bailment. Thus, a servant having custody of the goods of his master, or a guest using the goods of his host is not a bailee. The goods must be handed over to the bailee for whatever is the purpose of bailment. Once this is done a bailment is constituted.

   **For example:** A lady employed a goldsmith for making new ornaments out of old jewellery. Every evening she received the unfinished jewellery and put it into a box kept at the goldsmith's shop. She kept the key of that box with herself. One night the jewellery was stolen from the box. It was held that there was no bailment as the goldsmith had re-delivered to the lady (the bailor) the jewellery bailed with him [Kaliperumal V.Visalakashmi].

   Delivery of goods may be either actual or constructive. Actual delivery may be made by handling over the goods to the bailee. Delivery of gold to a goldsmith for making jewels is an instance of actual delivery. Constructive delivery, on the other hand, does not involve change of physical possession, goods remain where they are, but something is done which has effect of putting them in the possession of the bailee.

2. **Delivery of goods must be for some purpose:** Section 148 requires that there must not only be a delivery of goods, but the delivery must be for some purpose. Where some goods are delivered by mistake, there is no bailment. Delivery of goods being for a purpose, the bailee is bound to return the goods as soon as the purpose is achieved. Where a person takes a jewel to wear it during a mela he is only a bailee as he is under an obligation to return the jewel after the function.

3. **Contract:** Bailment is based upon a contract between the parties. The relationship of bailor and bailee is the creation of a contract. Since a minor cannot enter into a contract, he cannot be held liable as a bailee if he misuses the goods or incurs losses. However, he can be compelled to redeliver the goods to the bailor if the goods are in his possession. A bailment can also arise even if there is no contract between the parties. It may arise by operation of law as in the case of a finder of lost goods or persons to whom goods have been sent wrongly or in excess of the quantity ordered.

   **For example:** Certain motor vehicles and other goods belonging to the plaintiff were sized by the state in exercise of its powers under a sea customs act. The goods while in the custody of

the state remained totality uncared for. The state was held liable as a bailee.[State of Gujarat V.Memon Mohamed,1885].

4. **Movable goods:** The bailment can only be of movable goods. Money is not included in movable goods. Transfer of immovable property does not constitute bailment.

5. **Return of goods:** Bailment of goods is always for some purpose and is subject to the condition that when the purpose is achieved the goods will be returned to the Bailor or disposed of according to his directions. If there is no contract to deliver back or otherwise to dispose of the goods according to directions, there is no bailment at all. The goods may be returned either in original or altered form. Thus, when a piece of cloth is given to a tailor for being stitched, a contract of bailment is established and the tailor is under an obligation to return the cloth duly stitched. It is this characteristic of bailment which distinguishes it from other contracts. A bailment is distinguishable from sale, exchange or barter. In these transactions, both possession and ownership are transferred and therefore, the person buying is under no obligation to return.

**A. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. A bailment involves the transfer of ownership of goods.
2. In a contract of bailment, delivery of goods is essential.
3. A bailor is the person who receives the goods.
4. Bailment must always be for a lawful purpose.
5. The bailee must return the exact same goods delivered, not similar goods.
6. Bailment can exist without consideration.
7. A written contract is always required to create a valid bailment.
8. Delivery of goods can be actual or constructive in a bailment.
9. Bailment is not possible if the goods are immovable property.
10. In bailment, the goods are delivered permanently to the bailee.

**ANSWERS: 1.F, 2.T, 3.F, 4.T, 5.T, 6.T, 7.F, 8.T, 9.T, 10.F**

## 11.4. Kinds of Bailment

Bailment can be classified under the following heads:

1. **Voluntary and involuntary bailment:** Voluntary bailment is the outcome of an express contract between the parties, whereas involuntary bailment arises by the operation of law. Examples of involuntary bailment are in case of finder of goods, persons to whom goods have been sent wrongly or in express of the quantity ordered or bailee's heirs in case of bailee's death.
2. **Gratuitous and non-gratuitous bailment:** Where the bailee keeps the goods for the bailor without reward, it is a gratuitous bailment. Where some consideration passes between the parties, it is a non-gratuitous bailment or bailment for reward. e.g., a motor car let out for hire, goods given to a carrier for carriage at a price; articles given to a person for being repaired for remuneration, etc.

**B. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. A bailment where the bailor does not receive any reward or remuneration is called a _____ bailment.
2. A bailment for _____ is one where the bailee is compensated for the services rendered.
3. Bailment can be classified into two types: gratuitous bailment and _____ bailment.
4. In a gratuitous bailment, the benefit is either for the bailor or the _____, but not both.
5. In a bailment for hire, the bailment is for the _____ of both parties.
6. When goods are delivered for safe custody without any charge, it is an example of a _____ bailment.
7. A _____ bailment may be terminated by the bailor at any time.
8. In bailment for hire, the bailee is expected to take care of the goods as an _____ person would.
9. In gratuitous bailment, the _____ is liable only for gross negligence.
10. A _____ bailment is one where both the bailor and bailee derive some benefit.

**ANSWERS: 1. Gratuitous 2. Reward 3. Non-gratuitous 4. Bailee 5. Benefit 6. Gratuitous 7. Gratuitous 8. Ordinary prudent 9. Bailee 10. Bailment for reward**

3. **Bailment may also be classified in accordance with the benefit derived by parties.**

a. **Bailment for exclusive benefit of the bailor:** This occurs when the bailor delivers goods to the bailee solely for the bailor's benefit, and the bailee receives no compensation.
**Example**: You ask a friend to store your bicycle in their garage while you're out of town as a favor.

b. **Bailment for the exclusive benefit of the bailee**: This occurs when the bailor allows the bailee to use or possess the goods without compensation, solely for the bailee's benefit.
**Example**: You lend your laptop to a friend to help them finish a project.

c. **Bailment of mutual benefits**: This is a commercial bailment, where both parties benefit**,** often involving payment or compensation.
**Example**: Leaving your clothes at a dry cleaner, you pay for a service, and they earn revenue.

4. **Constructive Bailment**: It is a type of implied bailment that arises without an express agreement between the bailor and the bailee. It is created by operation of law when someone comes into possession of another person's goods under circumstances that impose a duty to return or care for them, even if there was no formal handing over.
**Example**: Imagine you are walking in a park and find a lost wallet on a bench. You pick it up with the intention of returning it to its rightful owner or handing it over to the police.

**C. CHECK YOUR PROGRESS**

- **MATCH THE COLUMN**

| Column A | Column B |
|---|---|
| 1. Gratuitous Bailment | A. Bailment for reward |
| 2. Bailment for Hire | B. Bailee receives compensation |
| 3. Bailment for Sole Benefit of Bailor | C. A gave his dress to a tailor for alteration |
| 4. Bailment for Sole Benefit of Bailee | D. A parked his bike at his friend's house for 2 hours for no consideration. |
| 5. Bailment for Mutual Benefit | E. C gave his camera to D to help him with his photography competition. |
| 6. Commercial Bailment | F. Another term for bailment for hire |
| 7. Returnable on Demand | G. Can be terminated anytime by bailor |
| 8. Non-Gratuitous Bailment | H. Bailee gets no reward |

**ANSWERS: 1-H, 2-B, 3-D, 4-E, 5-C, 6-F, 7-G, 8-A**

## 11.5. LET US SUM UP

Bailment is a legal relationship in which the owner of goods (the bailor) delivers them to another person (the bailee) for a specific purpose, under the agreement that the goods will be returned once the purpose is fulfilled or otherwise disposed of according to the bailor's instructions. The essential elements of bailment include: delivery of goods (without transfer of ownership), acceptance by the bailee, a specific purpose for holding the goods, and an agreement (express or implied) to return or dispose of the goods. Bailments can be classified into three main types based on who benefits from the arrangement. Bailment for the exclusive benefit of the bailor occurs when the bailee holds the goods as a favor, without compensation; here, the bailee owes only a slight duty of care**.** Bailment for the exclusive benefit of the bailee happens when the bailor lends goods to the bailee for the latter's personal benefit, again without compensation, but the bailee must exercise a high degree of care. Bailment for mutual benefit is the most common type in commercial transactions, where both parties receive value — such as in storage or repair services — and the bailee must exercise reasonable care. Each type of bailment carries different legal responsibilities and standards of care depending on who benefits from the arrangement.

## 11.6. KEYWORDS

- **Bailment** – A legal relationship where one person (bailor) delivers goods to another (bailee) for a specific purpose, with the expectation of return or disposal after the purpose is fulfilled.
- **Bailor** – The person who owns the goods and delivers them to the bailee.
- **Bailee** – The person who receives the goods and is responsible for their care until returned or disposed of.
- **Delivery of goods** – The transfer of possession (not ownership) of goods from the bailor to the bailee.
- **Possession** – The physical control of goods, which is given to the bailee in a bailment.
- **Ownership** – The legal right to the goods; this remains with the bailor during bailment.
- **Consideration** – Something of value (e.g., payment or benefit) that may or may not be involved in a bailment, depending on the type.

- **Duty of care** – The level of care the bailee must take while handling the bailor's goods; varies by type of bailment.
- **Return of goods** – The obligation of the bailee to return the goods once the purpose of the bailment is completed.

## 11.7. SELF ASSESSMENT QUESTIONS

1. Define bailment and explain its essential elements with examples.

2. Distinguish between gratuitous bailment and bailment for reward. Support your answer with suitable examples.

**3.** Is delivery of goods essential to constitute a bailment? Discuss with relevant provisions and judicial interpretations.

## 11.8. LESSON END EXCERCISES

1. Define bailment. What are its essential elements? Support your answer with legal provisions and examples.

2. Explain and distinguish between the different kinds of bailment based on benefit to the parties.

**3.** Compare and contrast gratuitous bailment with bailment for mutual benefit.

## 11.9. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT III**

**SEMESTER: III** **LESSON: 12**

# SPECIAL CONTRACT I

**STRUCTURE**



## 12.0. Learning Objectives and Outcomes

**Learning Objectives**

- To distinguish between the roles of a bailor and a bailee in a contract of bailment.
- To learn the rights of a bailor, including the right to claim goods and compensation for unauthorized use.
- To learn the duties of a bailor, such as disclosing known faults and bearing necessary expenses in gratuitous bailments.
- To understand the rights of a bailee, such as the right to lien and reimbursement for expenses.

- To understand the duties of a bailee, including taking reasonable care of the goods and not using them without permission.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- List and describe the rights and duties of the bailor in a bailment contract.
- List and describe the rights and duties of the bailee in a bailment contract.
- Differentiate between the responsibilities of the bailor and bailee clearly.
- Apply the principles of bailment to real-world or hypothetical scenarios**.**
- Recognize the legal implications of breach of duties by either the bailor or bailee.
- Analyze disputes related to bailment and propose appropriate remedies based on rights and duties.

## 12.1. INTRODUCTION

The concept of bailment plays a significant role in the law of contracts and governs situations where the ownership of goods remains with one party (the bailor)**,** while possession is temporarily transferred to another party (the bailee) for a specific purpose. This transfer of possession creates a legal relationship, and both the bailor and bailee assume certain rights and duties under the law. These obligations ensure trust, accountability, and fairness between the parties during the period of bailment. For example, when a person hands over their car to a valet or deposits goods in a warehouse, a bailment is created. The bailor is primarily responsible for disclosing known defects in the goods and, in some cases, even unknown defects if negligence can be proven. The bailor also has the right to claim compensation if the bailee misuses the goods or causes damage due to negligence. On the other hand, the bailee is expected to take reasonable care of the goods, not to use them for unauthorized purposes, and to return them upon the completion of the bailment. If the bailee fails to return the goods or causes any loss, they may be held liable. The rights and duties of both parties differ slightly depending on whether the bailment is gratuitous (without reward**)** or for consideration**.** These legal principles help regulate day-to-day transactions involving temporary custody of goods and promote a sense of responsibility and legal clarity. Understanding the rights and duties of a bailor and bailee is essential not only for law students but also for individuals and businesses that engage in such arrangements

regularly. This topic, therefore, forms a crucial part of contract law and serves as a foundation for many commercial and personal dealings.

## 12.2. DUTIES OF BAILOR

A Bailor is the person who delivers the goods. His duties are as follows:

**1. Duty to disclose faults in goods bailed:** Section 150 lays down this duty. The section makes a distinction between a gratuitous bailor and a bailor for reward and provides as follows:

a) A gratuitous bailor is bound to disclose to the bailee all those faults in the goods bailed, of which he is aware and which materially interfere with the use of them or expose the bailee to extra ordinary risks, and if he fails to do so, he will be liable to pay such damages to the bailee as may have resulted directly from the faults. A gratuitous bailor will not be liable for damages arising to the bailee from defects of which he was ignorant.

**For example:** As appended to Section 150 – A lends a horse, which he knows to be vicious; to B. he does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

b) A bailor for reward is responsible for all defects in the goods bailed whether he is aware of the defects or not, if he does not disclose them to the bailee. Unlike, a gratuitous bailor, ignorance of the defects is no defence for him.

**For example:** As appended to Section 150 – A hires a carriage of B. The carriage is unsafe though B is not aware of it, and A is injured is responsible to A for the injury. (if the carriage were lent gratuitously would not be liable under the circumstances. Similarly, if B has told the fault to A, then also he would not be liable).

c) It may be mentioned that where the goods bailed are of dangerous nature, it is the of the bailor to disclose the fact to the bailee otherwise, he will be liable for all the resulting damage (Great Northern Rly.V. L.E.P. Transport Ltd.).

**For example:** A delivers to B, a carrier, some explosives in a case but does not warn B. The case is handled without extra care necessary for such articles and there is an explosion. The

carrier is injured and some other goods are damaged. A, the bailor, is liable for all the resulting damage.

2. **Duty to repay necessary expenses in case of gratuitous bailment:** Section 158 provides that where, by the conditions of the bailment, the goods are to be kept or to be carried or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, it is the duty of the bailor to repay all the necessary expenses incurred by the bailee for the purpose of the bailment. Thus, where a horse is bailed without record for safe custody, it is the duty of the bailor to reimburse the bailee for usual feeding expenses of the horse as well as for the medical expenses, if any.

3. **Duty to repay any extraordinary expenses in case of nongratuitous bailment:** Where under the terms of the bailment, the bailee is to receive remuneration for his services; it is the duty of the bailor to bear extraordinary expenses, if any, incurred by the bailee in relation to the thing bailed. In such a bailment, the bailor is not to bear the ordinary or usual expenses. Thus, where a horse is bailed for safe custody and the bailee is to receive Rs.20 per day as custody charges, the bailor is not liable to repay the bailee the ordinary expense of feeding the horse. But if during the bailee's custody the horses fall ill without any negligence on his part, the bailor must repay the bailee the medical expenses incurred in connection with the treatment of the horse, these being extraordinary expenses.

4. **Duty to indemnify the bailee:** Section 164 provides that a bailor is also bound to indemnify the bailee for any loss suffered by the bailee, by reason of the fact that the bailor was not entitled to bail the goods because of defective title.
   **For example:** A gives his neighbour's scooter to B for use without the neighbour's permission. The neighbour sues B and receives compensation. A is bound to indemnify B for his losses.

5. **Duty to receive back the goods:** It is the duty of the bailor to receive back the goods when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished. If the bailor refuses to take delivery of goods when it is offered at the proper time, the bailee can claim compensation for all necessary expenses of, and incidental to, the safe custody.

**A. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. The bailor is required to disclose all known defects in the goods bailed.
2. The bailor has no obligation to pay expenses in a gratuitous bailment.
3. If the bailor fails to inform the bailee of a defect, and the bailee suffers a loss, the bailor is not liable.
4. The bailor must compensate the bailee for any loss resulting from defective goods, if the defects were known to the bailor.
5. The bailor is not required to take the goods back after the bailment ends.
6. The bailor must bear extraordinary expenses incurred by the bailee in all types of bailment.
7. The bailor has a duty to accept the goods once the purpose of the bailment is fulfilled.
8. A bailor is always liable for any loss to the goods during bailment.

**ANSWERS: 1.T, 2.F, 3.F, 4.T, 5.F, 6.F, 7.T, 8.F**

## 12.3. RIGHTS OF BAILEE

1. **Enforcement of bailor duties:** The duties of the bailor are the rights of the bailee. As such the bailee can, by suit, enforce the duties of the bailor enumerated above. To recapitulate, the bailee has the following rights against the bailor (based on the bailor's duties discussed above):

a) Right to claim damages for loss arising from the undisclosed faults in the goods bailed (section 150).

b) Right to claim reimbursement for extraordinary expenses incurred in relation to the thing bailed (section 158).

c) Right to indemnify for any loss suffered by him by reason of defective title of the bailor to the goods bailed (section 164).

d) Right to claim compensation for expenses incurred for the safe custody of the goods if the bailor has wrongfully refused to take delivery of them after the term of bailment is over.

2. **Right to deliver goods to one of several joint bailors (section 165):** Where goods have been bailed by several joint owners, the bailee has a right to deliver them, to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.

3. **Right to deliver goods, in good faith, to bailor without title (section 166):** The bailee has a right to deliver the goods, in good faith, to the bailor without title, without incurring any liability towards the true owner.

4. **Right of lien:** The right to retain possession of the property or goods belonging to another until some debt or claim is paid, is called the right of lien. The right depends on possession and is lost as soon as possession of the goods is lost. As such, it is also called as 'possessory lien'. Lien may be of two types i.e., particular and general.

**Particular Lien**

Particular lien means the right to retain only that particular property in respect of which the charge is due.

**General Lien**

General lien means the right to retain all the goods of the other party until all the claimed of the holder against that party are satisfied. In other words, this is a right to retain the goods of another as a security for a general balance of account.

**Bailee's Particular Lien**

Section 170 confers the right of particular lien upon a bailee and provides that 'where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them'.

Thus, a bailee has a particular lien when the following conditions are fulfilled:

(i) The bailed must have rendered some service in relation to the thing bailed and must be entitled to some remuneration for it, which must not have been paid.

(ii) The service rendered by the bailee must be one involving the exercise of labour or skill in respect of the goods bailed, so as to confer an additional value on the article.

**For example:** A delivers a rough diamond to B, a jeweller, to be cut and polished which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered (Jeweller's labour and skill must have enhanced the value of the stone).

It is to be emphasized that there is no lien if the labour and skill must have enhanced the value of the stone). It is to be emphasized that there is no lien if the labour and skill exercised by the bailee does not improve the value of the goods bailed. Thus, a person who takes a horse for feeding and keeping at his stable has no lien for his charges because no additional value has been added to the horse by his labour. Similarly, there is no lien for safe custody charges because there is no exercise of labour or skill. In such cases, the bailee can only sue the bailor for the charges due.

(iii) The services must have been performed in full in accordance with the directions of the bailor, within the agreed time or reasonable time.

**For example:** A Gives cloth to B, a tailor, to make a coat. B promises A to deliver the coat as soon as it is finished, and to give a three month's credit for the price. B is not entitled to retain the coat until he is paid.

a) The goods must be in possession of the bailee. If possession is lost, the lien is also lost.
b) There must not be a contract to the contrary.

If all the above conditions are satisfied, the bailee can exercise his right of particular lien until he is paid for his services.

The following points must also be noted in connection with the bailee's particular lien:

a) The bailee retaining the articles to enforce his lien cannot charge for keeping it.
b) The bailee cannot exercise his lien for the non-payment of extra-ordinary expenses incurred in relation to the thing bailed. He should sue for them.

Besides, the bailee, other persons who are entitled to exercise the right of particular lien are: finder of goods (section 168), Pawnee (sections 173-174), agent (section 221) and unpaid seller (section 47, the sale of goods act).

**Bailee's General Lien**

A general lien is a right to retain the goods of another as a security for a general balance e of account. In simple words, this right entitles a person to retain possession of any goods belonging to another for any amount due to him whether in respect of these goods or any

other goods. For example, if two loans have been taken against two securities from a banker and the borrower repays one of these loans, the banker may retain both securities until his other loan is paid.

According to section 171, bailees coming within the following categories have a general lien in the absence of a contract to the contrary:

**(a) Bankers**

A banker has a general lien on all goods, cash, cheques and securities deposited with him as banker by a customer, for any money due to him as a banker. Thus, where a customer has a credit balance in one account of the bank and that the same time he owes money to the bank on another account, the banker's general lien entitles him to refuse the customer to operate the account in which he has a credit balance till he clears the debt due to the bank [Davendra Kum V.Chaudhary Gulab Singh]. But where valuables and securities are deposited for a specific purpose, e.g., for safe custody, the banker has no general lien on them as the acceptance of the goods for a special purpose impliedly excludes general lien [Cuthbert V. Robarts].

**(b) Factors**

A factor is an agent entrusted with the possession of goods in the ordinary course of his business for the purpose of sale. He has a general lien on the goods of his principal, if any money is due to him by his principal whether for advances made or for remuneration.

**(c) Wharfingers**

A wharfinger has a general lien on the goods as regards charges due for the use of his wharf against the owner of the goods.

**(d) Attorneys of high court**

An attorney or solicitor of a high court has a general lien on all papers and documents belonging to his client which are in his possession in his professional capacity until the fee for his professional service and other cost incurred by him are paid but if the solicitor refuses to act any more for the client, he is not entitled to any lien.

**(e) Policy brokers**

The policy brokers can retain the policy of fire or marine insurance for their brokerage.

**B. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. A bailee has the right to retain the goods bailed until the _____ due to him is paid.
2. The right of a bailee to retain goods until payment is known as the _____ lien.
3. If the bailor refuses to compensate the bailee for necessary expenses, the bailee can exercise the right of _____.
4. A bailee has the right to be _____ for any loss suffered due to the bailor's defective title to the goods.
5. The bailee has the right to _____ the bailor if the bailor's goods cause damage due to undisclosed defects.
6. In case of wrongful claim over the goods by a third party, the bailee has the right to deliver the goods only to the _____.
7. The bailee can apply to the court for determining the title of the goods under the _____ Act.
8. A bailee has the right to recover _____ expenses incurred in taking care of the goods in a gratuitous bailment.
9. If the goods are lost or damaged without the bailee's fault, he is _____ from liability.
10. A bailee has the right to claim _____ from the bailor for services rendered, if agreed.
11. If the bailor fails to disclose known defects and the bailee suffers loss, the bailor is _____.
12. The bailor must accept the goods back once the _____ of the bailment is completed.
13. In case of non-gratuitous bailment, the bailor must repay any _____ expenses to the bailee.
14. The bailor is bound to _____ the bailee for any loss due to defective title of goods.
15. The bailor is bound to disclose all known _____ in the goods bailed.
16. In a gratuitous bailment, the bailor must bear all _____ expenses incurred by the bailee.
17. The bailor has a duty to receive back the goods when the bailee _____ to return them.
18. If the bailor refuses to accept the goods after bailment ends, he is liable to pay _____ to the bailee.
19. The bailor must deliver the goods in a _____ condition fit for the purpose of bailment.
20. If the bailor's title to the goods is defective, the bailee may be exposed to claims by a _____.

