

# BUSINESS LAW

*N.D. Kapoor*



20936

R. 3

# BUSINESS LAWS

For ICWA Inter, New Syllabus

658.12



Welingkar

KAP  
Business Laws

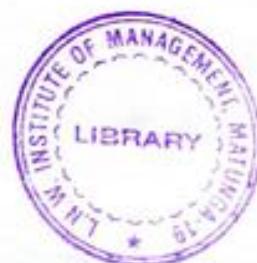
20936

Do Not Mark  
on the Books

N.D. KAPOOR

Formerly, Head of the Department of Commerce  
Hans Raj College, University of Delhi, Delhi

Author of *Elements of Mercantile Law*, *Elements of Company Law*,  
*Handbook of Industrial Law*



20936



**SULTAN CHAND & SONS**  
Educational Publishers  
New Delhi

- First Edition 2003  
Reprint with Correction, 2004, 2005  
Second Edition, 2008  
Reprint, 2010

© All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Publishers.

• Price : Rs. 220.00

• ISBN : 978-81-8054-598-6

• Published by :

SULTAN CHAND & SONS  
23, Daryaganj, New Delhi-110002  
Phones : 23243183, 23247051, 23266105, 23277843, 23281876  
Fax : 011 2326-6357

32905

★ Printed at : New A.S.Offset Press, Delhi

20936

## Preface

### To the Second Revised Edition

The author is glad to present the Second Revised edition of the popular book for the students.

One feature of the revised edition is the incorporation of Companies (Amendment) Act, 2006 enacted in May 2006 which was a major development.

India has about eight lakh companies at work spread throughout the country. Large number of new companies are incorporated every year. 22 Registrars of Companies with limited infrastructure were handicapped in administration of company law in such large number of companies. To ensure proper enforcement of and compliance with provisions of Companies Act, MCA-21 has made it mandatory for all companies, including private companies, to obtain a COMPANY IDENTIFICATION NUMBER (CIN).

The Companies (Amendment) Act, 2006 has made DIRECTOR IDENTIFICATION NUMBER (DIN) mandatory for all existing and future directors on Company Board. It is discussed in Chapter 16 on 'Company Management'. It will help the Government to keep track of the people who run the companies and facilitate legal action against defaulting directors.

The Companies (Amendment) Act, 2006 has also made Electronic Filing of Statutory Documents, Memorandum and Articles of Association, Balance Sheets, Annual Returns, Details of Charges, etc. mandatory under the Project termed as MCA-21. It is discussed in Chapter 4 regarding 'Formation of Company'. MCA-21 Project covers the following matters :

- Registration and incorporation of new companies
- Filing of Annual Returns and Balance Sheets
- Filing of forms for change of name/address/directors' details
- Registration, modification and verification of charges
- Inspection of documents
- Issue of certified copies
- Applications for permissions required under various provisions of Company Law
- Approvals from Central Government, Regional Director and ROC
- Investor Grievance Redressal.

This Project MCA-21 has great significance.

The students are advised to keep in mind the latest provisions of Companies (Amendment) Act, 2006 for mandatory Electronic Filing.

The Author looks forward to receiving maximum suggestions and comments for making the book more useful to the students.

N.D. KAPOOR



# Syllabus

Institute of Cost and Works Accountants of India  
Effective from July, 2002

**Paper 7 : Business Laws and Communication Skill**  
(One Paper : 3 hours : 100 marks)

**Section I—Business Laws (70 marks)**

- (i) **Indian legal system**—The judiciary system—Supreme Court, High Courts and other subordinate courts.
- (ii) **Essentials of Contract Act**—valid, void and voidable contracts, quasi-contract, bailment, conditions and warranties, breach of contract, damages.
- Main provisions of Sale of Goods Act.
- General concepts of Negotiable Instruments Act.
- (iii) **Partnership Act**—salient features, position of minors, implied authority, dissolution.
- (iv) **The Companies Act, 1956**—definition, fundamental matters relating to formation, promoters' function, fundamental matters and general framework of documents, meetings and proceedings; management of company operations, winding up; meetings and proceedings, mismanagement and arrangements, shares and debentures, borrowing of a company, accounts and audit, appointment and powers and duties of an auditor, cost accounting records and cost audit, authors' report and explanation, preparation and presentation of accounts of government companies and statutory corporations. Corporate laws as amended from time to time.