**ANSWERS: 1.Remuneration, 2.Particular, 3.Lien, 4.Indemnified, 5.Sue, 6.True owner/bailor, 7.Indian Contract, 8.Extraordinary, 9.Discharged, 10.Compensation/remuneration, 11.Liable, 12.Purpose, 13.Extraordinary, 14.Indemnify, 15.Defects, 16. Necessary / reasonable, 17. Offers / is ready, 18.Compensation/damages, 19.Reasonable/safe, 20.Third party**

## 12.4. RIGHTS OF BAILOR

1. **Enforcement of bailee's duties:** The duties of the bailee are the rights of the bailor. The bailor can enforce by suit all the duties of the bailee as his rights. To recapitulate, the bailor has the following rights against the bailee based on the bailee's duties discussed earlier:

   a) Rights to claim damages for loss caused to the goods bailed by bailee's negligence (section 151).

   b) Right to claim compensation for any damage arising from or during unauthorized use of the goods bailed (section 154).

   c) Right to claim compensation for any loss caused by the unauthorized mixing of goods bailed with the own goods (section 155-156).

   d) Right to demand return of goods as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished (section 160).

   e) Right to claim any natural accretion to the goods bailed (section 163).

2. **Right to terminate bailment if the bailee uses the goods wrongfully (section 153):** The bailor has a right to terminate the bailment, if the bailee does, with regards to the goods bailed, any act which is inconsistent with the terms of the bailment, although the term of bailment has not expired or the purpose of bailment has not been accomplished.

   **For Example:** As appended to section 153, A gives on hire to B a horse for his own riding B drives the horse in his carriage. The contract of bailment is voidable to the option of A.

3. **Right to demand return of goods at any time in case of gratuitous bailment (section 159) :** When the goods are lent without reward i.e., gratuitously, the bailor can demand their return whenever he pleases even though he lent them for a specified purpose or time and the bailee is not guilty of wrongful use. But if the premature return of goods causes the bailee loss in excess of benefit actually derived by him from the use of such goods, the bailor must indemnify the bailee for the amount in which the loss occasioned exceeds the benefit derived.

4. **Rights of Bailors and Bailees against Wrong-doers:** If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment has been made;

and either the bailor or the bailee may bring a suit against the wrong-doer for such deprivation or injury (section 180). Whatever is obtained by way of relief or compensation in any suit, is to be apportioned, as between the bailor and the bailee, according to their respective interests (section 181). For example, if somebody forcefully takes possession of a coat from a tailor's shop, then either the tailor or the owner of the coat may sue the wrong doer. If the tailor files a suit, he shall hand over the recovered amount, after deducting his tailoring charges, to the owner of the coat.

## 12.5. DUTIES OF BAILEE

A bailee is the person to whom the goods are delivered. His duties are as follows:

**1. Duty of reasonable care**

According to section 151, a bailee is under a duty to take as much care of the goods entrusted to him as a man of ordinary prudence would take of his own goods of similar bulk, quantity and value. The duty of the bailee starts as soon as the bailee accepts delivery or receives property. The standard of care required of a bailee is that of an average prudent man. When a bailee had taken the same care of the property entrusted to him, as a reasonably careful man can be expected to take care of his own goods, he is not responsible for the loss, destruction or deterioration of the thing bailed. If the care devoted by the bailee falls below this standard, he will be liable for loss of or damage to the goods but not otherwise. The test is, will an ordinary prudent man do so in similar circumstances? If the answer is yes, the bailee is not liable.

Bailee cannot be held answerable for any act of God , e.g., fire , war, flood, etc.But if an article bailed is kept unlocked by the bailee, while he locks up similar articles of his own, the bailee will be liable for the loss. Again where goods were in transit by rail, and good were looted by a mob under circumstances beyond control of the railways, the latter as bailees are exonerated from liability. In this case, the railways had taken all reasonable care of a prudent man and looting by an angry mob could not be anticipated.

**For example:** Silver was entrusted to a goldsmith for making ornaments. He kept it locked in an almirah and employed a watchman for the night. Inspite of these precautions the silver was stolen. The goldsmith had taken reasonable care of the goods and was not liable for the loss.

Section 151 lays down the absolute minimum of care required of a bailee. In case, bailee does take the amount of such care, then in the absence of any special contract to the contrary, he cannot be held responsible for the loss, destruction or deterioration of the thing bailed (section 152 ).

However, a contract to the contrary may lay down a different standard of care to be taken by the bailee. Thus, section 152 allows a bailee to undertake a higher responsibility or to limit his liability.

It is important to note that under this duty of reasonable care, the bailee is also bound to take reasonable steps to recover the goods if they have been stolen. Thus, where some goods were stolen from the bailee's custody without his fault, but he made no efforts whether by informing the owner or the police to recover them, he was held liable (Coldman V.Hill). Also note that the degree of care required from the bailee is the same whether the bailment is gratuitous or for reward.

**2. Duty not to make unauthorized use of goods**

Goods must be used by the bailee strictly for the purpose for which they have been bailed to him. An unauthorized use of goods would make the bailee absolutely liable for any loss or damage to the goods. Even an act of God or inevitable accident would be of no defence. A horse lent for riding should not be used for any other purpose and if it is used outsided the scope of the bailment; the bailee would be liable for any damage to the horse. Apart from this, the bailor may terminate the contract at once and insist on the goods being returned to him.

**For example:** A lends a horse to B, for his own riding only. B allows C, member of his family to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for injury done to the horse.

A hired a horse for the purpose of riding to the exhibition ground. On the exhibition ground the horse was frightened by the crowd and ran into a ditch and injured itself. The bailee (i.e. A) of the horse was not to be blamed. He is not liable for the injury to the horse.

**3. Duty not to mix goods bailed with his own goods**

It is also the duty of a bailee that he should not mix his own goods with those of the bailor, without bailor's consent. If the goods are mixed with the consent of the bailor, there is no

breach of duty and the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced (section 155). But if the bailee, without the consent of the bailor, mixes up his own goods with those of the bailor, whether intentionally or accidentally, the following rules apply:

a) Section 155 provides that if the bailee, with the consent of the bailor mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest in proportion to their respective shares in the mixture thus produced.

b) Section 156 provides that where goods are mixed without the consent of the bailor, and if the goods can be separated or divided, the property in the goods will remain in the parties respectively. The bailee is bound to bear the expenses of separation or division and also any damage arising from such unauthorized mixing.

**For example:** To section 156,A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark. A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of balls, and any other incidental damage.

c) Where the goods mixed cannot be separated, section 157 becomes applicable. In such a case the bailor is entitled to be compensated by the bailee for the loss of the goods.

**For example:** To section 157, A bails a barrel of cape flour worth Rs.450 to B. B, without A's consent mixes the flour with country flour of his own, worth only Rs.250 a barrel. B must compensate A for the loss of his flour.

**4. Duty not to set up any adverse title against the bailor**

A bailee is not authorized to set up the plea of juster tii, that is to say, that the goods belong to a third person. The bailee is estopped from challenging the right of the bailor to receive the goods back. Even if there is a person who has a better title to the goods than that of the bailor, the bailee may safely return the goods to the bailor and he will not be liable to the owner for conversion.

**5. Duty to return the goods**

Section 140 imposes a duty on the bailee to return or deliver the goods bailed. He must deliver back the goods as soon as the time for which they were bailed has expired or the purpose for which they were bailed has been accomplished. The bailee has no right to keep the goods and

he must return them without waiting for a demand. The duty to return by the bailee should be carried out according to the directions given by the bailor in that behalf. When the bailee fails to return the goods at the proper time. Section 161 provides that the bailee will be responsible for any loss, deterioration or destruction of the goods from that time. Section 159 provides that a gratuitous bailee is bound to return the goods at any time even though the loan is for a specified time or purpose. If such a termination of the bailment is likely to cause loss to the bailee exceeding the benefit derived by him from the bailment, the bailor must compensate the Bailee. Where several joint owners of goods bail them to a bailee there is a duty on the part of the bailee, in the absence of any agreement to the contrary, to deliver the goods back to one joint owner without the consent of all the owners (section 165). So in case of joint bailors, there is an option with the bailee to return the goods to one of the owners.

A bailee, who re-delivers the goods to the bailor or upon his directions, in ignorance of his lack of title, is not liable to the rightful owner. Section 166 protects a bailee from the consequence of wrong delivery provided be acts in good faith in delivering them back to the bailor.

**For example:** P delivered certain certain books to D, a book binder who promised to bind and return them within a reasonable time. D could not complete the job within a reasonable time. The books subsequently burnt in an accidental fire in D's premises. D was held liable in damages for the loss of the books, and the plea that the fire was accidental or an act of God was no avail [Shaw and Co.V.Symmons and Sons, 1917).

**6. Duty to deliver any accretion to the goods**

Section 163 provides that the duty of the bailee to deliver to the bailor any natural increase or profit occurring from goods bailed, unless there is a contract to the contrary. This duty means that the bailee is legally required to return not only the goods bailed but also any natural increase or profit (called "accretion") that comes from those goods while they are in the bailee's possession. The bailee cannot keep any benefit or profit that comes from the goods unless the bailor agrees.

**For Example:** Ram leaves a cow in the custody of Bheem to be taken care of. The cow has a calf. Bheem is bound to deliver the calf as well as the cow to Ram.

## C. CHECK YOUR PROGRESS

- **MULTIPLE CHOICE QUESTIONS**

1. **Which of the following is a right of the bailor?**
   A. To sell the goods bailed
   B. To claim compensation if goods are not returned on time
   C. To misuse the goods
   D. To change ownership of goods during bailment
   **Answer: B**
2. **One of the primary duties of the bailee is to:**
   A. Use the goods for personal benefit
   B. Return the goods only if payment is received
   C. Take reasonable care of the goods
   D. Destroy the goods after use
   **Answer: C**
3. **If the bailee uses the goods for unauthorized purposes, the bailor has the right to:**
   A. Ignore the act
   B. Claim damages and terminate the bailment
   C. Transfer ownership
   D. Sell the goods
   **Answer: B**
4. **The bailee must return the goods:**
   A. In better condition
   B. In a different form
   C. Without any request
   D. In the same condition, subject to normal wear and tear
   **Answer: D**
5. **Which of the following is NOT a duty of the bailee?**
   A. To return the goods on the expiry of bailment
   B. To use the goods as per instructions
   C. To pledge the goods
   D. To take reasonable care of the goods
   **Answer: C**
6. **In case of loss or damage without the bailee's fault, he is:**
   A. Always liable
   B. Liable only if goods are expensive
   C. Not liable
   D. Required to pay half the value
   **Answer: C**
7. **The bailor can demand the goods back before the agreed time in case of:**
   A. Gratuitous bailment
   B. Commercial bailment
   C. Pledge
   D. None of the above
   **Answer: A**
8. **The bailee must return any increase or profit from the goods to the bailor, unless:**
   A. The bailee is a relative
   B. There is a special agreement
   C. The goods are perishable
   D. The profit is too small
   **Answer: B**

## 12.6. LET US SUM UP

The rights and duties of the bailor and bailee form the foundation of the bailment relationship, ensuring that goods entrusted are properly cared for and returned. The bailor has the right to receive back the goods and to be informed of any defects, while their duties include disclosing known faults and reimbursing necessary expenses. The bailee, on the other hand, has the right to retain the goods until compensated and to use them only as permitted, while their duties involve taking reasonable care of the goods and returning them in good condition. These mutual rights and responsibilities help maintain trust and accountability between both parties, reducing disputes and protecting their interests in various commercial and personal transactions.

## 12.7. KEYWORDS

- **Bailor**: The person who delivers goods or property to another for safekeeping or use under a bailment contract.

- **Bailee**: The person who receives goods or property from the bailor and is responsible for its care and return.

- **Rights of Bailor**: Legal entitlements of the bailor, including the right to get back the goods and claim compensation for misuse or damage.

- **Duties of Bailor**: Obligations of the bailor such as disclosing known defects in the goods and paying necessary expenses in gratuitous bailment.

- **Rights of Bailee**: Legal protections for the bailee, such as the right to retain the goods until payment or reimbursement and to use the goods only as permitted.

- **Duties of Bailee**: Responsibilities of the bailee, including taking reasonable care of the goods and returning them according to the terms of the bailment.

- **Gratuitous Bailment**: A bailment where only one party benefits without payment or compensation.

- **Lien**: The right of the bailee to retain possession of the goods until payment or claims are settled.

- **Negligence**: Failure by the bailee to take proper care of the goods, potentially leading to liability.

## 12.8. SELF ASSESSMENT QUESTIONS

1. Explain the concept of bailment. Discuss in detail the rights and duties of a bailor under a contract of bailment.

2. Discuss the legal obligations of a bailee. How do these duties ensure the protection of the bailor's property?

3. Critically analyze the rule that a bailee cannot set up jus tertii (right of a third person) against the bailor. Are there any exceptions to this rule?

## 12.9. LESSON END EXCERCISES

1. Examine the mutual rights and duties of the bailor and bailee. How do these responsibilities contribute to a fair and functional bailment relationship?

2. To what extent is a bailee liable for the loss, damage, or unauthorized use of goods? Discuss with reference to relevant provisions of law.

3. Write an essay on the right of lien available to a bailee. Under what circumstances can a bailee exercise this right?

## 12.10. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT III**

**SEMESTER: III** **LESSON: 13**

# SPECIAL CONTRACT I

**STRUCTURE**



## 13.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and concept of pledge under the Indian Contract Act.
- To identify the essential elements of a valid pledge.
- To distinguish between pledge and bailment.
- To know the rights and duties of the pawnee (the person to whom goods are pledged).
- To know the rights and duties of the pawnor (the person who pledges the goods).
- To understand the concept of pledge by non-owners or persons with limited interest.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define the term pledge under the Indian Contract Act and understand the purpose and legal significance of a pledge.
- List the key requirements for a valid pledge.
- Recognize the legal capacity of parties to make a pledge.
- Distinguish between bailment and pledge based on purpose, rights and obligations, right to sell the goods.
- Identify the rights and duties of the pawnor and the pawnee.
- Understand conditions where non-owners or limited interest holders (like mercantile agents or co-owners) can make a valid pledge.

## 13.1. INTRODUCTION

The concept of pledge plays a significant role in the realm of commercial and contractual law, particularly in securing loans or obligations through movable property. A pledge is defined under the Indian Contract Act, 1872, as a special kind of bailment where goods are delivered by one party (called the pawnor) to another (called the pawnee) as **s**ecurity for the repayment of a debt or performance of a promise. Unlike a typical bailment, a pledge involves a specific intent to offer goods as collateral, with the assurance that the goods will be returned upon the fulfilment of the obligation. This legal arrangement not only helps in building trust between parties but also facilitates smooth credit transactions in trade and commerce. To create a valid pledge, certain essentials must be satisfied, such as delivery of movable goods, the presence of a debt or obligation, and the lawful capacity of the parties involved. While both pledge and bailment involve the transfer of possession, they differ in purpose, rights, and legal remedies. A pledge is always for securing an obligation, while a bailment may be for safekeeping, transportation, or use. The law also clearly defines the rights and duties of both the pawnee and the pawnor. The pawnee has the right to retain the goods until payment is made and may even sell them under certain conditions. However, they are also bound to take reasonable care of the goods and return them upon completion of the contract. On the other hand, the pawnor has the

right to redeem the goods and must fulfil the obligation or repay the debt. Furthermore, the law recognizes situations where even non-owners, such as mercantile agents or co-owners, can create a valid pledge under specific circumstances. Understanding these provisions ensures that the rights of both parties are protected and obligations are lawfully enforced.

## 13.2. MEANING OF PLEDGE

Pledge is a special kind of bailment. It is a transfer or bailment of goods as a security for the payment of a debt or performance of a promise. Every contract by which the possession of goods is transferred as security is deemed to be a pledge. The word pawn is synonymous with the word pledge. The bailor in this case is called the pledgor or pawnor and the bailee is called the pledge or the Pawnee. Thus, if A being in need of money, raises money from a money –lender on the security of his furniture, the transaction is one of pledge. The pledge is bound to return the furniture on the satisfaction of his debt.

According to section 172 of the Indian contract act 1872, "The bailment of goods as security for payment of a debt or performance of a promise is called pledge".

**For example:** A borrows Rs.100 from B and keeps his watch as security for payment of the debt. The bailment of watch is called a pledge.

Thus, a pledge is only special kind of bailment. Here goods are deposited with a lender or promise as security for the repayment of a loan or performance or promise. Otherwise, like bailment, a pledge also involves only a transfer of possession of goods pledged. The ownership remains with the pledgor. The pledge or pawnee has only a special interest in the goods pledged. The general interest remains in the pawnor and wholly reverts to him on discharge of the debt. Further, like bailment, a pledge is concerned with only movable goods. The movable goods include any kind of goods, valuables and documents of title, e.g., the railway receipt , bill of lading , etc. (Morvi Merchantile Bank V.Bank of India). Even a savings bank pass book issued by post office which must accompany any withdrawal and may be pledged (J&K Bank V.Tek Chand).

## 13.3. ESSENTIALS OF PLEDGE

The essentials elements of pledge according to section 172 are-

1. **Delivery of goods:** Delivery of goods to a pledge is necessary to constitute a pledge. The delivery to the pawnee may be actual or constructive. Delivery of the key of warehouse where the pledged goods are stored in a constructive delivery and are sufficient to create a pledge. A pledge involves a transfer of possession of goods pledged and not of title. The ownership remains with the pledgor or pawnor. Goods may be made the subject of pledge provided they are capable of delivery.

   **For example:** X, a producer of a film borrowed a sum of money from Y, a money lender. X agreed to deliver as a security the final prints of the film when they are ready, but they were never delivered. The court held that it was not a valid pledge as there was only an agreement to deliver the possession of final prints of the film, and not the actual or constructive transfer of possession (Revenue Authority V.Sunder Sanam Pictures, 1968).

2. **The delivery of goods should be by way of security:** A contract of pledge must be supported by a valid consideration. The pawnor must give some property of goods by way of security for securing a loan from the pawnee.

3. **The security being for the payment of a debt or performance of a promise:** A pledge is made to secure debts and obligations by delivery of some security. Debts may be present, past or future. The Pawnee does not acquire the right of ownership over the goods pledged, but he has a lien on the goods for the payment of a debt or performance of a promise.

## 13.4. Distinction between Bailment and Pledge

In both the cases there is a delivery of movable goods and obligations to return the goods to the actual depositor. But there are some points of difference as well:

a. In a pledge, the bailment in made as a security for the due discharge of a legal obligation. In ordinary bailment this is not so.

b. In case of gratuitous bailment, the bailee is bound to return the goods on demand by the bailor. On the other hand, pledgee is not bound to return the goods delivered as security on demand by the bailor unless and until the debt is repaid or promise is performed.

c. On a bailment of goods what passes to the bailee is a right of the possession of the goods bailed whereas on a pledge the pledge obtains a special property in the goods pledged.

d. A bailee has a right of lien on the goods bailed but no right of sale. A pledgee has such a right under certain circumstances.

e. In case of bailment, the bailee may use the goods bailed as per the terms of the contract. In a pledge, the pawnee has no right of using the goods.

**A. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. A pledge is a special kind of _____.
2. The person who gives goods as security is called _____. The person to whom goods are pledged is called _____.
3. In a pledge, _____ of goods is transferred, not ownership.
4. Delivery of goods is _____ for a valid pledge.
5. The pawnee has the right to _____ the goods if the pawnor defaults.
6. The pawnee must give _____ before selling the pledged goods.
7. In bailment, goods are delivered for a specific _____ and to be returned after use. In pledge, goods are delivered as _____ for a loan or debt.
8. In pledge, the pawnee cannot _____ the goods unless authorized.
9. A pledge without _____ is not valid.
10. A pledge is defined under Section _____ of the Indian Contract Act, 1872.
11. In pledge, ownership remains with the _____.
12. Only _____ goods can be pledged.

**ANSWERS: 1.Bailment, 2.Pawnor, Pawnee, 3.Possession, 4.Essential, 5.Sell, 6.Reasonable notice, 7.Purpose, Security, 8.Use 9.Consideration, 10.172, 11.Pawnor, 12.Existing and specific.**

## 13.5. Rights and Duties of Pawnee

1. **Right of retainer:** Section 173 entitles the pawnee to retain the goods pledged till he is paid not only the debt but also interest thereon, and all expenses incurred in respect of the possession or the preservation of the goods pledged. This section gives only a right to retain the goods and does not confer the power to sell.

2. **Right of particular lien :** A pawnee cannot retain the goods for any debt other than that for which the pledge was made. But in the absence of anything to the contrary he can retain the goods pledged for the subsequent advances (Sfection 174). This right does not extend to any previous debt due to the pawnee.

3. **Right to extraordinary expense:** Under section 173, a pawnee has a lien for necessary expenses only. But section 175 entitles the pawnee to recover from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. But he has no right of lien over the goods for extraordinary expenses. An example of extraordinary expenses is the cost of curing a pledged cow if it develops a disease.

4. **Right in case of default of the pawnor.** Where a pawnor makes default in the payment of the debt or performance of the promise, at the stipulated time, section 176 provides the following rights to the pawnor.

   (a) he may bring a suit against the pawnor upon the debt or promise and may retain the goods pledged as a collateral security ; or

   (b) he may sell the property pledged on giving the pawnor reasonable notice of the sale.

In case the sale proceeds are less than the amount due, the pawnor continues-to be liable to pay the balance; if the sale proceeds are greater than the amount due, the surplus shall be given to the pawnor. The right of the pawnor to sue upon the debt or promise does not exclude or destroy his right to sell the goods pledged. The pawnee's rights to sue or to sell the goods pledged are concurrent and not alternative rights. He may retain the goods and only sue for debt. It is not necessary that the notice of sale should specify the date, place or time of sale. But a sale without notice is void. A pawnee may sell the goods pledged either by public auction or private treaty. A pawnee cannot sell the pawned goods to himself. Such a sale would be void. A pawnee is under a duty to take reasonable care of the goods

pledged with him. Further the pawnee is not permitted to use the goods pledged, and if he does so, he will be responsible for damages for any loss caused due to such use. He is also bound to surrender the pledged goods on the payment of the debt.

**B. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

**1.** The pawnee has the right to retain the goods until the debt is repaid.
**2.** The pawnee can sell the pledged goods without giving any notice to the pawnor.
**3.** The pawnee has the duty to take reasonable care of the pledged goods.
**4.** The pawnee becomes the owner of the goods if the pawnor fails to pay the debt.
**5.** The pawnee can use the pledged goods for personal benefit.
**6.** The pawnee can sue the pawnor for recovery of the debt without selling the goods.
**7.** If the pledged goods are damaged due to the pawnee's negligence, the pawnee is liable.
**8.** The pawnee cannot return the goods to anyone other than the pawnor.
**9.** The pawnee has no duty to return the goods even after repayment.
**10.** The pawnee can retain the goods only for the specific debt for which they were pledged.
**11.** The pawnee must keep the goods separate from his own property.
**12.** The pawnee can claim ownership of the goods after the due date passes.

**ANSWERS: 1.T, 2.F, 3.T, 4.F, 5.F, 6.T, 7.T, 8.T, 9.F, 10.T, 11.T, 12.F.**

## 13.6. Rights and Duties of Pawnor

Where a pawnor defaults in payment of the pledge amount within the stipulated time, he can yet pay it before the actual sale is held. The right of redemption can only be exercised prior to actual sale. But he is bound to pay expenses that may have arisen from his default and which the pawnee had to bear (Section 177).

The pawnor has the right to take back the goods with increase, if any, that the goods have undergone during the period of pledge. In a case before the Delhi High Court the pledge was that

of certain shares of a company and during the period of pledge the company issued bonus shares. It was held that these increases belonged to the pawnor. [M.R. Dhawan V. Madan Mohan AIR 1969 Delhi 313].

## 13.7. Pledge by Non-Owners

It is only the owner of goods who can make a valid pledge of them. This rule is based on the maxim that no man can pass a better title than he himself has. This rule applies both to contracts of sale and contracts of pledge. A pledge made by any other person may not be valid. Thus for example where goods were left in the possession of a servant while the owner was temporarily absent, a pledge made by the servant was held to be invalid. Similarly where certain goods are left in the care of a person for some special purpose he cannot pledge them. A person, however, innocent who accepts in pledge goods from another, not the owner, acquires no lien on them except in certain cases.

Sections 178, 178-A and 179 provide the cases where a pledge of goods made by a person who is not the real owner is valid and binding.

1. **Pledge by a mercantile agent:** Section 178 provides that a pledge by a mercantile agent, which is not authorised by the owner of the goods, will be valid if the following conditions are fulfilled ;

   (a) The mercantile agent is in possession of goods or document of title to the goods ;

   (b) Such possession is with the consent of the owner;

   (c) The mercantile agent acts in the ordinary course of business while making the pledge ;

   (d) The pawnee acts in good faith ; and

   (e) The pawnee has no notice of the pawnor's defective title.

   All the above conditions must be satisfied before a valid pledge can be made by the mercantile agent.

   **For example:** A jewellery-broker was entrusted with a diamond for sale. He pledged it for his own purpose. It was a valid pledge.

   A salesman of a company pawned the goods of the company. The pawnee acting in good faith gets a perfect title.

Section 178 authorises only the mercantile agents and hence a pledge by a servant or by a person entrusted with goods for a specific purpose or by a wife is not valid even though in possession of goods with the consent with the owner.

2. **Pledge by person in possession under voidable contract:** Section 178A deals with a pledge made by a person who has obtained possession of goods under a contract voidable under section 19 or 19-A of the Contract Act. Possession in such a case is not obtained by free consent. A pledge made by a person who has obtained goods by fraud, misrepresentation, undue influence and coercion would be valid provided the following conditions are satisfied.

   (a) The contract under which the pawnor obtained possession of the goods has not been rescinded at the time of the pledge ;

   (b) The pawnee acts in good faith ; and

   (c) The pawnee has no notice of the pawnor's defective title.

   **For example:** A gets an ornament by inducing the owner to sell it to him by undue influence. Before the contract is rescinded by the owner, he pawns it to B. B will get a good title to the ornament provided he acted in good faith and was unaware of A's defective title. When goods are obtained by theft, a pledge by a thief will not be valid. A pawnee in such a case will acquire no lien over the goods.

3. **Pledge where pawnor has only a limited interest:** Section 179 lays down that where a pawnor has only a limited interest, the pledge can be valid only to the extent of that interest. Thus, where a person has only a mortgagee's interest or a mere lien, and he pledges the goods, pledge will be valid only to the extent of that interest. For example, A finds a watch on the road and repairs it spending Rs. 20. He pledges the watch to B for Rs. 40. The true owner C can recover the watch only on paying Rs. 20 to the pledgee.

4. **Pledge by a co-owner in possession:** Where there are several joint owners of goods and goods are in the sole possession of one of the co-owners with the consent of other co-owners, such a co-owner may create a valid pledge of goods.

5. **Pledge by seller or buyer in possession after sale:** A seller who has got possession of goods even after sale can make a valid pledge provided the pawnee acts in good faith. Similar is the rule in the case of a buyer.

## C. CHECK YOUR PROGRESS

- **MULTIPLE CHOICE QUESTIONS**

1. **What is the primary right of a pawnor?**
   A. To sell the goods
   B. To retain the goods
   C. To redeem the goods before sale
   D. To use the goods pledged
   **Answer:** C.
2. **Until when can the pawnor redeem the goods?**
   A. After the goods are sold
   B. At any time after the due date
   C. Before the actual sale by pawnee
   D. Never
   **Answer:** C.
3. **Which of the following is NOT a duty of the pawnor?**
   A. To pay the debt
   B. To provide full ownership
   C. To compensate for expenses
   D. To disclose any defects in goods
   **Answer:** B.
4. **Under which condition can a non-owner make a valid pledge?**
   A. When goods are stolen
   B. When he has no interest
   C. When he is a mercantile agent acting in the ordinary course of business
   D. When he is a thief
   **Answer:** C.
5. **A pledge by a mercantile agent is valid if _____.**
   A. He is in possession lawfully
   B. He owns the goods
   C. The goods are gifted to him
   D. He hides the goods
   **Answer:** A.
6. **Which section of the Indian Contract Act deals with pledge by non-owners?**
   A. Section 172
   B. Section 176
   C. Section 178
   D. Section 148
   **Answer:** C.
7. **A pledge by a person in possession under a voidable contract is valid if _____.**
   A. The contract is rescinded before the pledge
   B. He has no knowledge
   C. He acts dishonestly
   D. He pledges to himself
   **Answer:** A.
8. **A pledge made by a person with limited interest is valid to the extent of _____.**
   A. Market value
   B. Full value of goods
   C. His own interest
   D. Pawnee's interest
   **Answer:** C.

## 13.8. LET US SUM UP

A pledge is a legal arrangement where movable goods are delivered by a debtor (pawnor) to a creditor (pawnee) as security for a loan or performance of an obligation. For a pledge to be valid, it must meet certain essential elements, including the delivery of goods, lawful purpose, and rightful possession. Though a pledge is a form of bailment, it is distinct in its purpose and the rights it grants to the pawnee, such as the right to sell the goods in case of default. Both the pawnor and pawnee have clearly defined rights and duties to ensure fair conduct and legal protection. Additionally, a pledge can also be created by certain non-owners, like mercantile agents or persons with limited interest, under specific legal conditions. This topic provides a well-rounded understanding of the concept, differences, and legal implications of a pledge in contractual relationships.

## 13.9. KEYWORDS

- **Pledge**: A bailment of goods as security for the repayment of a debt or performance of a promise.
- **Pawnor**: The person who delivers goods as security (the borrower).
- **Pawnee**: The person to whom the goods are delivered (the lender).
- **Bailment**: A legal relationship in which the owner delivers goods to another for a specific purpose, with the promise of return.
- **Movable Property**: Goods that can be physically moved and are eligible for pledge (e.g., gold, vehicles, stocks).
- **Delivery of Goods**: The act of physically or constructively handing over the goods to the pawnee for the pledge to be valid.
- **Right to Retain**: The pawnee's right to keep the pledged goods until the debt or obligation is fulfilled.
- **Right to Sell**: The pawnee's right to sell the pledged goods after giving reasonable notice if the pawnor defaults.
- **Duties of Pawnee**: Obligations like taking reasonable care of goods and not using them.
- **Duties of Pawnor**: Obligations such as repaying the loan and compensating for any loss or expense.

- **Constructive Delivery**: A legal form of delivery where possession is transferred without physical handing over.
- **Pledge by Non-Owners**: Valid pledge made by persons other than the actual owner (e.g., mercantile agents, co-owners).
- **Voidable Contract**: A contract that is valid unless cancelled by one of the parties; goods obtained under such a contract may be pledged.
- **Limited Interest**: When a person has partial rights in goods (e.g., a finder or bailee), and can pledge only to that extent.

## 13.10. SELF ASSESSMENT QUESTIONS

**1.** Discuss the key differences between a bailment and a pledge. How is a pledge considered as a special type of bailment?

2. Delivery of possession is essential in a pledge." Explain this statement with reference to the essentials of a valid pledge.

**3.** Discuss the legal implications and rights of both parties when the pawnor defaults in payment or performance of obligation.

## 13.11. LESSON END EXCERCISES

1. Explain the meaning of a pledge. What are the essential elements required for a valid pledge under the Indian Contract Act?

2. Who is a Pawnee? What are the rights and duties of a pawnee in a contract of pledge? Illustrate with examples.

3. Under what circumstances can a valid pledge be made by a person who is not the actual owner of the goods? Explain the legal provisions related to pledge by non-owners.

## 13.12. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT III**

**SEMESTER: III** **LESSON: 14**

# SPECIAL CONTRACT I

**STRUCTURE**



## 14.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and legal definition of a contract of indemnity.
- To identify the essentials required to constitute a valid contract of indemnity.
- To recognize the rights of the indemnity holder (indemnified party).
- To understand the rights of the indemnifier in a contract of indemnity.
- To apply the concepts in legal or commercial situations involving indemnity.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define indemnity and explain its meaning under contract law.
- Identify and explain the essential elements of a valid contract of indemnity.
- Distinguish between express and implied contracts of indemnity.
- Describe the legal rights of the indemnified (indemnity holder) under a contract.
- Understand and explain the rights of the indemnifier.
- Apply the principles of indemnity to real-life legal and commercial scenarios.
- Analyze how indemnity protects parties from financial loss due to the actions of others.
- Interpret key legal provisions and relevant case laws (if applicable) related to indemnity.

## 14.1. INTRODUCTION

A contract of indemnity is a significant concept in the field of contract law, primarily aimed at offering protection against financial losses. It involves a legal agreement in which one party, known as the indemnifier, promises to compensate the other party, known as the indemnity holder, for any loss or damage that may occur due to the actions of the indemnifier or a third party. This type of contract is commonly used in commercial transactions, insurance policies, and other financial arrangements to manage and allocate risk between parties. To constitute a valid contract of indemnity, certain essential elements must be present. These include lawful consideration, mutual consent, and a clear intention to indemnify. The contract may be express or implied and must comply with the general principles of the Indian Contract Act or relevant legal framework. The indemnity holder is granted several rights, such as claiming damages, legal costs, and other amounts incurred while defending a legal claim. Simultaneously, the indemnifier also holds specific rights, including being notified of legal claims and the right to defend the action. Understanding these aspects is crucial for parties entering into such agreements, as it helps ensure fair risk distribution and legal protection in case of unforeseen events.

## 14.2. MEANING AND DEFINITION OF INDEMNITY

Section 124 to 127 of the Indian contract covers contract of indemnity. “A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the

conduct of any other person, is called a contract of indemnity" [section 124].

A contract of indemnity is really a part of the general class of contingent contracts. It is entered into with the object of protecting the promise against anticipated loss. The contingency upon which the whole contract of indemnity depends is the happening of loss.

The person who promises to make good the loss is called the indemnifier (Promisor), and the person whose loss is to be made good is called the indemnified or indemnity holder (Promisee).

**For example:** A contract to indemnify B for the likely loss to B incase of not going to Bombay in connection with a business transaction. This is a contract of indemnity where in the object is to indemnify the promise for loss caused to him by the conduct of the promisor himself. A is called the indemnifier and B the indemnity holder.

It may be noted that the definition of the contract of indemnity as given in section 124 of the Indian contract act, is not exhaustive. By this definition, the scope of indemnity is restricted to the cases where there is express promise to indemnify against the loss caused (a) by the promisor himself; or (b) by any other person. In other words, the express promise to indemnify must be to indemnify against the loss caused by the human acts. This definition excludes the (a) implied promise to indemnify; and (b) cases of loss arising from accidents and events not depending on conduct of human beings, e.g., accidental fires, perils of the sea, etc. Thus, the expression contract of indemnity in section 124 has been used in the narrow sense. The general law about contract of indemnity is much wider than the contract of indemnity, as defined in section 124. According to the general law about contract of indemnity, the losses arising from accidents or events, which do not depend on the conduct of human beings, are also covered by a contract of indemnity in a wider sense. According to the English law, a contract of indemnity means, "A promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor". This definition includes a promise of indemnity against the loss arising from any cause whatsoever e.g., fire, perils of sea, accidents, etc. Thus, it is not necessary that the loss must be caused by human beings. Keeping in view, the wider concept of contract of indemnity, the contracts of fire insurance and marine insurance are always regarded as contracts of indemnity.

The principle of indemnity is not confined to principal and agent or vendor or the vendees but is a general rule though sections 124 and 125 deal only with express promises of indemnity. A duty to indemnity may also be available by operation of law, e.g., a duty of a principal to indemnify an

agent from the consequence of all lawful acts done by him as an agent [section 223].

Thus, it would be observed that a contract of indemnity is a contingent contract, i.e., has to be performed on the happening of a certain event and which event may cause loss to be promise or the indemnity holder. It may be pointed out here that it is not a wagering agreement in which case the object is not to protect or save the promisee from any loss which the latter might suffer on the happening of the contingency. Thus, it may be made clear that a contract of indemnity does not deal with those cases where a loss is caused by an event or accidents which do not or may not depend upon the conduct of the indemnity or any other person, e.g., if a ship is sunk due to a storm, the loss is not covered by a contract of indemnity because the loss is not caused by the promisor or any other person.

It may be noted that a person may undertake to say the other from loss caused to him, by the conduct of a third person either at the request of the third person or without any request from such third person. In the first case, there would be a contract of guarantee and the third person would be responsible to the surety. In the latter, case there would be a contract of indemnity and the third person i.e., debtor cannot be held responsible to the indemnifier, as there is no privity of contract between them.

A contract of indemnity, being a species of contract, must have all the essential elements of a valid contract; and an indemnity given under coercion or for an illegal object cannot be enforced. Further, a contract of indemnity may be express or implied. For example, there is an implied promise to indemnify agent by the principal in a contract of agency. Similarly, when shares are transferred the transferee is impliedly bound to indemnify the transferor against future calls made before the registration of transfer.

## 14.3. ESSENTIALS OF CONTRACT OF INDEMNITY

1. **Two Parties**

   There must be two parties in a contract of indemnity, the Indemnifier (the one who promises to compensate), and the Indemnified / Indemnity Holder (the one who is protected against loss). Both parties must be legally competent to contract.

2. **Express or Implied Agreement**

   A contract of indemnity may be express, which means **c**learly stated in words (written or spoken), or **i**mplied**,** which means arising from the conduct of the parties or circumstances, such as the role of an agent acting on behalf of a principal.

3. **Intention to Create Legal Obligation**

   The agreement must be made with the intention to create a legal obligation, not a casual or social promise. This ensures enforceability under law.

4. **Compliance with General Principles of Contract Law**

   This contract being specie of contract is subject to all the rules of contract, such as free consent, legality of object, mutual agreement, capacity to contract, etc.

5. **Loss Must Be Caused**

   A contract of indemnity is enforceable only when the promise suffers a loss the happening of which is unknown. The indemnity holder entitled to enforce the contract only if he suffers the loss against which the indemnity holder was promised to be protected.

6. **Lawful Consideration and Object**

   Consideration in the case of contract of indemnity is essential to enable the indemnity holder to claim to be compensated. Like all valid contracts, the object (purpose) and consideration of the indemnity must be lawful. Any illegal objective makes the contract void.

   **For example:** A agrees to indemnify B if the latter published a defamatory article in his newspaper against C. If C sues B and is fined, he cannot recover fine from A inspite of his promise to indemnify B.

**Commencement of Indemnifier's Liability Controversy Settled:**

In the Indian Contract Act, there is no provision regarding the time of commencement of indemnifier's liability under the contract. Thus, for the purpose of knowing the time of commencement of indemnifier's liability i.e., when does the indemnifier become liable to pay, we have to look into the observations of the courts in various judicial decisions. There is difference of opinion among the different High Courts, like Lahore, Nagpur, etc. have held that the indemnifier is not liable until the indemnified (i.e., indemnity holder) has incurred an actual loss. In other words, the indemnifier becomes liable to pay only after the indemnity holder had suffered actual loss by paying of the claim.

On the other hand, some high courts like Madras, Allahabad, Calcutta, Bombay, etc. have held that the indemnifier becomes liable to pay even before the indemnity –holder had incurred actual loss. In the other words, the indemnity-holder can compel the indemnifier to make good his loss even before he had suffered actual loss by paying off the claim. It may be noted that the latter view appears to be more correct. If the payment is a condition, precedent to recovery, the contract may be of little value to the person to be indemnified, who may be unable to meet the claim in the first instance.

**Limitation:** Any suit filed before the actual loss incurred will be dismissed as premature as the cause of action arises when the damage is suffered.

Adamson V.Jarvis, 1827: The plaintiff, an auctioneer, sold cattle under instructions from the defendant. The cattle did not belong to the defendant. The true owner held the auctioneer liable, and the auctioneer in turn sued the defendant for the loss he suffered by acting as the agent of the defendant. The court held that the plaintiff was entitled to assume that he would be indemnified by the defendant.

**A.CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. **A contract of indemnity is defined under Section 124 of the Indian Contract Act.**
   ✓ **True**
2. **Indemnity can only be claimed after the indemnifier has suffered actual loss.**
   ✗ **False** – Indemnity can be claimed even when liability becomes absolute, not necessarily after the loss is suffered.
3. **There must be at least three parties involved in a contract of indemnity.**
   ✗ **False** – Only two parties: the indemnifier and the indemnified (or indemnity holder).
4. **The purpose of an indemnity contract is to hold the indemnified harmless from loss.**
   ✓ **True**
5. **Indemnity can only arise from an express agreement.**
   ✗ **False** – It can be either **express** or **implied** from the circumstances.
6. **In indemnity, the liability of the indemnifier is contingent upon the occurrence of a loss.**
   ✓ **True**
7. **A contract of indemnity is valid even if the consideration is not lawful.**
   ✗ **False** – Like all contracts, it must have lawful consideration to be valid.
8. **The indemnity holder can sue the third party in his own name under all circumstances.**
   ✗ **False** – Generally, it is the indemnifier who has the right to sue after paying the indemnified's loss.
9. **The indemnifier's liability is limited to the actual loss suffered by the indemnity holder.**
   ✓ **True**
10. **An indemnity contract can never be a part of a commercial transaction.**
    ✗ **False** – Indemnity contracts are **commonly used** in commercial transactions.

## 14.4. Rights of Indemnified/Indemnity Holder

The indemnified (or indemnity holder) is the person who is protected against loss in a contract of indemnity**.** Under Section 125 of the Indian Contract Act, 1872, the indemnity holder has specific rights when sued by a third party.

For the sake of clarity, we shall be discussing the rights of indemnity-holder when sued with the help of an example. Suppose a vendor contracts to indemnify the vendee against the costs of litigation if title to the property is disturbed and the vendee is sued by a rival owner, then the vendee i.e., the indemnity-holder has the following rights against the vendor i.e., the indemnifier:

**1.** he is entitled to **recover all damages** which he may be compelled to pay in respect of suit to which the promise to indemnify applies.

**2.** he is entitled to **recover all costs reasonable incurred**, in bringing or defending such suit , provided he acted prudently or with the authority of the promisor (indemnifier).

**3.** he is also entitled to **recover all sums which he may have paid under the terms of any comprise** of any such suit, provided the compromise was not contrary to the orders of the indemnifier and was prudent or was authorized by the promisor (indemnifier).

**4.** The essence of indemnity is the **right of the indemnified to not suffer loss or right to be held harmless**. So he have the right to be placed in the same position as he would have been if the contract had been properly performed or no loss occurred.

In short, the indemnity-holder can recover from the indemnifier, all damages, all costs of the suit and compromise money , if any, provided he acted prudently or with due authority of the indemnifier.

## 14.5. Rights of Indemnifier

The act makes no mention of the rights of an indemnifier. It has been held [Jaswant Singh Ji V. Section of State 14 Bom.299] that the rights, in such cases, are similar to the rights of the suety under section141, viz, he becomes entitled to the benefit of all the securities which the creditor has against the principal debtor whether he was aware of them or not.

**B. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

1. **Which of the following is a right of the indemnified (indemnity holder)?**
   A. Right to sue third parties directly
   B. Right to compel indemnifier to perform unlawful acts
   C. Right to recover damages and costs from indemnifier
   D. Right to cancel the contract unilaterally
   **Answer: C**
2. **Which of the following is a duty of the indemnifier?**
   A. To act as a guarantor
   B. To compensate for lawful losses only
   C. To refuse payment if no suit is filed
   D. To modify the contract terms unilaterally
   **Answer: B**
3. **The indemnity holder is entitled to recover all EXCEPT:**
   A. Lawful damages
   B. Costs incurred in defending a suit
   C. Amounts paid voluntarily without legal obligation
   D. Sums paid under court orders
   **Answer: C**
4. **The indemnifier becomes liable to pay:**
   A. Only when the indemnity holder files a suit
   B. Only after actual loss is suffered
   C. As soon as liability of indemnity holder becomes absolute
   D. When the indemnity holder demands payment regardless of circumstances
   **Answer: C**
5. **Which of these is a right of the indemnifier after compensating the indemnity holder?**
   A. To recover money from the third party (subrogation)
   B. To cancel the contract
   C. To terminate the indemnity holder's rights
   D. To sue the court for issuing orders
   **Answer: A**
6. **A duty of the indemnity holder is to:**
   A. Hide material facts
   B. Cooperate with the indemnifier
   C. Avoid informing the indemnifier
   D. Take action without legal advice
   **Answer: B**
7. **Which of the following is NOT a valid ground to refuse indemnity?**
   A. Loss caused by negligence of indemnity holder
   B. Fraud by the indemnity holder
   C. Indemnified took action in good faith under legal obligation
   D. The indemnity holder incurred expenses under court direction
   **Answer: C**
8. **The rights of the indemnity holder arise when:**
   A. The indemnity contract is signed
   B. The indemnifier suffers a loss
   C. The indemnity holder's liability becomes certain
   D. Both parties agree to terminate the contract
   **Answer: C**

## C. CHECK YOUR PROGRESS

- **ONE-LINER QUESTIONS**

1. **Q:** Under which section of the Indian Contract Act is indemnity defined?
   **A:** Section 124
2. **Q:** How many parties are there in a contract of indemnity?
   **A:** Two
3. **Q:** What is the primary purpose of an indemnity contract?
   **A:** To protect against loss
4. **Q:** Who promises to compensate in an indemnity contract?
   **A:** Indemnifier
5. **Q:** Who is protected in an indemnity contract?
   **A:** Indemnity holder
6. **Q:** Can an indemnity contract be implied?
   **A:** Yes
7. **Q:** Does a contract of indemnity require lawful consideration?
   **A:** Yes
8. **Q:** Is indemnity limited to contracts only in writing?
   **A:** No
9. **Q:** Can indemnity be claimed before actual loss occurs?
   **A:** Yes
10. **Q:** Is a contract of indemnity valid in commercial transactions?
    **A:** Yes
11. **Q:** What is the liability of the indemnifier based on?
    **A:** Loss or anticipated liability
12. **Q:** What kind of loss is covered in indemnity—past or future?
    **A:** Future (anticipated)
13. **Q:** What is the nature of indemnity—contingent or absolute?
    **A:** Contingent
14. **Q:** Does indemnity apply to criminal liability?
    **A:** No
15. **Q:** Is indemnity applicable when the act is unlawful?
    **A:** No

## 14.6. LET US SUM UP

A contract of indemnity plays a vital role in safeguarding parties from financial loss arising from specific events or actions. It is defined as a legal agreement where one party promises to compensate another for the damage or loss suffered. For such a contract to be valid, it must meet certain essential elements, including mutual consent, a lawful purpose, and the presence of actual or potential loss. The indemnity holder is entitled to recover all legitimate expenses, damages, and costs incurred while acting within the scope of the agreement. On the other hand, the indemnifier holds certain rights, such as defending the claim and receiving notice of legal actions. Together, these components ensure a fair and balanced indemnity relationship, fostering trust and accountability between the parties involved.