(v) **General concepts and objects of :**

1. Foreign Exchange Management Act,
2. MRTP Act,
3. Competition related Laws,
4. Payment of Bonus Act,
5. Payment of Gratuity Act,
6. Consumer Protection Act,
7. Air, Water and Noise Pollution Act,
8. Industrial Development & Regulation Act,
9. Industrial Disputes Act, and
10. Current Legislations.

# Brief Contents

X<sup>✓</sup>  
Introductory—Indian Legal System

**PART ONE—LAW OF CONTRACT AND SPECIAL CONTRACTS**

	Page
(i)—(viii)	
1.1. Law of Contract—An Overview	1
1.2. Classification of Contracts ✓	7
1.3. Offer and Acceptance ✓	11
1.4. Consideration ✓	23
1.5. Capacity to Contract ✓	31
1.6. Free Consent ✓	37
1.7. Legality of Object ✓	52
1.8. Performance of Contract ✓	60
1.9. Discharge of Contract ✓	69
1.10. Remedies for Breach of Contract ✓	79 ✓
1.11. Quasi-Contracts ✓	85 ✓
2. Indemnity and Guarantee ✓	89
3. Bailment and Pledge ✓	101
4. Contract of Agency ✓	111
5.1. Sale of Goods ✓	129
5.2. Conditions and Warranties ✓	135
5.3. Transfer of Property ✓	142
5.4. Performance of Contract ✓	149
5.5. Rights of an Unpaid Seller ✓	153
6.1. Law of Partnership	159
6.2. Relations of Partners	170
6.3. Dissolution of Firm	184
7.1. Negotiable Instruments	191 ✓
7.2. Parties to a Negotiable Instrument	201
7.3. Negotiation	205
7.4. Presentment and Dishonour	207
7.5. Discharge of a Negotiable Instrument	213

**PART TWO—CORPORATE LAW**

8.1. Company Law	217
8.2. Kinds of Companies	224
8.3. Promotion and Incorporation of a Company	231
8.4. Memorandum of Association	237
8.5. Articles of Association	247
8.6. Prospectus	256



8.7. Shareholders of a Company	272
8.8. Directors	276
8.9. Meetings and Proceedings	282
8.10. Accounts and Auditors	297
8.11. Prevention of Oppression and Mismanagement	311
8.12. Winding Up	317
<b>PART THREE—OTHER LAWS</b>	
9. The Foreign Exchange Management Act, 1999	341
10. The Payment of Bonus Act, 1965	347
11. The Payment of Gratuity Act, 1972	355
12. The Consumer Protection Act, 1986	361
13. The Air (Prevention and Control of Pollution) Act, 1981	383
14. The Water (Prevention and Control of Pollution) Act, 1974	389
15. The Industries (Development and Regulation) Act, 1951	395
16. The Industrial Disputes Act, 1947	401
17. Environment Protection Act, 1986	417
18. Competition Related Laws	427
19. The Monopolies and Restrictive Trade Practices Act, 1969	451
S.I.—S.32	
Q.1—Q.13	

**SCANNER OF EXAMINATION QUESTIONS****QUESTION PAPERS**

# Detailed Contents

1. INTRODUCTORY—INDIAN LEGAL SYSTEM	(i)
WHAT IS LAW (i)	
SOURCES OF LAW (ii)	
SOURCES OF INDIAN LAW (iii)	
ENGLISH LAW (iii)	
CUSTOMS OR CUSTOMARY LAW (v)	
JUDICIAL PRECEDENTS (v)	
JUDICIARY INTRODUCTORY (vi)	
LEGISLATION (vii)	
PERSONAL LAW (vii)	
TEST QUESTIONS (viii)	
<hr/>	
<b>PART 1—GENERAL PRINCIPLES OF LAW OF CONTRACT &amp; SPECIAL CONTRACTS</b>	
<hr/>	
1-1. LAW OF CONTRACT—AN OVERVIEW	1
OBJECT OF LAW OF CONTRACT 1	
THE INDIAN CONTRACT ACT, 1872 1	
DEFINITION OF CONTRACT 2	
ESSENTIAL ELEMENTS OF A VALID CONTRACT 3	
TEST QUESTIONS 5	
PRACTICAL PROBLEMS 5	
1-2. CLASSIFICATION OF CONTRACTS	7
Classification according to validity 7	
Classification according to formation 7	
Classification according to performance 9	
TEST QUESTIONS 10	
1-3. OFFER AND ACCEPTANCE	11
OFFER 11	
Legal rules as to offer 12	
Special terms in a contract 14	
ACCEPTANCE 15	
Who can accept ? 15	
LEGAL RULES AS TO ACCEPTANCE 16	
COMMUNICATION OF OFFER, ACCEPTANCE AND REVOCATION 28	
Contracts over telephone or telex or oral communication 19	
When does an offer come to an end ? 20	
TEST QUESTIONS 21	
PRACTICAL PROBLEMS 21	

<p><b>1-4. CONSIDERATION</b></p> <p>DEFINITION OF CONSIDERATION 23 LEGAL RULES AS TO CONSIDERATION 24 STRANGER TO CONTRACT 27 A CONTRACT WITHOUT CONSIDERATION IS VOID—EXCEPTIONS 28 TEST QUESTIONS 29 PRACTICAL PROBLEMS 30</p> <p><b>1-5. CAPACITY TO CONTRACT</b></p> <p>MINORS 31 PERSONS OF UNSOUND MIND 34 OTHER PERSONS 34 TEST QUESTIONS 36 PRACTICAL PROBLEMS 36</p> <p><b>1-6. FREE CONSENT</b></p> <p>Meaning of consent and free consent 37 COERCION 38 UNDUE INFLUENCE 40 Difference between coercion and undue influence 41 MISREPRESENTATION 42 FRAUD 43 Distinction between fraud and misrepresentation 46 MISTAKE 46 Mistake of law 46 Mistake of fact 46 TEST QUESTIONS 50 PRACTICAL PROBLEMS 51</p> <p><b>1-7. LEGALITY OF OBJECT</b></p> <p>When is consideration or object unlawful ? 52 UNLAWFUL AND ILLEGAL AGREEMENTS 53 AGREEMENTS OPPOSED TO PUBLIC POLICY 55 TEST QUESTIONS 58 PRACTICAL PROBLEMS 59</p> <p><b>1-8. PERFORMANCE OF CONTRACT</b></p> <p>OFFER TO PERFORM 60 BY WHOM MUST CONTRACTS BE PERFORMED ? 61 DEVOLVATION OF JOINT LIABILITIES AND RIGHTS 62 TIME AND PLACE OF PERFORMANCE 63 TIME AS THE ESSENCE OF CONTRACT 64 APPROPRIATION OF PAYMENTS 65 ASSIGNMENT OF CONTRACTS 66 TEST QUESTIONS 68 PRACTICAL PROBLEMS 68</p>	<p>23</p> <p>31</p> <p>37</p> <p>52</p> <p>60</p>	<p><b>1-9. DISCHARGE OF CONTRACT</b></p> <p>DISCHARGE BY PERFORMANCE 69 DISCHARGE BY AGREEMENT OR CONSENT 69 DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE 71 Discharge by supervening impossibility 72 DISCHARGE BY LAPSE OF TIME 74 DISCHARGE BY OPERATION OF LAW 74 DISCHARGE BY BREACH OF CONTRACT 75 TEST QUESTIONS 77 PRACTICAL PROBLEMS 77</p> <p><b>1-10. REMEDIES FOR BREACH OF CONTRACT</b></p> <p>Where there is a right, there is a remedy 79 RESCISSON 79 DAMAGES 80 QUANTUM MERUIT 82 SPECIFIC PERFORMANCE 82 INJUNCTION 83 TEST QUESTIONS 83 PRACTICAL PROBLEMS 83</p> <p><b>1-11. QUASI-CONTRACTS</b></p> <p>KINDS OF QUASI-CONTRACTS 85 TEST QUESTIONS 87 PRACTICAL PROBLEMS 87</p> <p><b>2. INDEMNITY AND GUARANTEE</b></p> <p>CONTRACT OF INDEMNITY 89 Rights of indemnity-holder when sued 90 CONTRACT OF GUARANTEE 91 Distinction between indemnity and guarantee 92 NATURE OF SURETY'S LIABILITY 93 KINDS OF GUARANTEE 93 RIGHTS OF SURETY 94 DISCHARGE OF SURETY 96 TEST QUESTIONS 99 PRACTICAL PROBLEMS 99</p> <p><b>3. BAILMENT AND PLEDGE</b></p> <p>BAILMENT 101 CLASSIFICATION OF BAILMENTS 102 DUTIES AND RIGHTS OF BAILOR AND BAILEE 103 Duties of bailor 103 Duties of bailee 103 Rights of bailor 104 Rights of bailee 105</p>	<p>(ix)</p> <p>69</p> <p>79</p> <p>85</p> <p>89</p> <p>101</p>
---	---	--	--