## 14.7. KEYWORDS

- **Indemnity:** A legal promise by one party to compensate another for loss or damage incurred.
- **Contract of Indemnity:** An agreement where one party undertakes to protect the other from specific losses.
- **Indemnifier:** The person who promises to compensate for the loss; the party giving the indemnity.
- **Indemnity Holder / Indemnified**: The person who is protected against the loss; the party receiving the indemnity.
- **Express Contract**: A contract clearly stated in words, either spoken or written.
- **Implied Contract**: A contract formed by actions or conduct of the parties rather than written or spoken words.
- **Loss or Damage**: Any harm or financial detriment that the indemnity holder may suffer.
- **Compensation**: Money or benefits provided to cover a loss or injury.
- **Legal Costs**: Expenses incurred by the indemnity holder in defending or settling a legal claim.
- **Good Faith**: Acting honestly and with sincere intention, especially in legal dealings or settlements.
- **Notice of Claim**: An official intimation to the indemnifier that a legal claim or loss has occurred.
- **Reimbursement**: The act of repaying someone for expenses or losses they have incurred.

## 14.8. SELF ASSESSMENT QUESTIONS

1. Discuss how contracts of indemnity are applied in insurance law. Provide examples from real-life commercial situations.

2. Compare and contrast the roles and responsibilities of the indemnifier and the indemnified in a contract of indemnity.

3. Examine the remedies available to an indemnity holder if the indemnifier fails to perform their obligations.

## 14.9. LESSON END EXCERCISES

1. What are the essential elements of a valid contract of indemnity? Discuss each element in detail.

2. Evaluate the importance of good faith and full disclosure in the formation and execution of a contract of indemnity.

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**3.** Explain the rights of the indemnity holder under a contract of indemnity. How do these rights protect the indemnified party?

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## 14.10. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT III**

**SEMESTER: III** **LESSON: 15**

# SPECIAL CONTRACT I

**STRUCTURE**



## 15.0. Learning Objectives and Outcomes

**Learning Objectives**

- To define and explain the meaning and purpose of a contract of guarantee in legal and commercial contexts.
- To recognize and describe the roles of the three parties, creditor, principal debtor, and surety, in a contract of guarantee.
- To identify and explain the legal requirements and essentials for a valid contract of guarantee, including consideration, consent, and enforceability.

- To distinguish between a contract of indemnity and a contract of guarantee, focusing on differences in parties, liability, and legal obligations.
- To understand the rights and obligations of the creditor in relation to the surety and the principal debtor.
- To explain the nature, scope, and extent of the surety's liability, including when and how the liability arises or is discharged.
- To identify and describe the various rights of the surety, such as subrogation, indemnity, contribution, and right to securities, after fulfilling the obligation.
- To apply the principles of contracts of guarantee to practical scenarios and case studies to assess liability and enforceability.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define and explain the concept and purpose of a contract of guarantee in legal and financial contexts.
- Identify and describe the roles of the three main parties involved—surety**,** principal debtor**,** and creditor**.**
- List and explain the essential elements required for a valid contract of guarantee, such as free consent, consideration, and lawful object.
- Differentiate clearly between a contract of indemnity and a contract of guarantee, highlighting key distinctions in structure, liability, and application.
- Explain the rights and obligations of the creditor, including their duty to act in good faith and to protect the interests of the surety.
- Analyze the nature and extent of the surety's liability, including the principle of co-extensive liability and circumstances leading to discharge.
- Identify and discu**ss** the rights of the surety—such as the right of subrogation, indemnity, contribution, and access to securities.
- Apply legal principles of contracts of guarantee to hypothetical or real-life case scenarios to determine legal consequences.

## 15.1. INTRODUCTION

The topic ″Contract of Guarantee″ is a crucial area within the law of contracts, particularly relevant in financial and commercial dealings where credit is extended. A contract of guarantee involves three key parties: the creditor, the principal debtor, and the surety. It serves as a legal assurance by the surety to fulfil the obligations of the principal debtor in case of default. Understanding the learning objectives of this topic is essential for developing a sound grasp of how guarantees operate in both personal and business contexts. One of the fundamental learning objectives is to understand the essentials of a valid contract of guarantee, which include the presence of three parties, mutual consent, a lawful object, and valid consideration. Learners are expected to explore the necessary elements that make such a contract enforceable in the eyes of law. Another objective is to distinguish between a contract of indemnity and a contract of guarantee, as both serve protective purposes but differ in structure, liability, and legal implications. This distinction is essential for correctly applying the relevant legal principles in real-life situations. Further, students will examine the rights and obligations of creditors, understanding the responsibilities they owe to both the surety and the principal debtor, and how their conduct can impact the surety's liability. The topic also delves into the nature and extent of the surety's liability, emphasizing that the surety's responsibility is typically co-extensive with that of the principal debtor, unless otherwise agreed. Lastly, the topic focuses on the rights of the surety, including subrogation, indemnity, contribution, and access to securities, which safeguard the surety's interests after fulfilling the guarantee. Through this topic, learners will gain the ability to analyze, interpret, and apply the legal concepts of guarantee contracts in various legal and commercial scenarios.

## 15.2. CONTRACT OF GUARANTEE

Where a person gives a guarantee to another person, either to (a) performing a promise or (b) discharging the liability of a third person, there arises a "Contract of Guarantee" According to section 126 of the Contract Act, "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 or guarantor, and 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.

**For example:** A lends Rs. 5000 to B on C's promise to pay the same if B fails to pay within a year.

This is a contract of guarantee.

A contract of guarantee may be either oral or written. It may be expressed or implied and may even be inferred from the conduct of the parties concerned. A contract of guarantee is entered into with the object of enabling a person to get a loan or goods on credit or an employment. A guarantee may be either oral or written [section 126].

**For example:** A, advances a loan of Rs.5,000 to B and C promises to A that if B does not repay the loan,C will do so. This is a contract of guarantee. Here B is the principal debtor, A is the creditor and C is the surety or guarantor. It is important that C must stand surety at the request of B, because then only there will be privity of contract between C and B and it will be a contract of guarantee between A and C. If without B's request C promises to pay on default, it will be a contract of indemnity.

On the request of B, A promises the employer of B that if B makes a default he shall make good the same to him. There is a contract of guarantee.

It may be noticed that in a contract of guarantee, there are three separate contracts-one between the principal debtor and the creditor, the second between the creditor and the surety, and the third between the surety and the principal debtor where in the principal debtor requests the surety to act as surety and impliedly promises to indemnify the surety in case the surety incurs liability.

It is of the essence of a contract of guarantee that there should be a liability, existing or future, enforceable at law. Thus, a guarantee given for a non-enforceable obligation e.g., a time barred debt is not good (Manju Mahadeo V, Shivappa Manju). However, a guarantee given for the debt of a minoris an exception to this rule. It has been held in Kashiba V.Sharipat that where a minor's debt has been knowingly guaranteed, the surety is liable as a principal debtor although the debt transaction, in itself, is void and unenforceable. It must be observed that when the debt of a minor, which is void ab initio, is guaranteed, the contract between the surety and the creditor will be enforced as for there is a direct contract between them. The contract of the so-called surety is regarded not a collateral but a principal contract. In fact, in such a case there cannot be a contract of guarantee in the true sense.

The Bombay High Court considered the question in Manju Mahadeo V.Shivappa Manju, supra and held that "if a minor could not default, the liability of the guarantee being secondary does not arise at all". Similar, decision has given by Madras High Court in Edvavan Nambiar V.Moolaki Raman.

**Consideration for Guarantee**

A contract of guarantee, like every other contract, must also satisfy all the essential element of a valid contract, e.g., genuine consent, legality of object, competency of parties, etc. it should also be supported by some consideration. But there need be no direct consideration between the surety and the creditor and the consideration received by the principal debtor is sufficient for the surety. Section 127 expressly provides to this effect and states that , "anything done, or any promise made, for the benefit of principal debtor, may be a sufficient consideration to the surety for giving the guarantee".

**For example:** A requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is sufficient consideration for C's promise.

## 15.3. ESSENTIALS OF CONTRACT OF GUARANTEE

Following are the essentials of a valid guarantee:

1. **Existence of a principal debt:** A contract of guarantee pre-supposes the existence of a liability enforceable at law. If no such liability exists, there can be no contract of guarantee. Thus, where the debt which is sought to be guaranteed is already time barred or void the surety is not liable.

   **For example:** A bank made an overdraft to a customer. The overdraft was guaranteed by D. The overdrafts were contrary to a statue, which not only imposed penalty upon the parties to such a drafts but also made them void. The customer having defaulted, D was sued for the loss. It was held that D was not liable. The court observed, "If no debt is due, if the banker is forbidden from having any claim against his customer, there is no liability incurred by the surety". [Iwan V.Bank of Scotland, 1836].

   Sometimes a guarantee for a void debt may be held enforceable.

   a. Where a minor's debt has been guaranteed, the surety is liable although minor himself is not liable to pay it.

   b. Where the directors of a company guarantee their company's loan which is void being ultravires, the directors are liable.

2. **Valid contract:** A contract of guarantee is just like any other contract may be either oral or in writing. Similarly, other essentials of a valid contract viz; competency of the parties, free consent, consideration, lawful object, etc., must be there in order to make the contract enforceable by law. However, consideration need not be a benefit to the surety himself. It may be a benefit to the principal debtor. In any case, the presence of lawful consideration, whether valuable or not, must be there to make the contract valid.

3. **Tripartite agreement:** Every contract of guarantee involves three agreements between (i) the creditor and the principal debtor, (ii) the surety and the creditor, and (iii) the surety and the principal debtor. The contract between the surety and the principal debtor is one of indemnity. Principal debtor indemnifies the surety that if the surety pays the amount in case of default committed by him, he (principal debtor) will indemnify the surety in case of loss such a contract is always implied.

4. **Secondary liability:** The test which applied to determine whether the contract is one of guarantee or indemnity is whether the obligation has been undertaken at the debtor's request in which case the contract is one of guarantee. If the obligation is undertaken without any request of the debtor, the contract is one of indemnity. The intention of the parties is also important whether making them primarily or collaterally liable. Hence, the promise to be primarily and independently liable is not a guarantee, though it may be an indemnity. Hence, in a court of guarantee the primary liability is with the principal debtor.

5. **Existing liability:** It is necessary that the principal contract must be in existence at the time of contract of guarantee is made, the original contract by which the principal debtor undertakes to repay the money to the creditor may be about to come into existence. Further, the liability under the contract of guarantee may either be personal or proprietary according to the terms of contract.

6. **The promise to pay must be conditional:** It is another important essential element of a contract of guarantee. There must be a conditional promise to be liable on the default of the principal debtor. In other words, the liability of the surety should arise only when the principal debtor makes a default. Any liability, which is incurred independently of the default of the principal debtor, is not within the definition of guarantee.

7. **Consideration:** A contract of guarantee, being a specie of contract, is subject to all the rules of a valid contract. Something, done for the benefit of the principal debtor is considered as consideration for the guarantee to make the contract valid. The legal detriment incurred by the promise at the promisor's request is sufficient to constitute the element of consideration.

8. **Competency:** The principal debtor, surety and creditor must be person competent to contract. However, under certain circumstances, a surety is liable though the principal debtor is not .i.e., the original contract is void as in the case of a contract with a minor the surety is liable not only as surety but also as a principal debtor.

9. **Consent:** There must be free consent; otherwise the contract of guarantee may become void or voidable. Generally, a contract of guarantee is not a contract of utmost good faith. i.e., uberrimae fidei, but it is sometimes a first cousin to it. Mere non-disclosure will not affect the contract of surety ship unless there is intentional concealment. Where the guarantee is take for good behaviour of an employee, the employer must disclose any misconduct of the principal debtor in his office of which he is aware. Normally, concurrence of all the parties must be there for a valid contract of guarantee.

**A.CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. A contract of guarantee always requires consideration to be valid.
2. In a contract of guarantee, there are only two parties involved.
3. The surety's liability arises only when the principal debtor defaults.
4. A guarantee can never be oral; it must be in writing to be valid.
5. The surety is liable only to the extent of the amount guaranteed.
6. If the creditor changes the terms of the contract with the principal debtor without the surety's consent, the guarantee may be discharged.
7. A continuing guarantee is applicable only for a single transaction.
8. The guarantee is not enforceable if the principal debt is void.
9. Co-sureties always share liability equally by default.
10. A minor can be a surety in a contract of guarantee.

**ANSWERS: 1.T, 2.F, 3.T, 4.F, 5.T, 6.T, 7.F, 8.T, 9.T, 10.F**

## 15.4. Distinguish Between a Contract of Indemnity and a Contract of Guarantee

The following are the points of distinction between the two:-

**1.** In a contract of indemnity, there are two parties-the indemnifier and the indemnity-holder. In a contract of guarantee, there are three parties- the creditor, the principal debtor and the surety.

**2.** In a contract of indemnity, the liability of indemnifier is primary in nature. In a contract of guarantee, the liability of the surety is secondary, i.e., the surety is liable only on default of the principal debtor.

**3.** In a contract of indemnity, the indemnifier acts independently without any request of the debtor or the third party. Whereas in a contract of guarantee, it is necessary that the surety should give the guarantee at the request of the debtor.

**4.** In a contract of indemnity, the liability of the indemnifier arises only on the happening of a contingency, where as in a contract of guarantee there is an existing legal debt or duty, the performance of which is guaranteed by the surety.

**5.** In a contract of guarantee, the surety, after he discharges the debt owing to the creditor, can proceed against the principal debtor in his own right. But in the case of a contract of indemnity, the indemnifier cannot sue the third party for loss in his own name, because there is no privity of contract. He can do so only, if there is an assignment in his favour, otherwise he must bring the suit (against the third party) in the name of the indemnified.

**6.** A contract of indemnity is for the reimbursement of loss, whereas a contract of guarantee is for the security of a debt or good conduct of an employee.

**7.** In indemnity there is only one contract between the indemnifier and the indemnified, while in guarantee, there are three contracts-one between the principal debtor and the creditor, the second between the creditor and the surety, and the third between the surety and the principal debtor.

**8.** A contract of guarantee is not a contract of uberrimae fidei i.e., one requiring complete disclosure of all the material facts by the principal debtor or the creditor to the surety before the contract is entered into by him. Thus, when a guarantee is given to a bank, it is not

bound to inform the surety of matters affecting the credit of the debtor, or of any circumstances connected with the transaction which may render the position of the surety more onerous. However, it is the duty of a party taking a guarantee to put the surety in possession of all the facts likely to affect the degree of his responsibility, and if he neglects to do so it is his peril. The contract of guarantee is invalid in the following cases:-

i) **Misrepresentation:** Any guarantee which has been obtained by means of representation made by the creditor, or with his knowledge and assent concerning a material part of the transaction is invalid (Section 142).

ii) **Concealment:** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid (section 143).

**For example:** D was invited to give a guarantee for the fidelity of a servant. The employer had earlier dismissed the servant for dishonesty, but did not disclose these facts to D. the servant committed embezzlement. The surety was held not liable. "The surety believed that he was making himself answerable for a presumably honest man not for a known thief",[London General Onmibus Co.V.Holloway,1912].

iii) **When co-surety does not join:** When a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

## 15.5. Rights and Obligations of the Creditor

### a) Rights against Surety

The rights of a creditor against the surety are:

1. **Demand payment when due:** As the liability of the surety arises, the creditor is entitled to demand payment from the surety although the debt is time-barred against the principal debtor [Bombay Dyeing and Manufacturing Co. Ltd.V.State of Bombay, 1958] or principal debtor has been adjudged as bankrupt or the principal debtor's contract is void or voidable. He can file a suit against the surety without suing the principal debtor, even if the principal debtor is solvent. The liability of the surety is

immediate and not be deferred until the creditor has exhausted his remedies against the principal debtor.

2. **Proceed against surety before restoring to debtor/securities:** A creditor can directly proceed against the surety before restoring to the securities deposited by the principal debtor. Although the liability of the surety becomes the primary one along with the principal debtor. Of course, the contract may specifically provide that the creditor must exhaust his remedies against the principal debtor or give notice or proceed against the securities.

3. **Claim for legal expenses:** A creditor can claim the cost of fruitless legal suit against the principal debtor sued at the request of the surety i.e., the right of indemnity. If the surety has any account with the creditor (banker), the latter has the general lien either on the balance of the former's account or on the securities (of the surety in his possession).

4. **Prove against the official receiver in case of surety's insolvency:** If the surety becomes insolvent, the creditor has the right to recover the dues from the estate of the insolvent party. But the surety's liability should first be determined by recalling the loan from the principal debtor and only in case of the latter's default the creditor can claim the dues from the official receiver of the surety.

5. **Proceed against any one surety in the case of co-sureties:** In case of co-sureties, the creditor will be at liberty to proceed against any one for the whole debt.

6. **Concurrent remedy:** A creditor may also pursue his remedy concurrently against both the principal debtor and the surety and obtain decree against both in the same suit.

**b) Obligations on Creditors**

The Indian Contract Act, 1872 imposes the following obligations on a creditor in a contract of guarantee:

1. **Not to change any terms of the original contract:** The creditor should not change any term of the original contract without seeking the consent of the surety. Section 133 provides, "Any variance made without the surety's consent, in the terms of the contract

between the principal debtor and the creditor, discharges the surety as to the transactions subsequent to the variance".

**For example:** A banker contracts to lend X Rs. 5,000 on March 4. A guarantees repayment. The banker pays X Rs.5,000 on January 1. A in this case is discharged from his liability as the contract has been varied as much as the banker might sue X before March,4,but it can not sue A as the guarantee is from March,4.

2. **Not to release or discharge the principal debtor:** The creditor is under obligation not to release or discharge the principal debtor. Section 134 states, "The surety is discharged by a 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".

   **For Example:** A gives a guarantee to banker C for repayment of the debt granted, to B. B later contracts with his creditors (including C, the banker) 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 surety ship.

3. **Not to compound or give time to, or agree not to sue the principal debtor:** Section 135 provides, "A contract between the creditor and the principal debtor, by which the creditor makes a composition with or promises to give time to, or sue the principal debtor, discharges the surety, unless the surety assents to such contract". If the time for repayment is extended, the debtor may die or become insane or insolvent or his financial position may become weaker in the mean while, with the effect the surety's remedy to recover the money in case the principal debtor defaults may be impaired. However, there are certain exceptions. They are:-

a) Section (136) states that if the creditor makes an agreement with a third party but not with the principal debtor, to give extension of time to the principal debtor, surety is not discharged even if his consent has not been sought.

**For example:** C, the holder of an overdue bill of exchange, drawn by A as surety for B and accepted by B, contracts with M to give time to B.A is not discharged.

b) Mere forbearance on the part of creditor to sue the principal debtor, or to enforce any other remedy against him, does not, in the absence of a provision to the contrary, discharge the surety (Section 137).

**For example:** B owes C (banker) a debt guaranteed by A, and the debt becomes payable, but C does not sue B for a year after the debt becomes payable. A is not discharged from his surety ship.

c) If the creditor releases one of the co-sureties, the other sureties (or co-sureties) are thereby not discharged. The co-surety released by the creditor is also not released from his liability to the other sureties (Section 138).

**B. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. In a contract of guarantee, there are _____ parties involved.
2. The person who promises to discharge another's liability is called the _____ in a guarantee.
3. In a contract of indemnity, liability is _____, whereas in a guarantee, liability is _____.
4. A contract of guarantee involves a _____, a principal debtor, and a surety.
5. In a contract of guarantee, the surety's liability arises only if the _____ fails to fulfil their obligation.
6. A creditor must act in _____ and not conceal material facts from the surety.
7. If a creditor gives time to the principal debtor without the surety's consent, the surety may be _____ from liability.
8. A creditor has the obligation to not impair the _____ that the surety may rely upon.
9. The creditor must not make a contract with the principal debtor that alters the terms of the original contract without _____ consent.
10. A creditor can sue the principal debtor and the surety _____ or separately.

**ANSWERS: 1.Three, 2.Surety, 3. Primary, secondary, 4.Creditor, 5.Principal debtor, 6.Good faith, 7.Discharged, 8.Securities, 9.Surety's, 10.Jointly.**

## 15.6. Nature and Extent of Surety's Liability

As regard to the extent of the surety's liability. Section 128 provides, thus, "the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract". The phrase "co-extensive with that of the principal debtor" shows the quantum of the surety's liability. Accordingly, the quantum of obligation of a surety is the same as that of the principal debtor, unless there is a contract to the contrary. In general, it will be neither more nor less, although by a special contract it may be made less than that of the principal debtor, but never greater.

**For example**

A guarantee to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C.A is liable not only for the amount of the bill and interest thereon, but also for the notarial charges which may have been incurred for noting and protesting the bill.

Section 128 provides only for the maximum extent of the surety's liability and it does not deal with the nature of surety's liability. For this, we have to depend upon some other provisions of the contract act and judicial decisions; on the basis of which the following generalizations can be made regarding the nature of surety's liability.