(x)		(xi)
LAW RELATING TO LIEN 105 FINDER OF GOODS 107 TERMINATION OF BAILEMENT 107 PLEDGE 108 Difference between pledge and bailment 108 PLEDGE BY NON-OWNERS 108 TEST QUESTIONS 109 PRACTICAL PROBLEMS 109		CAVEAT EMPTOR 140 TEST QUESTIONS 140 PRACTICAL PROBLEMS 140
4. CONTRACT OF AGENCY ✓ DEFINITION OF AGENT AND PRINCIPAL 111 CREATION OF AGENCY 112 Agency by express agreement 112 Agency by implied agreement 112 DELEGATION OF AUTHORITY 116 RELATIONS OF PRINCIPAL AND AGENT 117 Duties of agent 117 Rights of agent 119 Duties and rights of principal 119 Rights of principal 120 RELATIONS OF PRINCIPAL WITH THIRD PARTIES Extent of agent's authority 120 Position of principal and agent in relation to third parties 121 PERSONAL LIABILITY OF AGENT 123 TERMINATION OF AGENCY 125 Irrevocable agency 126 TEST QUESTIONS 127 PRACTICAL PROBLEMS 127	111	5-3. TRANSFER OF PROPERTY 142 PROPERTY, POSSESSION AND RISK 142 PASSING OF PROPERTY 142 Specific goods 143 Unascertained goods 143 Goods sent on approval or on sale or return 144 SALE BY NON-OWNERS 145 TEST QUESTIONS 147 PRACTICAL PROBLEMS 147
5-1. SALE OF GOODS ✓ FORMATION OF CONTRACT OF SALE 129 Contract of sale of goods 129 Sale and agreement to sell 129 Sale and hire-purchase agreement 131 Distinction between a sale and a hire-purchase agreement 132 SUBJECT-MATTER OF CONTRACT OF SALE 132 TEST QUESTIONS 134 PRACTICAL PROBLEMS 134	129	5-4. PERFORMANCE OF CONTRACT 149 DELIVERY OF GOODS 149 Rules as to delivery of goods 150 TEST QUESTIONS 152 PRACTICAL PROBLEMS 152
5-2. CONDITIONS AND WARRANTIES ✓ CONDITION AND WARRANTY 135 Distinction between a condition and warranty 135 EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES 136 Implied conditions 136 Implied warranties 139	135	5-5. RIGHTS OF AN UNPAID SELLER 153 WHO IS AN UNPAID SELLER ? 153 Rights of an unpaid seller against the goods 153 Right of lien 154 Right of stoppage in transit 155 Right of re-sale 156 Right of withholding delivery 156 TEST QUESTIONS 157 PRACTICAL PROBLEMS 157
6-1. LAW OF PARTNERSHIP 159 DEFINITION OF PARTNERSHIP 159 Law of partnership—extension of the law of agency 160 FORMATION OF PARTNERSHIP 160 PARTNERS, FIRM, FIRM NAME 161 TEST OF PARTNERSHIP 162 PARTNERSHIP AND OTHER ASSOCIATIONS 163 Partnership and joint Hindu family 163 Partnership and co-ownership 164 DURATION OF PARTNERSHIP 165 REGISTRATION OF FIRMS 166 Effects of non-registration 167 TEST QUESTIONS 168 PRACTICAL PROBLEMS 168		159
6-2. RELATIONS OF PARTNERS 170 RELATIONS OF PARTNERS TO ONE ANOTHER 170		