**1)** The liability of a surety **is secondary or contingent**, i.e., the surety is liable only on default of the principal debtor. Thus, if the surety becomes insolvent before default by the principal debtor (i.e., before the date on which the debt is due for repayment), the creditor cannot prove against the surety's official receiver in insolvency.

**2)** The liability of the surety **arises immediately on the default of the principal debtor**, unless there is an express provision in the contract that the creditor must in the first instance proceed against the principal debtor or must give a notice of default to the surety. If the contract is silent, the creditor may file a suit against the surety directly without suing the principal debtor or without making the principal debtor as co-defendant. In other words, the creditor is not bound to exhaust his remedies against the principal debtor before suing the surety (Bank of Bihar V.Damodar Prasad). The logic behind this rule is that, in law,it is the surety's liability duty to see that the principal debtor fulfils his obligation. Therefore, as soon as the time for payment has come and the principal debtor does not or is unable to pay or perform his obligation, the surety becomes liable directly, unless otherwise agreed.

**3)** Where a creditor holds securities from the principal debtor for his debt, the creditor need not first resort to these securities before suing the surety, unless otherwise agreed.

**4)** The surety will not be liable where the creditor has obtained guarantee by misrepresenting (either innocently or knowingly) a material part of the transaction or by keeping silence as to material circumstance, e.g., obtaining guarantee for the conduct of an employee without disclosing to the surety his previous dishonesty (section 142-143).

**5)** The law treats two separate contracts of guarantee from creditor's point of view i.e., one between the creditor and the principal debtor and the other between the creditor and the surety. In other words, the law does not treat the principal debtor and the surety as one person, and there is no such thing that the surety will be liable only if the principal debtor is liable. One may be liable while the other may not be.

If some variation in the contract is done latter on by the creditor and principal debtor, without surety's consent, the surety is not liable while the principal debtor is liable.

An admission by the principal debtor is no evidence against the surety or a judgement obtained against the principal debtor will not be enforceable against the surety, unless otherwise agreed. A surety's liability must be proved by a suit on him independent of any admission by the principal debtor or taking him as a co-defendant (Rambhajan V. Sheo Prasad).

A debt may become time-barred as against the principal debtor but the surety may still be liable, if he stood surety at a later date (When the debt was still subsisting) or, if he has kept own liability alive by bonafide payment of interest or part of the principal sum within the period of limitation. Of course, in such a case, after paying the creditor, the surety is entitled to recover the amount from the principal debtor, as the sum so paid was paid rightfully within the meaning of section 145. it may be noted that if a debt has become time-barred as against both the principal debtor and surety, then none of the two is liable to the creditor. If the surety pays such a debt he cannot recover it from the principal debtor, because the sum so paid was paid wrongfully within the meaning of section 145 [Tara Chand Lakhmichand V.Gopal].

A discharge of the principal debtor by operation of law e.g., insolvency, does not discharge the surety. The surety remains liable to the full amount of debt (Bank o f India Ltd.V.R.F.Cowasjee). However, when liability of the principal debtor is sealed down under Debt Relief Act, surety's liability is also reduced (Narayan Singh V.Chattar Singh).

The surety is liable even if the contract between the creditor and the principal debtor is voidable at the option of the principal debtor and is avoided by him (of course, in such a case, after paying the creditor, the surety can claim payment from the principal debtor under section 145, where he has a right to be indemnified for any sums paid rightfully under the guarantee).

## 15.7. Rights of Surety

Rights of surety are discussed under the following three heads:

1. Against the principal debtor
2. Against the creditor, and
3. Against the co-sureties.

### A. Rights of the Surety against the Principal Debtor

The surety can exercise the following two rights against the principal debtor –

1. **Right of Subrogation [section 140]:** Soon after making a payment and discharging the liability of the principal debtor, the surety is clothed with all the rights of the creditor which he can himself exercise against the principal debtor. This right of the surety is called the right of subrogation. The surety steps in to the shoes of the creditor. The surety who pays the debt is entitled to all the remedies which the creditor could have enforced not merely against the principal debtor but also against all persons claiming under him. Thus, if the creditor has the right to stop goods in transit or has a seller's lien, the surety, on payment of all he is liable for, would be entitled to exercise these rights, but it is only on payment of the debt, that the surety can claim to walk into the shoes of the creditor.

   **For example:** A mortgage a house to B.C offers himself as a surety for B.A fails to pay. B recovered the amount from C.C can get into the shoes of the creditor B enforce the mortgage itself against A.

2. **Right to indemnity[section 145]:** "In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has 'rightfully paid' under the guarantee, but no sums which he had paid wrongfully". Thus, a surety is entitled to be indemnified by the principal debtor for whatever sum he has 'rightfully paid' under the guarantee. The

expression 'rightfully paid' means a just and equitable payment. It covers the principal sum, interest thereon, noting charges in case of a bill of exchange, and costs of the suit if there are reasonable grounds to defend the suit. It does not cover unjust payment like the payment made of a debt which is time barred as against both the principal debtor and surety.

The following two points must also be noted in connection with his right to indemnity:

a) The surety cannot claim more than what he has actually paid to the creditor. Thus, if he discharges the debt by compromise at less than its full amount, he can get from the principal debtor only the amount actually paid.

b) Actual payment either in cash or by transfer of property is essential for asking the principal debtor to pay. A promissory note given by the surety will not be sufficient to claim indemnity.

**For example:**

- B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so (some variation in terms later might be A's plea) but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.
- B 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. B then endorses the bill to C.C, the holder of the bill, demands payment of it from A, and on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit and has to pay the amount of the bill and costs. A can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.
- A guarantees to C as regards payment for rice to be supplied by him to B up to the extent of Rs. 2,000 ( supplies to B rice at a less amount of rice supplies). A cannot recover from B (principal debtor) more than the price of the rice actually supplied.

## B. Rights of the Surety against the Creditor

The surety enjoys the following rights against the creditors

### (i) Right to benefit of creditor's securities [section 141]

The surety is entitled to demand from the creditor, at the time of payment, all the securities

which the creditor has against the principal debtor at the time when the contract of surety ship is entered into or subsequently acquired. Whether the surety knows of the existence of such surety or not is immaterial. If by negligence the creditor loses or, without the consent of the surety, parts with such security as acquired at the time of contract, the surety is discharged to the extent of the value of security. But if the security is lost due to the act of God or enemies of the state or unavoidable accident, the surety would not be discharged (Krishan TalwarV.Hindhustan Commericial Bank).Similarly, if the subsequently acquired securities are parted with, the liability fo the surety would not be reduced (Bhushayya V.Suryanarayan).

It is to be remembered that the surety is entitled to the benefit of the securities only after paying the debt in full. He cannot claim the benefit of a part of the securities merely because he has paid a part of the debt (Goverdhandas V.Bank of Bengal).

**For example:**

- C advances to B, his tenant, Rs.2,000 on the guarantee of A. C has also a further security for the Rs.2,000 by a mortgage of B's furniture. C cancels the mortgage, B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.
- C, a creditor, whose advance to B is secured, by a decree, receives also a guarantee for that advance from A. C after wards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.
- 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.

**(ii) Right to claim set-off, if any:**

The surety is also entitled to the benefit of any set-off or counter-claim, which the principal debtor might possess against the creditor in respect of the same transaction.

**C. Rights of Surety against Co-Sureties**

Where a debt is guaranteed by more than one surety, they are called co-sureties. In such a case all the co-sureties are liable to contribute towards the payment of the guaranteed debt as per agreement among them. But in the absence of any agreement, if one of the co-sureties is compelled to pay the

entire debt, he has a right of contribution from the other co-surety or sureties. The rules of contribution are laid down in sections 146-147 which are as follows:

Where they are sureties for the same debt for similar amount: The co-sureties are liable to contribute equally and are entitled to share the benefit of securities, if any, held by any one of the co-sureties, equally. To sum up the principle, it may be said. "As between co-sureties, there is equality of burden and benefit". Further, for any application of the principle it is immaterial whether the sureties are liable jointly under one contract or severally under several contracts, and whether with or without the knowledge of each other. There is, however, no right of contribution between persons who become sureties not for the same debt but for different debts.

**For example:** A, B and C are sureties to D for the sum of Rs.1,000 lent to E, and there is a contract between A,B and C that A is to be responsible to the extent of one quarter, B to the extent of one quarter, and C to the extent of one half. E makes default in payment. As between the sureties, A is liable to pay Rs.250, Rs.250& Rs.500.

Where there are sureties for the same debt for different sums: The rule is that, "subject to the limit fixed by his guarantee, each surety is to contribute equally,(and not proportionately to the liability undertaken)".

**For example:** A, B and C as sureties for D, enter into three several bonds each in a different penalty, namely, A in the penalty of Rs.10,000 , B in that of Rs.20,000 and C in that of Rs.40,000 , contributed for D's duly accounting to E, then,

a) If D makes default to the extent of Rs.30,000, A, B and C ,are each liable to pay Rs.10,000.

b) If D makes default to the extent of Rs.40, 000, A is liable to pay Rs.10, 000 and B and C Rs.15, 000 each.

c) If D makes default to the extent of Rs.60,000, then A is liable to pay Rs.10,000

,B Rs.20,000 and C Rs.30,000 and.

d) If D makes default to the extent of Rs.70, 00, A, B and C, are each liable to pay the full penalty of his bond.

**C. CHECK YOUR PROGRESS**

- **ONE LINER QUESTIONS**

**Q. When does a surety's liability begin?**
**A**. *When the principal debtor defaults.*

**Q**.**Is the surety's liability primary or secondary?**
**A**. *Secondary.*

**Q**. **Can a surety be held liable beyond the agreed amount?**
**A**. *No, liability is limited to the amount stated in the contract.*

**Q**. **Can the creditor sue the surety without suing the principal debtor?**
**A**. *Yes.*

**Q**. **Is the surety discharged if contract terms are changed without consent?**
**A.** *Yes.*

**Q**. **Is a surety still liable if the debt becomes time-barred?**
**A**. *No.*

**Q**. **Is a surety liable even if unaware of the principal debtor's default?**
**A**. *Yes.*

**Q. Can the surety recover legal costs from the principal debtor?**
**A.** *Yes, if reasonably incurred due to default.*

**Q. What is the right of subrogation?**
**A.** *The surety can use the creditor's rights after paying the debt.*

**Q. What is the right of indemnity?**
**A.** *The surety can recover payment from the principal debtor.*

**Q. What is the right of contribution?**
**A.** *The right to recover proportionate amounts from co-sureties.*

**Q. Is the surety released if the creditor releases securities without consent?**
**A.** *Yes, to the extent of the value of the securities.*

## 15.8. LET US SUM UP

The Contract of Guarantee is a fundamental concept in contract law, particularly relevant in financial and credit-based transactions. It involves a tripartite agreement where one party, known as the **surety**,

promises to fulfil the obligation or repay the debt of a principal debtor if they fail to do so, to the satisfaction of the creditor**.** For a contract of guarantee to be valid, it must fulfil certain essential elements, such as free consent, lawful consideration, and the existence of a legally enforceable obligation. The surety's liability is generally **co-extensive** with that of the principal debtor, meaning they are equally responsible unless specified otherwise. The topic also highlights important differences between a contract of indemnity and a contract of guarantee, particularly in terms of the number of parties involved and the nature of liability. Furthermore, the creditor has specific rights and duties, including the duty not to act in a way that prejudices the surety's rights. Once the surety has performed their obligation, they are entitled to several legal rights, such as the right of subrogation**,** right to indemnity, and right to contribution if there are co-sureties. Understanding these principles helps in analysing legal situations where third-party guarantees are involved and provides insight into risk management and legal obligations in commercial agreements.

## 15.9. KEYWORDS

- **Contract of Guarantee**: A legal agreement where one person (surety) promises to repay a debt or fulfil an obligation if the principal debtor fails to do so.

- **Surety**: The person who gives the guarantee and agrees to be responsible for the debt or obligation of another.

- **Principal Debtor**: The person who has the primary obligation to repay the debt or fulfil the contractual duty.

- **Creditor**: The person or entity to whom the debt or obligation is owed.

- **Consideration**: Something of value exchanged between parties, which is necessary for forming a valid contract; in a guarantee, consideration for the principal debtor also serves as consideration for the surety.

- **Co-extensive Liability**: The legal principle that the surety's liability is equal to that of the principal debtor unless otherwise agreed.

- **Contract of Indemnity**: A contract where one party promises to compensate another for any loss suffered, involving only two parties.

- **Primary Liability**: The direct responsibility to perform a contract; in indemnity, the indemnifier holds primary liability.

• **Secondary Liability**: The liability that arises only when the principal debtor fails to perform; this is the surety's position in a guarantee.

• **Subrogation**: The right of the surety to step into the shoes of the creditor after paying off the debt, to recover from the principal debtor.

• **Indemnity (Right of Surety)**: The surety's right to be compensated by the principal debtor for the amount paid under the guarantee.

• **Contribution**: The right of a surety to recover proportionate shares from co-sureties if they have jointly guaranteed a debt.

• **Discharge of Surety**: The release of the surety from liability due to various reasons, such as changes in the contract without consent or misconduct by the creditor.

• **Material Fact**: Any important information that must be disclosed to the surety by the creditor for the guarantee to be valid.

## 15.10. SELF ASSESSMENT QUESTIONS

1. Discuss the roles and legal relationships between the three parties involved in a contract of guarantee. How is mutual consent established among them?

2. Explain the principle that the surety's liability is co-extensive with that of the principal debtor. Are there exceptions to this rule? Illustrate with cases.

3. Discuss the legal rights and obligations of a creditor under a contract of guarantee. How do these duties impact the surety's liability?

## 15.11. LESSON END EXCERCISES

**1.** Explain the essential elements of a valid contract of guarantee. Discuss the legal requirements for its enforceability with relevant examples.

2. With the help of suitable illustrations, explain how a contract of guarantee differs in purpose and function from a contract of indemnity.

3. Discuss the right of subrogation and contribution in a contract of guarantee. How do these rights function in multi-surety arrangements?

4. Explain the nature and extent of a surety's liability in a contract of guarantee.

## 15.12. SUGGESTED REDINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT IV**

**SEMESTER: III** **LESSON: 16**

# SPECIAL CONTRACT II

**STRUCTURE**



## 16.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the definition and scope of a contract of sale of goods.
- To identify the parties involved in a sale of goods contract.
- To recognize the essential elements required to form a valid contract of sale of goods.
- To comprehend the legal rights and obligations of the buyer and seller under the contract.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define what constitutes a contract of sale of goods.
- Identify the parties involved in a sale of goods contract.
- List and explain the essential elements required to form a valid contract of sale of goods.
- Apply legal principles to practical scenarios involving sale of goods contracts.

## 16.1. INTRODUCTION

A contract of sale of goods is a fundamental concept in commercial law that governs the exchange of goods for a price between two parties—the buyer and the seller. It is a legally binding agreement where ownership of goods is transferred from the seller to the buyer in return for a monetary consideration, known as the price. This contract plays a crucial role in everyday trade and commerce, facilitating smooth business transactions. Understanding the essentials of such a contract is vital because it ensures that the agreement is valid, enforceable, and protects the rights of both parties involved. The essentials of a contract of sale of goods include key elements such as the existence of two competent parties, a lawful subject matter (movable goods), mutual consent, and a definite price. Furthermore, the contract can be either executed, where the ownership transfers immediately, or executory, where the transfer happens at a future date. Distinguishing between a sale and an agreement to sell is important as it affects when the ownership and risk pass from the seller to the buyer. A thorough grasp of these basics is essential for anyone involved in buying or selling goods to avoid disputes and ensure smooth commercial dealings.

## 16.2. MEANING OF CONTRACT OF SALES OF GOODS

According to section 4 of the Sale of Goods Act, 1930, “A contract of sale of goods is a contract whereby the seller’s transfers or agrees to transfer the property in goods to the buyer for a price.” A Contract of sale may be absolute of conditional. In absolute sale the property in the goods passes from the seller to the buyer immediately and nothing remains to be done by the seller. In conditional contract of sale, the property in the goods does not pass to the buyer absolutely until a certain conditions fulfilled. A contract of sale of goods results, like any other contract, by an offer by one party and its acceptance by the other. Thus, it is a consensual transaction. The parties to the contract enjoy unfettered

discretion to agree to any terms they like relating to delivery and payment of price etc. the sale of goods act does not seek to fetter this discretion. It simply lays down certain positive rules of general application for those cases where the parties have failed to contemplate expressly for contingencies which may interrupt the smooth performance of a contract of sale, such as the destruction of the thing sold, before it is delivered or the insolvency of the buyer, etc. the act leaves the parties free to modify the provisions of the law by express stipulations.

**A. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

**1. In which year the Sale of Goods act enacted?**
A. 1857
B. 1930
C. 1881
D. 1942
**Answer: B**

**2. A contract of sale of goods is a contract whereby the seller _____.**
A. Transfers or agrees to transfer the property in goods to the buyer
B. Delivers the goods to the buyer
C. Gifts the goods to the buyer
D. Leases the goods to the buyer
**Answer: A**.

**3. A contract of sale may be:**
A. Absolute
B. Conditional
C. Either absolute or conditional
D. Neither absolute nor conditional
**Answer: C.**

**4. The subject matter of a contract of sale must be:**
A. Services
B. Goods
C. Real estate
D. All of the above
**Answer: B.**

## 16.3. ESSENTIALS OF CONTRACT OF SALES OF GOODS

Section 4(1) of the sale of goods act defines a contract of sale of goods as, "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price".

This definition reveals the following essential characteristics of a contract of sale of goods:

**1. Two parties**

The first essential is that there must be two distinct parties to a contract of sale viz., a buyer and a seller, as a person cannot buy his own goods. Thus, for Example, when students of a hostel take meals with a mess run by themselves on co-operative lines, there is no contract of sale. The students are undivided joint owners of the meals they are consuming. As a matter of fact every member of the mess is consuming his own goods on the basis of understanding that he must restore to the mess what he consumed so that the mess continues to provide meal for its members. An undivided joint owner must be distinguished from a part owner who is a joint owner with divisible share.

According to section 4(1), there may be a contract of sale between one part owner and another, For Example, if A and B jointly owns a typewriter, A may sell his own ownership in the typewriter to B, thereby making B sole owner of the goods.

Similarly, a partner may buy the goods from the firm in which he is a partner and vice-versa. There is, however, one exceptional case when a person may buy his own goods. Where a person's goods are sold in execution of a decree, he may himself buy them, so as to save them from a transfer of ownership to someone else [Moore Vs. Singer Manufacturing Co., 1904].

**2. Transfer of property**

Property here means ownership. Transfer of property in the goods is another essential of a contract of sale of goods. A mere transfer of possession of the goods cannot be termed as sale. To constitute a contract of sale the seller must either transfer or agree to transfer the property in the goods to the buyer. Further, the term property as used in the sale of goods act, means general property in goods as distinguished from special property [section 2(11)]. If P who owns certain goods pledges them to R, he has general property in the goods, whereas R (the Pawnee) has special property or interest in the goods to the extent of the amount of advance he has made to the pawnor. Similarly, in the case of bailment of goods for the purpose of repair, the bailee has special interest in goods bailed to the extent of his labour charges.

**3. Goods**

The subject matter of the contract of sale must be goods. According to section 2(7), "goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale". Thus, every kind of movable property except actionable claim and money is regarded as goods. Goodwill trademarks, copyrights, patent right, water, gas, electricity, decree of a court of law, are all regarded as goods. Shares and stocks are also included in goods. With regard to growing crops, grass and things attached to or forming part of the land, such things are regarded as goods as soon as they are agreed to be separated from the land. Thus, where trees were sold so that they would be cut out and separated from the land and then taken away by the buyer, it was held that there was a contract of sale of movable property or goods [Kursell Vs. Timber Operators & Contractors Ltd., 1927]. But contracts for sale of things, "forming part of the land itself are not contracts for sale of goods.

For Example, a contract for the sale of coal mine or building-stone quarry is not a contract of sale of goods. Money, actionable claims and immoveable property are excluded from the definition of "goods".

i **Actionable claims** means which can be enforced by a legal action or a suit, e.g., a debt. A debt is not good because it can only be assigned as per the transfer of property act but cannot be sold.

ii **Money** means current money. It is not regarded goods because it is the medium of exchange through which goods can be bought. Old and rare coins, however, may be treated as goods and sold as such.

iii The sale of **immoveable property** is not covered under the sale of Goods Act, 1930. The sale of immoveable property is governed by a separate act i.e., Transfer of property Act, 1882.

**4. Price**

The consideration for a contract of sale must be money consideration called the price. If goods are sold or exchanged for other goods, the transaction is barter, governed by the transfer of property act and not a sale of goods under this act. But if goods are sold partly for goods and partly for money, the contract is one of sale [Aldridge V.Johnson, 1857].

For example: A refrigerator company supplies a new refrigerator of Rs. 9000 in exchange of old

refrigerator and Rs. 6000 in cash. It is a sale under the sale of goods act.

**B. CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

**1. Under the Sale of Goods Act, "goods" means every kind of movable property other than:**
A. Land
B. Money and actionable claims
C. Buildings
D. Furniture
**Answer: B.**

**2. Which of the following is** not **essential for a valid contract of sale?**
A. Two parties
B. Transfer of property
C. Delivery of goods
D. Consideration in money
**Answer: C.**

**3. The consideration in a contract of sale must be:**
A. In the form of goods only
B. In the form of services only
C. In the form of money only
D. In the form of money or goods
**Answer: C.**

**4. In Sale of Goods Act, Transfer of property means:**
A. Transfer of possession
B. Transfer of plant and machinery
C. Transfer of will
D. Transfer of ownership
**Answer: D.**

**5. Includes both a sale and an agreement to sell**

The term contract of sale is a generic term and includes both a sale and an agreement to sell.

**Sale:** Where under a contract of sale the property in the goods is immediately transferred at the time of making the contract from the seller to the buyer, the contract is called a sale [section 4(3)]. It refers to an absolute sale, e.g., an outright sale on a counter in a shop. There is immediate conveyance of the ownership and mostly of the subject-matter of the sale as well

delivery may be given in future. It is an executed contract.

**An agreement to sell:** Where under a contract of sale the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called, "an agreement to sell"[section 4(3)]. It is an executory contract and refers to a conditional sale.

**For example:** On 1st January, A agrees with B that he will sell B his scooter on 15 January for a sum of Rs.30; 000.It is an agreement to sell, since A agrees to transfer the ownership of the scooter to B at a future time.

An agreement to sell become a sale when the time lapse or the conditions are fulfilled subject to which the property in the goods is to be transferred [section 4(4)].