Rights of a partner	170
Duties of a partner	172
<b>RELATIONS OF PARTNERS TO THIRD PARTIES</b>	<b>173</b>
TYPES OF PARTNERS	175
Minor partner	177
RECONSTITUTION OF A FIRM	178
TEST QUESTIONS	182
PRACTICAL PROBLEMS	182
<b>6-3. DISSOLUTION OF FIRM</b>	<b>184</b>
DISSOLUTION WITHOUT THE ORDER OF COURT	184
DISSOLUTION BY COURT	185
SETTLEMENT OF ACCOUNTS	186
TEST QUESTIONS	189
PRACTICAL PROBLEMS	189
<b>7-1. NEGOTIABLE INSTRUMENTS</b>	<b>191</b>
DEFINITION OF NEGOTIABLE INSTRUMENT	191
NOTES, BILLS AND CHEQUES	192
TYPES OF NEGOTIABLE INSTRUMENTS	193
BILL OF EXCHANGE	194
Distinction between a bill and a Promissory note	195
CHEQUE	195
Crossing of cheques	196
MATURITY AND DAYS OF GRACE	198
TEST QUESTIONS	199
PRACTICAL PROBLEMS	200
<b>7-2. PARTIES TO A NEGOTIABLE INSTRUMENT</b>	<b>201</b>
HOLDER AND HOLDER IN DUE COURSE	202
TEST QUESTIONS	203
PRACTICAL PROBLEMS	203
<b>7-3. NEGOTIATION</b>	<b>205</b>
TRANSFER BY NEGOTIATION	205
TRANSFER BY ASSIGNMENT	205
TEST QUESTIONS	206
PRACTICAL PROBLEMS	206
<b>7-4. PRESENTMENT OF A NEGOTIABLE INSTRUMENT</b>	<b>207</b>
PRESENTMENT FOR ACCEPTANCE	207
When presentment for acceptance is excused	208
PRESENTMENT FOR SIGHT	208
PRESENTMENT FOR PAYMENT	208
Presentment for payment not necessary	208
DISHONOUR	209
Dishonour by non-acceptance	209

Dishonour by non-payment	209
<b>NOTICE OF DISHONOUR</b>	<b>209</b>
<b>PENALTIES IN CASE OF DISHONOUR OF CHEQUES</b>	<b>210</b>
TEST QUESTIONS	211
PRACTICAL PROBLEMS	212
<b>7-5. DISCHARGE OF A NEGOTIABLE INSTRUMENT</b>	<b>213</b>
DISCHARGE OF AN INSTRUMENT	213
DISCHARGE OF A PARTY OR PARTIES	213
Material alteration	214
TEST QUESTIONS	215
PRACTICAL PROBLEMS	215

**PART II—CORPORATE LAW**

<b>8-1. COMPANY LAW</b>	<b>217</b>
NATURE OF COMPANY	217
DEFINITION OF COMPANY	217
CHARACTERISTICS OF A COMPANY	218
LIFTING OR PIERCING THE CORPORATE VEIL	219
COMPANY DISTINGUISHED FROM PARTNERSHIP	221
TEST QUESTIONS	223
PRACTICAL PROBLEMS	223
<b>8-2. KINDS OF COMPANIES</b>	<b>224</b>
ON THE BASIS OF INCORPORATION	224
ON THE BASIS OF LIABILITY	224
ON THE BASIS OF NUMBER OF MEMBERS	225
Private company	225
Public company	226
Distinction between public company and Private company	226
Special privileges of private company	227
Conversion of public company into private company	228
ON THE BASIS OF CONTROL	228
Holding company and subsidiary company	229
TEST QUESTIONS	230
PRACTICAL PROBLEMS	230
<b>8-3. PROMOTION AND INCORPORATION OF A COMPANY</b>	<b>231</b>
INCORPORATION OF COMPANY	231
Documents to be filed with the registrar	231
CERTIFICATE OF INCORPORATION	232
Effects of registration	233
PROMOTER	233
PRE-INCORPORATION CONTRACTS	235

TEST QUESTIONS 236	
PRACTICAL PROBLEMS 236	
<b>8-4. MEMORANDUM OF ASSOCIATION</b>	<b>237</b>
Purpose, printing, signing and form of memorandum 237	
CONTENTS OF MEMORANDUM 237	
Name clause 238	
Registered office clause 239	
Objects clause 240	
Capital clause 240	
Liability clause 240	
Association clause 241	
ALTERATION OF MEMORANDUM 241	
DOCTRINE OF ULTRA VIRES 244	
TEST QUESTIONS 245	
PRACTICAL PROBLEMS 246	
<b>8-5. ARTICLES OF ASSOCIATION</b>	<b>247</b>
Contents of articles 247	
Signature of articles 248	
ALTERATION OF ARTICLES 249	
ARTICLES AND MEMORANDUM—THEIR RELATION 250	
ARTICLES AND MEMORANDUM—DISTINCTION 250	
LEGAL EFFECT OF MEMORANDUM AND ARTICLES 251	
CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES 252	
DOCTRINE OF INDOOR MANAGEMENT 253	
TEST QUESTIONS 254	
PRACTICAL PROBLEMS 255	
<b>8-6. PROSPECTUS</b>	<b>256</b>
DEFINITION 256	
Dating of prospectus 257	
Registration of prospectus 257	
CONTENTS OF PROSPECTUS 258	
OFFER FOR SALE—DEEMED PROSPECTUS 261	
MISSTATEMENTS IN PROSPECTUS AND THEIR CONSEQUENCES 262	
STATEMENT IN LIEU OF PROSPECTUS 267	
COMMENCEMENT OF BUSINESS 268	
UNDERWRITING COMMISSION AND BROKERAGE 269	
TEST QUESTIONS 270	
PRACTICAL PROBLEMS 270	
<b>8-7. SHAREHOLDERS OF A COMPANY</b>	<b>272</b>
WHO CAN BECOME A MEMBER ? 272	
HOW TO BECOME A MEMBER ? 273	
CESSATION OF MEMBERSHIP 274	

TEST QUESTIONS 275	
PRACTICAL PROBLEMS 275	
<b>8-8. DIRECTORS</b>	
APPOINTMENT OF DIRECTORS 277	
Disqualification of directors 280	
TEST QUESTIONS 281	
PRACTICAL PROBLEMS 281	
<b>8-9. MEETINGS AND PROCEEDINGS</b>	<b>282</b>
MEETINGS 282	
GENERAL MEETINGS OF SHAREHOLDERS 282	
STATUTORY MEETING 282	
ANNUAL GENERAL MEETING 284	
EXTRAORDINARY GENERAL MEETING 286	
REQUISITES OF A VALID MEETING 288	
PROXIES 291	
VOTING AND POLL 291	
RESOLUTIONS 293	
KINDS OF RESOLUTIONS 293	
TEST QUESTIONS 295	
PRACTICAL PROBLEMS 295	
<b>8-10. ACCOUNTS AND AUDITORS</b>	<b>297</b>
ACCOUNTS 297	
STATUTORY BOOKS 298	
ANNUAL ACCOUNTS AND BALANCE SHEET 299	
FILING OF ACCOUNTS WITH THE REGISTRAR 302	
AUDITORS 302	
APPOINTMENT OF AUDITORS 303	
RIGHTS, POWERS AND DUTIES OF AUDITORS 305	
SPECIAL AUDIT 308	
AUDIT OF COST ACCOUNTS 309	
TEST QUESTIONS 309	
PRACTICAL PROBLEMS 310	
<b>8-11. PREVENTION OF OPPRESSION AND MISMANAGEMENT</b>	<b>311</b>
THE PRINCIPLE OF MAJORITY RULE 311	
PREVENTION OF OPPRESSION AND MISMANAGEMENT 312	
PREVENTION OF OPPRESSION 313	
PREVENTION OF MISMANAGEMENT 313	
WHO MAY APPLY FOR RELIEF 314	
POWERS OF COMPANY LAW BOARD 314	
POWERS OF CENTRAL GOVERNMENT 315	
TEST QUESTIONS 316	
PRACTICAL PROBLEMS 316	