6. **No formalities to be observed**

Section 5 provides that the sale of goods act, does not prescribe any particular form to constitute a valid contract of sale. A contract of sale of goods can be made by mere offer and acceptance. The offer may be made either by the seller or the buyer and the same must be accepted by the other. Neither payment nor delivery is necessary at the time of making the contract of sale. Further, such a contract may be made either orally or in writing or partly orally and partly in writing or may be even implied from the conduct of the parties. Where articles are exhibited for sale and a customer picks up one and the sales assistant packs the same for him, there has resulted a contract of sale of goods by the conduct of the parties.

**C. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

1. A contract of sale must involve two parties — a buyer and a seller.
2. Goods in a contract of sale include immovable property.
3. The consideration for a contract of sale can be in the form of goods.
4. A contract of sale can be either absolute or conditional.
5. A sale and an agreement to sell are the same.
6. Delivery of goods is essential at the time of making a contract of sale.
7. There cannot be a contract of sale between co-owners of goods.

**ANSWERS: 1.T, 2.F, 3.F, 4.T, 5.F, 6.F, 7.F**

## 16.4. LET US SUM UP

The contract of sale of goods is a legally binding agreement between a buyer and a seller, where goods are exchanged for a price. Its essentials include the presence of two competent parties, movable goods as the subject matter, mutual consent, and a definite price. Understanding the difference between a sale and an agreement to sell is crucial, as it affects the transfer of ownership and risk. The contract may involve various types of goods—existing, future, specific, or unascertained—each with different legal implications. The rights and obligations of both parties, including implied terms and conditions, help protect their interests and ensure fairness. Remedies for breach of contract are available to maintain trust and accountability in commercial transactions. Mastery of these fundamentals equips individuals and businesses to engage confidently and lawfully in the buying and selling of goods.

## 16.5. KEYWORDS

- **Contract of Sale of Goods**: A legal agreement where ownership of goods is transferred from the seller to the buyer for a price.
- **Buyer**: The party who agrees to purchase the goods in a sale contract.
- **Seller**: The party who agrees to transfer ownership of the goods to the buyer.
- **Passing of Property**: The transfer of ownership from the seller to the buyer.

## 16.6. SELF-ASSESSMENT QUESTIONS

1. Evaluate the role of mutual consent and lawful consideration in forming a valid contract of sale of goods.

2. Why the presence of a price is considered an essential element in a sale of goods contract?

## 16.7. LESSON END EXCERCISES

1. Explain the concept of a contract of sale of goods and discuss its essential elements.

2. Explain the importance of the subject matter (goods) being movable in a contract of sale.

## 16.8. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT IV**

**SEMESTER: III** **LESSON: 17**

# SPECIAL CONTRACT II

**STRUCTURE**



## 17.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the definitions of sale and agreement *to sell* under the Sale of Goods Act.
- To identify the key distinctions between a sale and an agreement to sell.
- To recognize when ownership and risk pass from seller to buyer in each case.
- To analyze the legal implications of a sale versus an agreement to sell.
- To explain the rights and obligations of parties under a sale and an agreement to sell.
- To understand the impact of breach of contract in both sale and agreement to sell situations.

**Learning Outcomes**

After going through this lesson learners will be able to:

- Define and explain the concepts of sale and agreement to sell.

- Distinguish clearly between a sale and an agreement to sell based on legal characteristics.
- Understand when ownership and risk transfer in both types of contracts.
- Compare the legal rights and duties of buyers and sellers in each type of contract.
- Explain the consequences of breach in a sale versus an agreement to sell.
- Identify real-life business transactions as either a sale or an agreement to sell.

## 17.1. INTRODUCTION

The distinction between a sale and an agreement to sell is a fundamental concept in the law of contracts, particularly under the Sale of Goods Act**.** Both terms refer to contracts involving the transfer of ownership of goods, but they differ significantly in terms of timing, legal effect, and the transfer of risk. In a sale, the ownership of goods is transferred from the seller to the buyer immediately at the time of the contract. In contrast, an agreement to sell implies a future transfer of ownership, either at a later date or upon the fulfilment of certain conditions. Understanding this difference is crucial because it determines the rights, obligations, and remedies available to each party in case of a breach or loss. This distinction also impacts commercial transactions, insurance, and liability. A clear grasp of these concepts enables individuals and businesses to make informed decisions, draft accurate contracts, and avoid legal disputes.

## 17.2. Difference between Sale and Agreement to Sell

The difference between sale and an agreement to sell depends upon the crucial point whether the property in goods has passed or is yet to pass from the seller to the buyer. Other points of difference between the two are as under:

1. **Transfer of property:** In a sale, the property in the goods passes from the seller to the buyer immediately so that the seller is no more the owner of the goods sold. In an agreement to sell, the transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled.

2. **Risk of loss:** In a sale, if the goods are destroyed, the loss falls on the buyer even though they were in the possession of the seller. In an agreement to sell, if the goods are destroyed, the loss falls on the seller, even though they were in the possession of the buyer.

3. **Nature of contract:** Sale is an executed contract plus a conveyance while agreement to sell is an executory contract.

4. **Consequences of breach by buyer:** In a sale, if the buyer fails to pay the price of the goods or if there is breach of contract by the buyer, the seller can sue for the price even though the goods are still in his possession. In agreement to sell, if there is a breach of contract by the buyer, the seller can only sue for damages and not for the price even though the goods are in the possession of the buyer.

5. **Right to re-sell:** In a sale, the seller cannot re-sell the goods, except in certain cases, e.g., a sale by the seller in possession of goods after sale as provided under section 30, or a sale by an unpaid seller as provided under section 54. if he re-sells the goods, the subsequently buyer will not acquire a title to the goods. In the agreement to sell, the buyer can only sue for damages.

6. **Insolvency of the seller:** In a sale, if the seller is declared insolvent, the buyer is entitled to recover the goods from the official receiver or assignee as he (buyer) has the ownership of the goods sold. In an agreement to sell, the buyer who has paid the price cannot claim the title of goods from the seller, if he is declared insolvent. He can only claim a rate able dividend from the official receiver or assignee of the insolvent seller.

7. **Insolvency of the buyer:** In a sale, if the buyer is declared insolvent before making the payment of the price for goods, the seller in the absence of lien over goods, will have to deliver the goods to the official receiver or assignee and can claim only the rate able dividend. The same will be the position, if the goods are in possession of the buyer. In an agreement to sell, if the buyer, who is declared insolvent, has not paid the price, the seller is not bound to deliver the goods, as the property in goods has not the passes to him.

8. **General or particular property:** Sale gives the buyer jus-id-idem (right against a particular individual). The buyer becomes the absolute owner and can use the goods in the way he likes. In the case of an agreement to sell, the buyer gets jus-in-personam (rights against a particular individual). In such a case, if default is committed, the aggrieved party may sue only for damages.

9. **Right to recover damages:** In a sale, if the seller commits a breach, the buyer may compel the seller to deliver him the goods or pay the damages on the basis of difference the selling price and market price on the date of breach. In the case of an agreement to sell, the buyer, in case of breach committed by the seller, can sue for damages only; as the ownership in good has not been transferred to him, he cannot compel for delivery of goods.

10. **Performance:** Performance of sale is absolute and without any condition; while in case of an agreement to sell, performance is conditional and is made in future.

## A. CHECK YOUR PROGRESS

- **MULTIPLE CHOICE QUESTIONS**

**1. When ownership of goods is transferred immediately from the seller to the buyer, it is called:**
A. Agreement to Sell
B. Hire Purchase
C. Sale
D. Mortgage
**Answer: C.**

**2. In which type of contract does the risk of loss usually pass immediately to the buyer?**
A. Sale
B. Agreement to Sell
C. Lease
D. None of the above
**Answer: A**.

**3. An agreement to sell becomes a sale when:**
A. The payment is made
B. Delivery is completed
C. The conditions are fulfilled or time elapses
D. The buyer changes his mind
**Answer: C.**

**4. In an agreement to sell, the ownership of goods is:**
A. Transferred immediately
B. Never transferred
C. Transferred on a future date or after conditions are met
D. Not relevant
**Answer: C**.

## B. CHECK YOUR PROGRESS

- **TRUE/FALSE**

**1.** In a sale, the seller retains ownership until full payment is made.

**2.** In an agreement to sell, the buyer has a right against the goods, not ownership.

**3.** If goods are destroyed before ownership is transferred, the loss is borne by the seller in an agreement to sell.

**Answers: 1.F, 2.T, 3.T**

**C. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. In a _____, the property in goods is transferred to the buyer at the time of making the contract.
2. An _____ to sell is a contract where the transfer of ownership is to take place at a future time or subject to certain conditions.
3. In a sale, the risk of loss is on the _____.

**Answers: 1.Sale, 2.Agreement, 3.Buyer**

## 17.3. LET US SUM UP

The difference between a sale and an agreement to sell lies primarily in the timing of the transfer of ownership and the associated legal consequences. In a sale, ownership and risk pass to the buyer immediately, making the buyer liable for any loss or damage to the goods thereafter. In an agreement to sell, the transfer of ownership is postponed to a future date or dependent on the fulfilment of certain conditions. This means the seller retains ownership and bears the risk until the agreement becomes a sale. This distinction is vital in understanding the rights, obligations, and remedies of the parties involved in a commercial transaction. Recognizing whether a transaction constitutes a sale or an agreement to sell helps in determining liability in case of breach, insolvency, or damage to goods, making it an essential concept in business law and trade practices.

## 17.4. KEYWORDS

- **Sale**: A contract where the ownership of goods is transferred from seller to buyer immediately.
- **Agreement to Sell**: A contract in which the transfer of ownership of goods is to take place at a future time or subject to a condition.
- **Ownership**: The legal right to possess, use, and dispose of goods.
- **Transfer of Property**: The point at which the rights of ownership pass from the seller to the buyer.

- **Risk**: The responsibility for loss or damage to the goods, which generally follows ownership.

- **Present Contract**: A contract (like a sale) where obligations are performed immediately.

- **Future Contract**: A contract (like an agreement to sell) where performance is scheduled for a future date.

- **Condition Precedent**: A condition that must be fulfilled before the agreement to sell becomes a sale.

- **Breach of Contract**: Failure to fulfil the terms of the contract, leading to legal consequences.

- **Remedies**: Legal solutions available in case of breach, such as compensation or cancellation.

- **Insolvency**: Inability of a party to pay debts, affecting the rights of ownership and goods in transit.

- **Legal Title**: The formal right of ownership that transfers in a sale but remains with the seller in an agreement to sell.

## 17.5. SELF-ASSESSMENT QUESTIONS

1. Examine the relevance of the timing of ownership transfer in differentiating between a sale and an agreement to sell.

2. How does the distinction between a sale and an agreement to sell affect the remedies available in case of breach of contract?

## 17.6. LESSON END EXCERCISES

1. Define and explain the terms ‘sale’ and ‘agreement to sell’. What are the key differences between the two?

2. Compare and contrast the rights and obligations of the buyer and seller under a sale and an agreement to sell.

3. Discuss how the insolvency of the buyer or seller affects a contract of sale and an agreement to sell.

## 17.7. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT IV**

**SEMESTER: III** **LESSON: 18**

# SPECIAL CONTRACT II

**STRUCTURE**



## 18.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the legal definition of "goods" under the Sale of Goods Act.
- To identify the essential characteristics that qualify something as "goods" in a sale contract.
- To learn the various classifications of goods (existing, future, specific, ascertained, and unascertained goods).
- To distinguish between different types of goods based on their nature and availability.
- To understand the concept and importance of price in a contract of sale of goods.
- To explore the different modes of fixing prices, such as by contract, agreed method, or market value.

- To analyze the legal implications of each mode of price determination.
- To recognize the consequences of the absence of a fixed price in a sale contract.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define the term "goods" as per the Sale of Goods Act.
- Identify what can and cannot be considered goods under the Act.
- Classify goods into categories such as existing, future, specific, ascertained, and unascertained goods**.**
- Understand the legal and commercial relevance of each type of goods.
- Explain the various modes of fixing prices in a contract of sale (e.g., fixed by contract, determined by a third party, or based on market value).
- Analyze how the absence of price or failure to fix a price affects the validity of the sale contract.
- Gain the ability to apply the principles of goods classification and price determination in practical contract scenarios.
- Able to distinguish between different sale situations based on the type of goods and pricing method used.

## 18.1. INTRODUCTION

In the field of commercial and contract law, the sale of goods plays a vital role in facilitating trade and business transactions. A contract of sale of goods is a legally binding agreement between a buyer and a seller, where the seller transfers or agrees to transfer the ownership of goods to the buyer for a price. The term “goods” refers to all types of movable property, excluding money and actionable claims, as defined under the Sale of Goods Act. Goods form the subject matter of such contracts and are broadly classified into existing goods, future goods, and contingent goods. Existing goods are those that are already owned and possessed by the seller at the time of the contract, while future goods refer to goods that will be manufactured or acquired by the seller after the contract is made. Contingent goods are a type of future goods, whose acquisition depends upon the occurrence of a specific event. Another essential element in a contract of sale is the price, which is the monetary consideration for the transfer of goods. The price may be fixed by the contract itself, determined in a manner agreed upon by the

parties, or left to be decided by a third party. In the absence of a fixed price, the buyer is obliged to pay a reasonable price depending on market conditions. Understanding the meaning and classification of goods along with the different modes of fixing prices is crucial for ensuring clarity, fairness, and enforceability in contracts of sale.

## 18.2. MEANING OF GOODS

Section 6 provides that "goods" form the subject matter of a contract of sale. Section 2(7) of the said act defining the term "goods are that goods means every kind of movable property other than actionable claim and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be served before sale or under the contract of sale".

On classifying the above definitions of goods, it is clear that:

i. Actionable claims are not goods because such a claim can only be enforced by action in a court of law, e.g., a debt due by one person to another is an actionable claim, but it cannot be bought or sold as goods.

ii. In the same way, money is not goods as money means current money and not old coins or paper money which can be sold or bought for collection purposes.

iii. Growing crops and grass are goods because they can be served from land and can be sold and bought.

iv. Forests are not goods, but forestry is goods as they are severed from the forests and can be sold and purchased. In the same way, trees are also goods.

**A.CHECK YOUR PROGRESS**

- **MULTIPLE CHOICE QUESTIONS**

**1. Which section of the Sale of Goods Act, 1930 defines "Goods"?**
a) Section 2(1)
b) Section 2(7)
c) Section 3
d) Section 4
**Answer: b)**

**2. Which of the following is *not* classified as goods under the Sale of Goods Act, 1930?**
a) Standing timber
b) Electricity
c) Stocks and shares
d) Land
**Answer: d)**

3. **According to the Sale of Goods Act, “goods” means every kind of movable property except:**
   a) Crops
   b) Stocks and shares
   c) Money and actionable claims
   d) Animals
   **Answer: c)**

4. **Which of the following would *not* fall under the definition of "goods"?**
   a) Immovable property
   b) Money
   c) Growing crops
   d) Land
   **Answer: c)**

5. **Which of the following would *not* fall under the definition of “goods” in the Sale of Goods Act?**
   a) Books
   b) Gold ornaments
   c) Currency notes used as legal tender
   d) Furniture
   **Answer: c)**

6. **Goods in the Sale of Goods Act include:**
   a) All types of property
   b) Immovable property
   c) Tangible movable property, including things attached to land which can be severed
   d) Intangible rights only
   **Answer: c)**

7. **Which one of the following is not ‘goods’ under the Act?**
   a) Standing crops agreed to be severed
   b) Future goods
   c) Actionable claims
   d) Things attached to land but agreed to be severed before sale
   **Answer: c)**

## 18.3. CLASSIFICATION OF GOODS

Goods which form the subject-matter of contract of sale may be divided into three types namely:

1. **Existing Goods**

   Goods owned and possessed by the seller at the time of the making of the contract of sale are called existing goods. Sometimes, the seller may be in possession but may not be the owner of the goods. For Example, in the case of sale by a mercantile agent or a pledge the

goods are possessed but not owned by the seller. Where the existing goods are the subject-matter of a contract, it is essential that they must be in actual existence, for a present sale can be made only of a subject matter having actual or possible existence. Thus, for Example: A sells his horse to B, believing it to be in existence but in fact the horse is dead, no contract will arise.

The existing goods can be further classified as under:

a. Specific Goods.
b. Ascertained Goods.
c. Uncertainty Goods.

**a) Specific Goods:** "Specific goods are those goods which are identified and agreed upon at the time of contract of sale are made. It is essential that the goods are identified and separated from the other goods at the time of contract of sale is made and the goods merely in an identifiable position does not make the goods specific.

**For example:** In the case of sale of one horse out of 25 horses, goods shall be specific if the horse is selected before the contract of sale is made. Here it is important to note all the horses are horses but they cannot be exactly similar to each other. Therefore, it is essential to select the horse out of the lot as specific goods.

**b) Ascertained Goods:** Sometimes the terms specific goods and ascertained goods are used interchangeably. But actually they are not same and different in the sense that specific goods are identified at the time of contract of sale whereas ascertained goods are identified after the contract of sale as per the terms decided. It is important to note here that the goods are almost of exactly the same type and quality and the buyer is to select keeping in mind the defective prices only.

**For example:** If there is going to be sale of 25 chairs for an office out of a lot of 100 such chairs of the same design and quality, the goods are unascertained till 25 particular chairs are selected so that they are not defective in any way and are considered to be the best of the lot for the satisfaction of the buyer, though they are all best and equal in quality, from the point of view of the seller. When the required 25 chairs are selected out of the lot, the goods are said to be ascertained goods for the contract of sale.

c) **Unascertained Goods:** When the goods are not separately identified or ascertained at the time of making a contract of sale, are known as unascertained goods. When the buyer does not select the goods for him from a lot of goods, but are defined or indicated only by description, we call them unascertained goods. As soon as particular goods are separated from the lot they become ascertained goods. In the Example quoted in ascertained goods, the lot of 100 chairs is unascertained goods. When 25 chairs are selected or identified for purchase they become ascertained goods.

2. **Future Goods:** Under section 2 (6), the goods which a seller does not possess at the time of the contract of sale, but will be manufactured, produced or acquired by him after making the contract of sale, is known as future goods. Under section 6(1) future goods may also be the subject matter of contract of sale. Under section 6 (3), a contract of sale for future goods, though expressed as an actual sale, purports to operate as an agreement to sell the goods and not a sale. This provision corroborates the fact that the ownership of a thing cannot be transferred before it comes into existence, e.g., contract of sale to sell the crop in advance is a contract to sell and not a sale and, if A agrees to sell a sofa to B, the sofa is yet to be manufactured, it is a contract to sell.

3. **Contingent Goods:** Under section 2, contingent goods are future goods. These are the goods, the acquisition of which by the seller depends upon a contingent even, which may or may not happen. Such goods may also be the subject matter of sale.

**For example:** X agrees with Y to sell him 100 quintals of wheat @ Rs.500 per quintal, provided there would be good rains and he would have a good crop. It is a contract to sell contingent goods.

**Effect of Destruction of Goods:**

Section 7 and 8 down the rules applicable to cases where the subject matter of a contract of sale is destroyed before and after the contract.

**Goods perishing before making of contract:**

Where there is a contract of sale of specific goods, the contract is void, if the goods, without the knowledge of the seller have at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract. If at the

time of the contract, the goods agreed to be sold have ceased to exist, the agreement of sale is void and there is no sale.

**For example:** A agrees to sell to B, a specific cargo supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain the ship carrying the cargo has been cast way and the goods lost. Neither party was aware of the facts. The agreement is void.

**Goods perishing before Sale but after Agreement to sell:**

Section 8 deals with the effect of perishing of specific goods before sale but after agreement to sell. Unlike section 7, it deals with a case where the goods are in existence at the time of making the contract but perish without the fault of either party before the risk has passed to the buyer. While under section 7, the contract is void ab initio, under the present section it not so, but performance on either side is excused as from the time of the perishing of the goods. An agreement to sell specific goods becomes void if subsequently the goods without the fault of the seller or buyer have perished or become damaged as no longer to answer their description in the agreement, provided this happens before the risk has passed to the buyer.

**B. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

**1.** Specific goods are those goods which are identified and agreed upon at the time of the contract of sale.
**2.** Unascertained goods are goods that have been clearly identified and separated from a larger lot.
**3.** Future goods are goods that the seller owns and possesses at the time of the contract.
**4.** Contingent goods are a type of future goods whose acquisition depends on a contingency.
**5.** Existing goods are those which are in existence and either owned or possessed by the seller when the contract is made.
**6.** Ascertained goods and specific goods are exactly the same.
**7.** Goods once identified from a larger bulk become ascertained goods.
**8.** Specific goods can be delivered without prior identification.
**9.** Unascertained goods cannot be transferred in ownership until they are ascertained.
**10.** Future goods are considered existing goods under the Sale of Goods Act.

**Answers: 1.T, 2.F, 3.F, 4.T, 5.T, 6.F, 7.T, 8.F, 9.T, 10.F**

## 18.4. Price and Mode of Fixing the Price

Price is an essential element of sale. Price means the money consideration for a sale of goods. No valid sale can take place without a price. If no consideration is given, then it will be a gift. It may be noted that old and rare coins are not included in the definition of the term money. The price constitutes the essence of a contract of sale as no sale can take place without a price. The price may be money actual paid or promised to be paid depending on whether the agreement is for cash or credit sale. However, where goods are sold for a fixed sum and the price is paid partly in terms of cash and partly in terms of valued goods it is a sale.

### Modes of Fixing the Price

According to section 9, the price may be fixed by one or the other of the following modes:

1. **It may be expressly fixed by the contract itself:** This is the most usual mode of fixing the price. The parties are free to fix any price they like and the court will not question as to the adequacy of price. But the sum should be definite. Where an alternative price is fixed, the agreement is void ab initio as it involves an element of wager [Broke V.Short, 1856].

2. **It may be fixed in accordance with an agreed manner provided by the contract:** It may be agreed that the buyer would pay the market price prevailing on a particular day, or that the price is to be fixed by a third party (i.e., valuer) appointed by the consent of the parties. But in the following cases, where the agreement of the parties as to price is uncertain, price is deemed as not capable of being fixed and hence the agreement is void ab initio for uncertainty: (a) If the price is agreed to be whatever sum the seller be offered by any third party; or (b) If the price is left to be fixed by one of the contracting parties, expressly. If no price is fixed then the contract is not void for uncertainty because in that case law usually allows market price prevailing on the date of supply of goods as the price bargained for.

3. **It may be determined by the course of dealings between the parties:** If the buyer has been previously paying to a particular seller the price prevailing on the date of placing the order, the course of dealings suggest that in subsequent transactions also the price as on the date of order will be paid.

**4.** If the price is not capable of being determined in accordance with any of the above modes, the buyer is bound to pay to the seller a reasonable price. What is reasonable price is a question of fact dependent on the circumstances of each particular case. Ordinarily, the market price of the goods prevailing on the date of supply is taken as reasonable price.

**Modes of payment of price:**

In the absence of an agreement to the contrary, the seller is not bound to accept any kind of payment other than the currency of the country. He is not bound to accept payment of cheque unless he has accepted cheque on previous occasions. By common consent or in accordance with an established course of dealing, the seller may accept payment either,

(a) By a cheque or draft;

(b) By a bank guarantee;

(c) By a letter of credit;

(d) By any other mode.

**C. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. The term **price** is defined under Section ___ of the Sale of Goods Act, 1930.
2. Price means the money consideration for the _____ of goods.
3. According to Section 9 of the Sale of Goods Act, the price may be fixed by the contract, or may be left to be fixed in _____.
4. If the price is not determined in accordance with the agreement, the buyer must pay a _____ price.
5. When the price is to be fixed by a third party and he fails to do so, the contract is considered _____.
6. A reasonable price is a question of _____.
7. If the buyer has received and appropriated the goods, he is liable to pay a _____ price even if the price was to be fixed by a third party who failed to do so.
8. The price may be fixed by the contract, by the course of dealings, or by reference to _____.
9. A contract without a fixed price or without a method to determine the price is not _____.
10. In case the price is to be fixed by a third party and one party prevents it, the other party may claim _____.

**Answers: 1.2(10), 2.Sale, 3.manager agreed upon, 4.reasonable, 5.Void, 6.fact, 7.reasonable, 8. market price / third party (either answer can be correct depending on interpretation), 9.enforceable, 10.damages**

## 18.5. LET US SUM UP

The topic "Meaning and Classification of Goods and Modes of Fixing Price in Sale of Goods" focuses on key concepts in commercial law related to transactions involving goods. Goods refer to movable tangible items that can be bought or sold, excluding money and actionable claims. They are classified into various types based on characteristics such as existing goods, future goods, and contingent goods. Existing goods are those physically available at the time of the contract, while future goods are yet to be manufactured or acquired, and contingent goods depend on the occurrence of a specific event. Additionally, goods can be specific, as identified and agreed upon by the parties, or unascertained, which are not specifically identified at the time of contract formation. Understanding these classifications helps in determining rights and obligations in sales contracts. In sale of goods, fixing the price is a crucial element. Price determination can happen through various modes. It may be fixed by the parties explicitly in the contract, allowing clear terms for the transaction. Alternatively, the price can be left to be fixed later by one of the parties or by a third party appointed by them. If the price is not fixed and the parties fail to decide on it, the law may intervene to determine a reasonable price based on market standards or other relevant factors. Moreover, the price can sometimes be determined through external criteria such as market rates or by reference to the seller's list price. These modes ensure flexibility and fairness in commercial transactions, providing mechanisms to resolve ambiguities related to price. Overall, understanding the meaning, classification of goods, and modes of fixing price is fundamental for the effective execution of sale of goods contracts.

## 18.6. KEYWORDS

- **Goods**: Tangible, movable property that can be bought or sold, excluding money and actionable claims.
- **Existing Goods**: Goods that are owned or possessed by the seller at the time of the contract.
- **Future Goods**: Goods that will be manufactured, produced, or acquired by the seller after the contract is made.
- **Contingent Goods**: Goods whose acquisition by the seller depends upon a certain event that may or may not happen.

- **Specific Goods**: Goods that are clearly identified and agreed upon at the time of the contract.
- **Unascertained Goods**: Goods that are not specifically identified at the time of the contract.
- **Ascertained Goods**: Goods that are identified and appropriated to the contract after the agreement is made.
- **Sale of Goods**: A contract in which the ownership of goods is transferred from seller to buyer for a price.
- **Price**: The monetary consideration paid by the buyer to the seller in exchange for the goods.
- **Mode of Fixing Price**: The method or basis on which the price is determined in a sale of goods contract.
- **Express Agreement**: Price is fixed explicitly by mutual consent in the contract.
- **Third-Party Fixation**: Price is decided by a person other than the buyer or seller, agreed upon in advance.
- **Market Price**: The prevailing price of goods in the market at the time of the sale.
- **Reasonable Price**: A fair price determined in the absence of an agreed price, often based on market value or trade practices.

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## 18.7. SELF-ASSESSMENT QUESTIONS

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1. Explain the legal meaning of 'goods' and distinguish between specific, ascertained, and unascertained goods.

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2. How is a reasonable price determined in a sale of goods contract? Discuss the legal provisions and case laws, if any.

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3. Define and explain 'contingent goods'. How are they different from future goods? Discuss with appropriate legal provisions.

## 18.8. LESSON END EXCERCISES

1. Define 'goods' under the Sale of Goods Act. Discuss the various classifications of goods with suitable examples.

2. Discuss the significance of the classification of goods in a contract of sale. How does it affect the transfer of property and risk?

3. What do you understand by the term ‘price’ in a contract of sale? Explain the various modes of fixing the price under the Sale of Goods Act.

## 18.9. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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**C. No: - BCG-303** **UNIT IV**

**SEMESTER: III** **LESSON: 19**

# SPECIAL CONTRACT II

**STRUCTURE**



## 19.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the meaning and legal significance of conditions and warranties in a contract of sale.
- To differentiate between a condition and a warranty under the Sale of Goods Act.
- To explain the implied conditions in a contract of sale (e.g., condition as to title, description, quality, and fitness).

- To describe the implied warranties (e.g., quiet possession, free from encumbrance).
- To identify situations where a condition may be treated as a warranty.
- To understand the concept of breach of condition vs. breach of warranty and the legal remedies available.

**Learning Outcomes**

After going through this lesson, learners will be able to:

- Define the terms condition and warranty as used in a contract of sale.
- Distinguish between a condition and a warranty with appropriate examples.
- Explain the legal consequences of breach of a condition versus breach of a warranty.
- Identify and describe the implied conditions and warranties in a contract of sale under the Sale of Goods Act.
- Interpret how and when a breach of condition may be treated as a breach of warranty.
- Demonstrate an understanding of the buyer's and seller's rights and obligations related to conditions and warranties.
- Evaluate relevant case laws that illustrate the application of conditions and warranties.

## 19.1. INTRODUCTION

In any contract for the sale of goods, the terms agreed upon by the parties form the foundation of their legal relationship. Among these terms, the concepts of conditions and warranties play a crucial role in defining the rights and obligations of the buyer and the seller. The Sale of Goods Act**,** which governs contracts related to the sale of goods, provides a clear distinction between these two types of contractual terms. A condition is a fundamental stipulation that is essential to the main purpose of the contract. If a condition is breached, the aggrieved party has the right to repudiate the contract and also claim damages. On the other hand, a warranty is a secondary stipulation, the breach of which does not entitle the aggrieved party to repudiate the contract but only to claim compensation for the loss suffered. The Act also recognizes certain implied conditions and warranties, which are automatically included in a contract of sale unless expressly excluded. These include conditions as to title,

description, and fitness for purpose, as well as warranties relating to quiet possession and freedom from encumbrances. Understanding these terms is essential not only for interpreting the legal validity of a sales agreement but also for resolving disputes that may arise due to non-performance or defects in the goods delivered. Through a study of conditions and warranties, one gains deeper insight into consumer protection, seller obligations, and the balance of fairness in commercial transactions governed by law.

## 19.2. MEANING OF CONDITION AND WARRANTIES

A contract of sale of goods contains various terms of stipulation regarding the quality of the goods, the price and the mode of its payment, the delivery of goods and its time and place. But all of them are not of equal importance. Some of these stipulations may be major terms which go to the very root of the contract and their breach may frustrate the very purpose of the contract, while others may be minor terms which are not so vital that their breach may seem to be a breach of the contract as such. In law of sales major terms are called conditions and minor terms are called warranties. From the terms of the contract it is necessary to distinguish mere statements of consideration or praise or expression of opinion made by the seller in reference to his goods. Such commendatory statements are neither conditions nor warranties. They do not form a part of the contract and as a result give no right of action. For Example, where a horse dealer, while praising his horse, states that the horse is very lucky and one whosoever shall purchase it must very soon become a millionaire, his statement, being mere commendatory in nature, does not form a part of the contract and its breach (i.e., if the buyer of the horse does not actually become a millionaire later) does not give rise to any legal consequences.

### Condition

A condition is a stipulation essential to the main purpose of the contract, the breach of which gives the aggrieved party a right to repudiate the contract itself [section 12(2)]. In addition, he may maintain an action for damages for loss suffered, if any, on the footing that the whole contract is broken and the seller is guilty of non-delivery. [Millers Machinery Co. Ltd. Vs. David Way & Son, 1934].

### Warranty

A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives

the aggrieved parity a right to sue for damages only, and not to void the contract itself[section 12(3)].

It will be seen that the above definition explain both the meaning and the legal effect of a condition and warranty. Accordingly, a condition forms the very basis of a contract of sale, the breach of which causes irreparable damage to the aggrieved party so as to entitle him even to repudiate the contract, whereas a warranty is only of secondary importance , the breach of which causes only such damage as can be compensated for the damages. In fact, a breach of condition is followed by the same consequence as the breach of a condition precedent in other contracts; namely, the innocent party has a right to rescind the contract, and claim damages. There is no hard and fast rule as to which stipulation is a condition and which one is a warranty. Section 12(4) lays down to the same effect thus, "whether a stipulation in a contract of sale is a condition or warranty depends in each case on the construction of the contract. A stipulation may be a condition though called a warranty in a contract". Thus, the court is not to be guided by the terminology of the parties but has to look to the intention of the parties by referring to the terms of the contract, its construction and the surrounding circumstances to judge whether a stipulation was a condition or a warranty. The most suitable test to distinguish between the two terms is that if the stipulation is such that its breach would be fatal to the rights of the aggrieved party, then such a stipulation is only a warranty.

**For examples:**

- A man buys a particular horse which is warranted quiet to ride and drive. If the horse turns out to be vicious, the buyer's only remedy is to claim damages. But if instead of buying a particular horse, a man asks a dealer to supply him with a quiet horse and the dealer supplies him with a vicious one, the stipulation is a condition, and the buyer can return the horse and can also claim damages for the breach of contract [Hartley V. Hyman, 1920].
- P goes to R, a horse dealer and says, "I want a horse which can runs at a speed of 30 miles per hour". The horse dealer points out a particular horse and says, "This will suit you". P buys the horse. Later on P finds that the horse can run only at a speed of 20 miles per hour. There is a breach of condition, P can repudiate the contract, return the horse to R and get back the price.
- But if P says to R, "I want to good horse". R shows him a horse and says, "This is a good horse and finds later on that it can run at a speed of 20 miles per hour only, there is a breach of warranty because the stipulation made by the seller did not form the very basis of the contract and was only

subsidiary one. Seller gave the assurance about the running speed of the horse of his own without being asked by the buyer. Hence, it is only of secondary importance.

The above illustrations are a clear proof of the fact that an exactly similar term may be a condition in one contract and a warranty in another depending upon the construction of the contract as a whole.

## 19.3. Difference between Condition and Warranty

| S. No. | Base | Condition | Warranty |
|---|---|---|---|
| 1. | Nature | It is fundamental in nature and essential for main purpose of contract. | It is supportive and collateral to the contract. |
| 2. | Breach | Due to breach of condition, the contract may be avoided. | Breach of warranty may give a rise to a right to claim for compensation. |
| 3. | Remedy | In breach of condition, aggrieved party has the option to repudiate the contract or to claim damages. | In breach of warranty, aggrieved party can claim for damages only. |
| 4. | Treatment | Breach of condition can be treated as breach of warranty. | Breach of warranty cannot be treated as breach of condition. |
| 5. | Fulfilling purpose | The main purpose of contract cannot be fulfilled unless the condition is fulfilled. | Fulfilment of a contract does not depend on the fulfilment of a warranty |
| 6. | Contract Termination | Breach of contract can render contract voidable. | Breach of warranty does not automatically render the contract void. |

**A.CHECK YOUR PROGRESS**

- **TRUE/FALSE**

**1.** A warranty is a guarantee that a product will perform as advertised.

**2.** Warranties only apply to used products.

**3.** A warranty means the product will never break.

**4.** There are two main types of warranties: express and implied.

**5.** An implied warranty automatically applies even if it's not written.

**6.** A warranty is the same as a return policy.

**7.** Warranty terms are legally binding.

**8.** Warranties cannot be limited or have conditions.

**9.** A product without a written warranty has no protection at all.

**10.** The duration of a warranty can vary depending on the product and company.

**Answers: 1.True, 2.False, 3.False, 4.True, 5.True, 6.False, 7.True, 8.False, 9.False, 10.True**

## 19.4. IMPLIED CONDITIONS AND WARRANTIES

In a contract of sale conditions and warranties may be express or implied. Express conditions and warranties are those which are entered in clear words in the contract. They are expressly provided in the contract of sale. Implied conditions and warranties are those, which the law incorporates into the contract unless the parties agree to the contrary. Implied conditions and warranties are enforced on the ground that the law presumes that the parties have incorporated them into their contract though they have not put them into it in express words. Thus, stipulations relating to title, merchantability, etc. are considered to be so important that they are treated as implied conditions and the stipulations relating to quiet possession and freedom from charges and encumbrances are treated as implied warranties. But, even though a condition or warranty may be implied by law, the implication may be negativated by an express agreement of the parties or by the usage of trade.

## 19.4.1. IMPLIED CONDITIONS:

The implied conditions laid down under the act are as follows:

1. **Condition as to title [Section 14(a)]**

   In every contract of sale, the first implied condition on the part of the seller is that, in the case of a sale, he has the right to sell the goods and that, in the case of an agreement to sell; he will have a right to sell the goods at the time when the property is to pass. Ordinarily, the seller has the right to sell the goods if either he is the owner of the goods or he is owner's agent. As a result of this condition, if the seller's title turns out to be defective the buyer is entitled to reject the goods and to recover his price. Notice that in the case of breach of condition as to title the buyer has no option to treat the breach of condition as breach of warranty and accept the goods and sue the seller for damages. In this case, he must return the goods to the true owner. He can of course recover the price from the seller because to total failure of condition.

   **For example:** R purchased a motorcar from D and used the same for several months. D had no title to the car and therefore, R was compelled to return the car to the true owner. R sued D to recover back the price which he had already paid. He was held entitled to recover the whole of the price paid by him despite the fact that he had used the car for some months [Rowland V.Divall, 1923].

   It may be noted that implied conditions as to title makes it obligatory upon the seller that he must not only be the owner but also must be able to uphold the validity of the contract. Thus, if the goods sold bear labels infringing the trade mark of another, the seller is guilty of breach of this condition although he had full ownership of the goods.

   It may further be noted that where a seller having not title to the goods at the time of sale, subsequently acquires the tile (e.g., by paying off the true owner) before the buyer seeks to repudiate the contract, that title feeds the defective titles of both the original and subsequent buyers and it will then be too late for the buyer to repudiate the contract [Patten V.Thomas Motors, 1965].

2. **In a sale by description**

   "Where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with description" (section 15). Lord Blackburn pointed out that, "If you contract to sell peas, you cannot oblige a party to take beans. If the description of the article tendered is different in any respect, if is not the article bargained for and the other

party is not bound to take it". It is important that the goods must correspond with the description whether it is a sale of specific goods or of unascertained goods. Further, the fact that the buyer has examined the goods will not affect his right to reject the goods, if the deviation of the goods from the description is such which could not have been discovered by casual examination, i.e., if the goods show any latent defects. The description may be in terms of the qualities or characteristics of the goods .e .g. long staple cotton, kalian wheat, sugar C-30, basmati rice or may simply mention the trade mark, brand name or the type of packing, etc.

**For Example:** Where there was a contract for the supply of new singer cars and one of the cars supplied having already run a consideration mileage was not new, there was a breach of condition on the part of the seller and the buyer was held entitled to reject the car[Andrews Bros.V.Singer & Co.,1934].

3. **In a sale by sample[section 17]**

   When under a contract of sale, goods are to be supplied according to a sample agreed upon, the implied conditions are:

   i. That the bulk shall correspond with the sample in quality;
   ii. That the buyer shall have a reasonable opportunity of comparing the bulk with the sample;
   iii. That the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample. In other words, there should not be any defect in the goods. If the defect is patent one, that is, easily discoverable by the ordinary care, and the buyer takes delivery after inspection, there is no breach of implied condition and the buyer has no remedy.

**For Example:** Two parcels of wheat were sold by sample. The buyer went to examine the bulk a week after. One parcel was shown to him but the seller refused to show the other parcel which are not there in the warehouse. Held, the buyer was entitled to rescind the contract [Lorymer V.Smith, 1822].

4. **In a sale by sample as well as by description [section 15]**

   When goods are sold by sample as well as by description, there is no implied condition that the bulk of the goods shall correspond both with the sample and with the description. If the

goods supplied correspond only with the sample and not with the description or vice-versa, the buyer is entitled to reject the goods. The bulk of the goods must correspond with both.

**For Example:** W agreed to sell G some oil described as 'foreign refined oil' warranted only equal to sample. The oil supplied, though corresponds with the sample, and was adulterated with hemp oil. Held, that since the oil supplied was not in correspondence with the description the buyer was entitled to reject the sample [Nichol Vs. Gods, 1854].

5. **Condition as to fitness or quality [section 16(1)]**

Ordinarily, in a contract of sale, there is no implied condition or warranty as to quality or fitness for any particular purpose of goods supplied; the rule of law being 'caveat emptor', which is, let the buyer, be aware. But an implied condition is deemed to exist on the part of the seller that the goods supplied shall reasonably fit for the purpose for which the buyer wants them, if the following conditions are satisfied:

a. The buyer, expressly or impliedly, should make known to the seller the particular purpose for which the goods are required; and
b. The buyer should rely on the seller's skill or judgement; and
c. The goods sold must be of a description which the seller deals in the ordinary course of his business, whether, he is the manufacturer or not.

The purpose must be made known expressly if the goods to be supplied can be used for several purposes, otherwise the condition as to fitness will not be implied and the buyer will have no right to reject the goods merely because they are unfit for the specific purpose he had in mind.

**For example:**

**a)** A buyer ordered for the Hessian cloth, which is generally used for packing purposes, without specifying the purpose for which he wanted the same. The cloth was supplied accordingly. On receiving the cloth the buyer found that it was not suitable for packing food products as it had an unusual smell. Held, that the buyer had no right to reject the cloth as it was suitable for packing purposes alright. The buyer ought to have disclosed his particular purpose to the seller in order to make him liable for the breach of implied condition as to fitness. The purpose need not be told expressly if the goods are fit for one particular purpose only or if the nature of the goods itself tells the purpose by implication. In such cases, the purpose is deemed to be made known to the seller impliedly.

**b)** Where a buyer demands tinned fruit juice, it is implied from the nature of the product itself that he wants it for consumption and if later on it is found to contain poisonous matter, there is a breach of implied condition as to fitness and the seller is liable in damages. Sometimes the implied purpose may also be gathered from usage of the trade e.g., Mobil oil for scooter implies 'two T's Mobil oil'. It is important that the implied condition as to fitness applies only in the case of sale of goods to a normal buyer. If the buyer is suffering from abnormality, and it is not made known to the seller at the time of sale, this condition does not apply.

6. **Condition as to merchantability [section 16(2)]**

This condition is implied only where the sale is by description. We have already seen that there is an implied condition in such cases, as per section 15, that the goods should correspond with the description. This sub-section lays down another implied condition in such cases, that is, that the goods should be of 'merchantable quality'. But for making this condition applicable, not only that the sale must be by description, but the following conditions must also be satisfied:

i. The seller should be a dealer in goods of that description, whether he be the manufacturer or not; and
ii. The buyer must not have any opportunity of examining the goods; there must be some latent defect in the goods which would not be apparent on reasonable examination of the same.
iii. If the buyer had an opportunity of making the examination but he avoids to examine, or if he has examined the goods, there is no implied condition as to merchantability as regards defects which such examination ought to have revealed [Proviso to section 16(2)].

The phrase 'merchantability quality' means that the goods are of such quality and in such condition that a reasonable man, acting reasonably, would accept them under the circumstances of the case in performance of his offer to buy those goods, whether he buys them for his own use or to sell again.

**For example:** Where the underwear supplied contained certain chemicals which could cause skin disease to a person wearing them next to skin it was held that because of such a defect the underwear's were not of merchantable quality and buyer was entitled to reject the goods.

7. **Condition as to wholesomeness**

This condition is implied only in a contract of sale of eatables and provisions. In such cases the goods supplied must not only answer to description and he merchantable but must also be wholesome.

**For example:** W bought a bottle of beer from H, a dealer in wines. The beer was contaminated with arsenic. W, on taking the beer, fell ill. H was held liable to W from the consequent illness [Wren Vs.Halt, 1903].

**B. CHECK YOUR PROGRESS**

- **FILL IN THE BLANKS**

1. A condition as to _____ is implied in every contract of sale, meaning the seller has the right to sell the goods.
2. When goods are sold by _____, there is an implied condition that they shall correspond with the description.
3. If goods are bought by sample, there is an implied condition that the _____ shall correspond with the sample in quality.
4. In a contract for the sale of goods, an implied condition of _____ quality applies when the buyer purchases goods from a seller who deals in such goods.
5. An implied condition as to fitness for a particular purpose arises when the buyer relies on the seller's _____ or judgment.
6. The condition as to _____ applies when goods are bought both by sample and by description. The goods must match both.
7. Under implied conditions, if the goods are not as described or not fit for purpose, the buyer has the right to _____ the contract.
8. A condition is a _____ term of the contract, the breach of which gives the right to reject the goods.

**ANSWERS: 1.Title, 2.Description, 3.Bulk, 4.Merchantable, 5.Skill, 6.Conformity, 7.Repudiate or terminate, 8.Fundamental.**

## 19.4.2. IMPLIED WARRANTIES

Unless otherwise agreed, the law incorporates into a contract of sale of goods the following implied warranties:

1. **Warranty of quiet possession [section 14(b)]:** In every contract of sale, the first implied warranty on the part of the seller is that "the buyer shall have and enjoy quiet possession of the goods". If the quiet possession of the buyer is in any way disturbed by a person having a superior right than that of the seller, the buyer can claim damages from the seller. Since disturbance of quiet possession is likely to arise only where the seller's title to goods is defective, this warranty may be regarded as an extension of the implied condition of title provided for by section 14(a). Infact, the two clauses of the section 14(a) & (b) are overlapping and it is not easy to see what additional rights this warranty confers on the buyer over and above those conferred by the implied condition as to title contained in section 14(a).

   **For example:** The plaintiff, a lady, purchased a second hand typewriter from the defendant. She thereafter spent some money on its repair and used it for some months. Unknown to the parties the typewriter was a stolen one and the plaintiff was compelled to return the same to the true owner. She was held entitled to recover from the sellers for the breach of this warranty damages reflecting not merely the price paid but also the cost of repair [Mason Vs. Burmingham, 1949].
2. **Warranty of freedom from encumbrances [section 14(c)]:** The second implied warranty on the part of the seller is that "the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made". If the goods are afterwards found to be subject to a charge and the buyer has to discharge the same, there is breach of warranty and the buyer is entitled to damages. It is to be emphasized that the breach of this warranty occurs only when the buyer in fact discharges the amount of the encumbrances, and he had no notice of that at the time of the contract of sale. If the buyer knows about the encumbrances on the goods at the time of entering into the contract, he becomes bound by the same and he is not entitled to claim compensation from the seller for discharging the same.

   **For example:** A, the owner of the watch, pledges it with B. After a week, A obtains possession of the watch from B for some limited purpose and sells it to C. B approaches C and tells him about the pledge affair. C has to make payment of the pledge amount to B. There is a breach of this warranty and C is entitled to claim compensation from A.

3. **Warranty of disclosing the dangerous nature of the goods to the ignorant buyer:** The third implied warranty on the part of the seller is that in case the goods sold are of dangerous nature he will warn the ignorant buyer of the probable danger. If there is breach of this warranty this buyer is entitled to claim compensation for the injury caused to him. Romar L.J. observed, "I think that, apart from any question of warranty, there is a duty cast upon a vendor, who knows of the dangerous character of the goods which he is supplying, and also knows that the purchaser is not, or may not be, aware of it, not to supply the goods without giving some warning to the purchaser of that danger".

   **For example:** C purchases a tin of disinfectant powder from A. A knows that the lid ofthe tin is defective and if it is opened without special care, it may be dangerous. But tells nothing to C, C opens the tin in the normal way whereupon the disinfectant powder flies into her eyes and causes injury. A is liable in damages to C as he should have warned C of the probable danger.

**C. CHECK YOUR PROGRESS**

- **ONE LINER QUESTIONS**

**Q.** What is the implied condition regarding the seller's right in a sale of goods?
**A.** *That the seller has the right to sell the goods (condition as to title).*

**Q.** Which implied condition ensures goods match their description?
**A.** *Condition as to description.*

**Q.** When does the condition of merchantable quality apply?
**A.** *When goods are bought from a seller who deals in such goods.*

**Q.** What condition applies when the buyer relies on the seller's skill for a specific purpose?
**A.** *Condition as to fitness for a particular purpose.*

**Q.** What is the implied condition in a sale by sample?
**A.** *That the bulk will correspond with the sample.*

**Q.** What does the condition as to wholesomeness relate to?
**A.** *That food or consumable goods are safe for use.*

**Q.** What is the implied warranty about the buyer's use of the goods without interference?
**A.** *Warranty of quiet possession.*

**Q.** Which warranty assures the buyer that goods are free from undisclosed encumbrances?
**A.** *Warranty as to freedom from encumbrances.*

**Q.** What is the consequence of breaching a condition in a contract of sale?
**A.** *The buyer may reject the goods and repudiate the contract.*

**Q.** What is the legal status of a warranty in comparison to a condition?
**A.** *It is a lesser term; breach allows for damages but not rejection of goods.*

## 19.5. LET US SUM UP

The concepts of conditions and warranties form a vital part of the Sale of Goods Act**,** as they determine the nature and extent of the obligations in a contract of sale. A condition is a core term that goes to the root of the contract. If breached, it allows the aggrieved party to terminate the contract and claim damages. In contrast, a warranty is a subsidiary term; its breach does not permit termination of the contract, but the affected party can sue for damages. The Act further includes implied conditions and warranties, which automatically apply to contracts unless specifically excluded. These include conditions relating to the right to sell**,** goods matching their description**,** fitness for a particular purpose**,** and merchantable quality. Implied warranties include the quiet possession of goods and their being free from any undisclosed encumbrances. The Act also provides that in certain situations, such as when the buyer has accepted the goods, a breach of condition may be treated only as a breach of warranty, emphasizing flexibility and fairness in commercial dealings. Understanding these provisions helps both buyers and sellers manage risks, ensure fair trade practices, and avoid unnecessary disputes. The distinction between conditions and warranties is crucial in determining the appropriate legal remedy and in maintaining a balanced relationship between the parties involved. Overall, this topic enhances one's legal insight into contract terms, especially in the context of goods sale transactions, and supports informed decision-making in both business and consumer contexts.

## 19.6. KEYWORDS

- **Condition**: A fundamental term of the contract; its breach allows the aggrieved party to repudiate the contract and claim damages.

- **Warranty**: A minor or secondary term of the contract; its breach only allows a claim for damages, not contract termination.

- **Implied Condition**: A condition that is not expressly stated but is assumed by law to be part of the contract (e.g., goods must match their description).

- **Implied Warranty**: A warranty automatically included in the contract by law, ensuring certain protections to the buyer (e.g., right to quiet possession).

- **Merchantable Quality**: A standard where goods must be of a quality acceptable in the market and fit for sale.

• **Fitness for Purpose**: An implied condition that goods must be suitable for the specific purpose the buyer has made known to the seller.

• **Title**: The legal right of ownership; the seller must have the right to sell the goods.

• **Quiet Possession**: An implied warranty ensuring the buyer will not be disturbed in their lawful use of the goods.

• **Encumbrance**: Any claim or liability attached to the goods that may affect the buyer's ownership or use.

• **Repudiation**: The rejection or cancellation of the contract due to a fundamental breach (usually of a condition).

## 19.7. SELF-ASSESSMENT QUESTIONS

1. "Every condition is a term of the contract, but every term is not a condition." Explain this statement with reference to the Sale of Goods Act, 1930.

2. How does the Sale of Goods Act, 1930 strike a balance between buyer's protection and seller's liability with respect to conditions and warranties?

3. Illustrate with examples how the treatment of condition is different from warranty.

## 19.8. LESSON END EXCERCISES

1. Explain the distinction between a condition and a warranty in a contract of sale. How does the Sale of Goods Act, 1930 deal with the breach of each? Support your answer with relevant case laws.

2. Discuss the concept of implied conditions and implied warranties under the Sale of Goods Act. How do these protect the interests of the buyer?

3. Under what circumstances can a breach of condition be treated as a breach of warranty under the Sale of Goods Act, 1930? Illustrate with examples.

## 19.9. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework

- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law

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**C. No :- BCG-303** **UNIT IV**

**SEMESTER: III** **LESSON: 20**

# SPECIAL CONTRACT II

**STRUCTURE**



## 20.0. Learning Objectives and Outcomes

**Learning Objectives**

- To understand the definition and meaning of an unpaid seller under the Sale of Goods Act.
- To identify the conditions under which a seller is considered unpaid.
- To recognize the rights available to an unpaid seller against the goods.
- To understand the rights of an unpaid seller against the buyer personally**.**
- To differentiate between rights against goods and rights against the buyer personally**.**
- To analyze circumstances under which these rights can be exercised.
- To understand the importance of protecting seller's rights in commercial transactions.

**Learning Outcomes**

After going through this lesson, the learners will be able to:

- Explain who qualifies as an unpaid seller under the Sale of Goods Act.
- Describe the legal rights of an unpaid seller against the goods (lien, stoppage in transit, and resale).
- Illustrate the rights of an unpaid seller against the buyer personally (suit for price, damages, etc.).
- Distinguish between the seller's rights against goods and rights against the buyer.
- Analyze real-life scenarios or case studies involving the rights of unpaid sellers.
- Apply the concept to resolve legal problems or disputes involving unpaid sellers.
- Demonstrate understanding of conditions and limitations under which each right can be exercised.
- Evaluate the practical significance of these rights in business and trade law.

## 20.1. INTRODUCTION

The rights of an unpaid seller form a crucial part of the legal framework governing the sale of goods and aim to protect sellers in commercial transactions where payment has not been fulfilled. An unpaid seller is defined as one who has not received the full price for the goods sold or has received a negotiable instrument, such as a cheque or bill of exchange that has been dishonoured. These rights are particularly important in ensuring that sellers are not left without remedy when a buyer defaults on payment. Under the Sale of Goods Act, the unpaid seller is granted specific rights against the goods and the buyer, which are categorized as rights against the goods (such as lien, stoppage in transit, and resale) and rights against the buyer personally (such as suing for the price or damages). These provisions not only protect the financial interests of sellers but also promote confidence in trade by providing clear legal recourse. For example, the right of lien allows the seller to retain possession of the goods until payment is made, while the right of stoppage in transit enables the seller to regain possession of goods in transit if the buyer becomes insolvent. The right of resale further empowers the seller to resell the goods under certain conditions, helping to mitigate losses. These legal rights reflect the principle of fairness in commerce, ensuring that sellers are not unjustly disadvantaged by the non-payment or insolvency of buyers. Understanding these rights is essential for anyone engaged in the buying and selling of goods.

## 20.2. MEANING OF UNPAID SELLER

An unpaid seller is a seller who has not been paid the whole of the price or any other negotiable instrument which is subsequently dishonoured. According to sec.45 (1) of the Sale of Goods Act, the unpaid seller means, a seller

a. Who has not been paid or tendered the whole of the price of goods sold and
b. Who has received a Bill of Exchange or any other negotiable instrument like cheques as conditional payment the condition being that the instrument shall be duly honoured.

## 20.3. Rights of Unpaid Seller against Goods and Buyer

The sale of goods act has expressly given two kinds of rights to an unpaid seller of goods, namely:

**1. Right against the goods:**

**a)** When the property in the goods has passed, the seller has the following rights:

i) Right of lien
ii) Right of stoppage of goods in transit
iii) Right of re-sale

These rights of an unpaid seller do not depend upon any agreement, express or implied between the parties. They arise by the implication of law.

**b)** When property in goods has not passed

i) Right of withholding delivery.

**2. Right against the buyer personally**

i) Right to sue for price.
ii) Right to sue for damages
iii) Right to sue for interest.

### (I) Rights of Unpaid Seller against the Goods

**(a) Right of lien [section 47-49]:** Lien is the right to retain possession of goods until payment in respect of them is paid. Section 47 (1) describes the circumstances in which an unpaid seller may exercise his right of lien. The unpaid seller of goods, who is in possession of them, can retain possession until payment or tender of the price in the following cases, namely:

a) Where the goods have been sold without any stipulation as to credit;

b) Where the goods have been sold on credit, but the term of credit has expired;

c) Where the buyer becomes insolvent

The right of lien is linked with possession and not with title. It is essentially a right over the property of another person. The unpaid seller's lien can be exercised only so long as the goods are in the actual possession of the seller or his agent. Once the possession is lost, the lien is also lost.

**For example:** A sold certain shares to B. The relative share certificates' and transfer forms duly signed were handed over by the seller to the buyer against payment of price by cheque. The buyer became insolvent. It was held by the Privy Council that the seller had no lien on shares because his lien ceased when he parted with possession [Bharuchs Vs.Wadihah].

The right of lien is indivisible in nature and so the buyer is not entitled to claim delivery of a portion of the goods on payment of a proportionate price. Further, this right is available even after part delivery of the goods has been made, unless such part delivery is made under such circumstances as to show an agreement to waive the lien [section 48].

**For example:** A sells to B a certain quantity of sugar. It is agreed that three months credit shall be given. B allows the sugar to retain in A's warehouse till the expiry of the three months and then does not pay for them. A may retain the goods for price.

**Termination of lien [section 49]:**

The right of lien is linked with the possession of the goods and this right is lost if the possession is lost. Unpaid seller loses his right of lien in the following cases:

1. **By delivery to carrier:** Delivery of the goods to a carrier for the purpose of transmission to the buyer operates as a delivery of the buyer himself and therefore the right of lien is lost, but the seller still has a right of stoppage in transit. The delivery to the carrier puts an end to the right of lien. But if the seller regains possession of the goods from the carrier by exercising his right of stoppage in transit, his lien revives. But if the seller takes back the goods from the carrier for any other purpose the right of lien does not revive.

   **For example:** The goods sold were delivered to the buyer's shipping agent who put them on board a ship. But the goods were returned to the seller for repacking. While they were still with the seller on this mission, the buyer became insolvent, and the seller being unpaid, claimed to retain the goods in exercise of his lien. It was held that having lost his lien by delivery to the shipping agent,

his refusal to deliver was wrongful [Valpy Vs. Gibson, 1847].

2. **By delivery to buyer:** The right of lien is also lost when the goods are delivered to the buyer or his agent. When the seller has given the buyer the possession under the contract of sale, all his rights in the goods are completely done. Where the goods are delivered back to the seller for a specific purpose, such as repairs, that does not revive the seller's right of lien.
   The seller's lien is however not defeated where the buyer has obtained the possession without the consent of seller, e.g., by some wrongful act. The buyer shall have to take the possession lawfully and under the terms of the contract.

3. **By waiver:** Where the seller has waived the right of lien, which may be express or implied the right of lien, is terminated. A waiver is express where the contract itself provides that the seller shall not be entitled to retain possession of the goods even if the buyer does not pay the price of the goods. A waiver is implied where the seller sells the goods on credit or grants a fresh term of credit.

4. **By tender of price:** Where the buyer tenders price for the goods purchased by him, the seller no more remains an unpaid seller, therefore his right of lien is also lost.

**(b) Right of stoppage in transit [section 50-52]**

The second important right which is available to an unpaid seller is the right of stoppage is transit. The right of stoppage means the right to stop further transit of the goods, to resume possession thereof and to retain the same till the price is paid. The right can be exercised under the following circumstances:

a) The seller must be unpaid.

b) The seller must have parted with the possession of the goods and the buyer must not have acquired it.

c) The buyer must be insolvent.

d) The property must have passed from the seller to the buyer

The right of stoppage in transit arises only after the seller has parted with possession of the goods and the buyer has become insolvent. This right is only available when the goods are neither in the possession of the seller nor that of the buyer, but are in the possession of a

middleman for the purpose of transmission to the buyer.

**For example:** B, who had bought goods from M/s Clark & Co. of Glasgow, instructed the seller to send the goods by a certain named ship to Melbourne. Goods were first railed to London and then shipped to Melbourne, a mate's receipt being sent to buyers, but it was too late. They then gave fresh notice to the ship owners claiming back the goods before the ship arrived at Melbourne. One arrival there, the receiver in bankruptcy of B demanded the bills of lading from the master. Held, that goods having been effectively stopped in transit, the trustee could not claim them [ Bahell Vs. Clark].

**Duration of transit:**

Since the right of stoppage in transit can be validity exercised only during transit, the question of duration of transit is of great importance. Goods are deemed to be in transit from the time they are delivered to be a carrier or other bailee for the purpose of transmission to have buyer until the buyer or his agent takes delivery thereof. The transit comes to an end in the following cases:

a) If the buyer or his agent obtains delivery of the goods before their arrival at the appointed destination.

b) 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 them on his behalf.

c) In case, the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent.

**How right of stoppage in transit is exercised:**

The unpaid seller may exercise the right of stoppage in transit:

(a) by actually taking possession of the goods; or

(b) by giving notice of his claim to the carrier or other bailee in whose possession are the goods

**(iii) Right of re-sale [section 54]:** In addition to the right of lien and stoppage in transit, the unpaid seller has got the valuable right of re-sale of the goods, which are the subject – matter of the contract. This limited right of re-sale is conferred by the section 54 which also enumerates the circumstances under which the right of re-sale may be exercised. The right

may be exercised in the following cases:

a) Where the goods are of a perishable nature. In this case, the unpaid seller need not give a notice to the buyer of his intention to resell the goods.

b) Where the unpaid seller has exercised his right of lien or stoppage in transit, he can give notice to the buyer of his intention to resell the goods.

c) Where the seller has expressly reserved a right of resale, in case the buyer makes default. In such a case, on resale though the original contract of sale is thereby rescinded, the unpaid seller does not lose his right to claim damages for breach of the contract.

**(iv) Right of withholding delivery**

Where the property in the goods has not passed to the buyer, the unpaid seller has in addition to other remedies against the buyer personally, a right of withholding delivery of goods which are the subject – matter of the contract. This right is similar to and co-existence with his right of lien and stoppage in transit. This right can be exercised even if the sale was on credit or that the goods were specific or unascertained.

**(II) Right of unpaid seller against the buyer personally:**

In addition to his rights against the goods, an unpaid seller has the following rights against the buyer personally.

**(i)Suit for Price (section 55):**

Where under a contract of sale, the property in the goods has passed to the buyer and the goods have actually come into his possession, the unpaid seller's only remedy is a suit for the price. Where under a contract of sale, the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay the price, the seller may institute a suit for the recovery of the same, although the property in the goods may not have passed.

**(ii) Suit for damages for non-acceptance [section 56]:**

Where the buyer wrongfully neglects or refuses to accept and pay for the goods the seller may sue him for damages for non-acceptance. The measure of damage is determined by the rules contained in sections 73 and 74 of the Indian contract act.

**(iii) Suit for interest (section 61):**

Where under a contract of sale, the seller tenders the goods to the buyer and the buyer wrongfully

refuses to accept and pay for them, the court may award interest on the price from the date of the tender of the goods or from the date when the price is payable.

## A. CHECK YOUR PROGRESS

- **MULTIPLE CHOICE QUESTIONS**

1. **Who is considered an "unpaid seller" under the Sale of Goods Act?**
   A. A seller who refuses to deliver goods
   B. A seller who has received full payment
   C. A seller who has not received full payment or received a dishonoured negotiable instrument
   D. A seller who has delivered defective goods
   **Answer:** C

2. **Which of the following is NOT a right available to an unpaid seller against the goods?**
   A. Right of lien
   B. Right of stoppage in transit
   C. Right of compensation
   D. Right of resale
   **Answer:** C

3. **The right of stoppage in transit can be exercised when the buyer becomes:**
   A. Violent
   B. Insolvent
   C. Uncooperative
   D. Late
   **Answer:** B

4. **The right of lien is lost when:**
   A. Goods are resold
   B. Buyer becomes insolvent
   C. Seller delivers goods to a carrier without reserving disposal rights
   D. Seller receives part payment
   **Answer:** C

5. **An unpaid seller can sue the buyer for the price of goods when:**
   A. Goods are delivered and accepted
   B. Goods are stolen
   C. Seller cancels the contract
   D. Goods are gifted
   **Answer:** A

**B. CHECK YOUR PROGRESS**

- **ONE LINERQUESTIONS**

**Q. Who is an unpaid seller?**
**A.** A seller who has not received full payment or has received a dishonoured negotiable instrument.

**Q.** What **is the right of lien?**
**A.** The right to retain possession of goods until full payment is received.

**Q. When can the right of stoppage in transit be exercised?**
**A.** When the buyer becomes insolvent and the goods are still in transit.

**Q. What is meant by resale by an unpaid seller?**
**A.** Selling the goods again if the buyer defaults and certain conditions are met.

**Q. Does the unpaid seller have rights against the buyer personally?**
**A.** Yes, including suing for price or damages.

**Q. When is the right of lien lost?**
**A.** When the seller delivers the goods to a carrier without reserving rights.

**Q. Can the unpaid seller reclaim goods after delivery to the buyer?**
**A.** No, once goods are delivered, the seller loses rights over them.

**Q. Which law governs the rights of an unpaid seller in India?**
**A.** The Sale of Goods Act, 1930.

**Q. What does 'insolvent buyer' mean?**
**A.** A buyer who is unable to pay their debts.

**Q. Is notice required for resale by an unpaid seller?**
**A.** Yes, unless the goods are perishable or the contract allows resale without notice.

**C. CHECK YOUR PROGRESS**

- **TRUE/FALSE**

**1.** An unpaid seller has no rights if the buyer becomes insolvent.

**2.** The right of resale can be exercised without any conditions.

**3.** The unpaid seller has rights both against the goods and against the buyer personally.

**4.** Once the seller gives up possession of goods voluntarily, the right of lien ends.

**5.** The right of stoppage in transit is applicable even after the buyer has taken delivery.

**Answers: 1.F, 2.F, 3.T, 4.T, 5.F**

## 20.4. LET US SUM UP

The rights of an unpaid seller are legal protections provided under the Sale of Goods Act, 1930, to safeguard sellers who have not received full payment for goods sold. A seller is considered "unpaid" when the whole price has not been paid or when payment has been made through a dishonoured negotiable instrument, such as a cheque or bill of exchange. The law grants such sellers two main types of rights: rights against the goods and rights against the buyer personally. The rights against the goods include the right of lien (to retain possession until payment is received), the right of stoppage in transit (to regain possession of goods if the buyer becomes insolvent during delivery), and the right of resale (to resell goods under specific conditions). These rights help the seller minimize financial loss due to non-payment. Additionally, the personal rights against the buyer include the right to sue for the price and the right to claim damages for breach of contract or non-acceptance. These provisions ensure fairness in commercial transactions and protect sellers from the risks associated with buyer default or insolvency. Understanding these rights is crucial for maintaining trust and balance in business dealings.

## 20.5. KEYWORDS

- **Unpaid Seller**: A seller who has not received full payment for goods sold or has received a dishonoured negotiable instrument (e.g., a bounced cheque).
- **Right of Lien**: The seller's right to retain possession of the goods until the full price is paid.
- **Right of Stoppage in Transit**: The right to stop goods in transit and regain possession if the buyer becomes insolvent before delivery.
- **Right of Resale**: The right to resell the goods if the buyer fails to pay, under specific conditions such as perishability or notice to the buyer.
- **Insolvent Buyer**: A buyer who is unable to pay debts and has ceased to pay or admits inability to pay.
- **Possession**: Physical control or custody of the goods.
- **Transit**: The period during which goods are being transported from the seller to the buyer.
- **Personal Remedies**: Legal actions the seller can take against the buyer, such as suing for the price or claiming damages.

## 20.6. SELF-ASSESSMENT QUESTIONS

1. Discuss the legal remedies available to an unpaid seller when the buyer becomes insolvent.

2. Under what conditions can an unpaid seller exercise the right of resale? What are the legal consequences of resale without giving notice to the buyer?

3. Illustrate the working of the right of stoppage in transit with a practical scenario. What are the limitations of this right?

## 20.7. LESSON END EXCERCISES

1. Define an unpaid seller. Discuss in detail the rights of an unpaid seller against the goods and against the buyer personally under the Sale of Goods Act.

2. Explain the right of lien, right of stoppage in transit, and right of resale available to an unpaid seller. Under what circumstances can these rights be exercised?

3. What is the significance of the rights of an unpaid seller in maintaining fair commercial practices? Support your answer with examples.

## 20.8. SUGGESTED READINGS


- Garg, Sareen, Sharma and Chawla, Business Regulatory Framework
- M.C.Kuchhal, Mercantile Law
- Chawla & Garg, Mercantile Law
- D.K.Kulshrestha, Commercial Law
- R.S.Sharma, Commercial Law


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