- 8-12. WINDING UP  
 MEANING OF WINDING UP 317  
 MODES OF WINDING UP 317  
 WINDING UP BY THE COURT 317  
 GROUNDS FOR COMPULSORY WINDING UP 317  
 PETITION (SEC. 439) 321  
 COMMENCEMENT OF WINDING UP 324  
 POWER OF COURT 324  
 CONSEQUENCES OF WINDING UP ORDER 325  
 PROCEDURE OF WINDING UP BY THE COURT 326  
 COMMITTEE OF INSPECTION 329  
 GENERAL POWERS OF THE LIQUIDATOR 330  
 STATEMENT OF AFFAIRS 331  
 DISSOLUTION OF COMPANY 333  
 CONTRIBUTORY 333  
 VOLUNTARY WINDING UP 336  
 TYPES OF VOLUNTARY WINDING UP 337  
 MEMBERS' VOLUNTARY WINDING UP 337  
 CREDITORS' VOLUNTARY WINDING UP 339  
 CONSEQUENCES OF WINDING UP 340 E  
 TEST QUESTIONS 340 J  
 PRACTICAL PROBLEMS 340 K
- 

**PART III—OTHER LAWS**

9. THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 341  
 DEFINITIONS 342  
 AUTHORISED DEALERS AND MONEY CHANGES 343  
 RESTRICTION ON DEALINGS IN FOREIGN EXCHANGE AND PAYMENTS 344  
 DUTY OF PERSONS ENTITLED TO RECEIVE FOREIGN EXCHANGE AND PAYMENTS FOR EXPORTED GOODS 344  
 POWER TO CALL FOR INFORMATION, SEARCH, SEIZURE, ARREST, EXAMINATION OF PERSONS AND INSPECTIONS 345  
 TEST QUESTIONS 346
10. THE PAYMENT OF BONUS ACT, 1965 347  
 DEFINITIONS 349  
 ELIGIBILITY AND DISQUALIFICATION FOR BONUS 351  
 DETERMINATION OF BONUS 351  
 TEST QUESTIONS 354
11. THE PAYMENT OF GRATUITY ACT, 1972 355  
 DEFINITIONS 364  
 PAYMENT AND FOREFEITURE OF GRATUITY AND EXAMINATION 358

- NOMINATION 359  
 TEST QUESTIONS 360
12. THE CONSUMER PROTECTION ACT, 1986 361  
 DEFINITIONS 362  
 CONSUMER PROTECTION COUNCIL 367  
 CONSUMER DISPUTES REDRESSAL AGENCIES 367  
 CONSUMER DISPUTES REDRESSAL FORUM 369  
 CONSUMER DISPUTES REDRESSAL COMMISSION 375  
 NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION 378  
 OBJECTIVE OF THE ACT 361  
 MISCELLANEOUS 380  
 TEST QUESTIONS 381
13. THE AIR (PREVENTION AND CONTROL OF POLLUTION) ACT, 1981 383  
 DEFINITION 383  
 CENTRAL AND STATE BOARD FOR THE PREVENTION AND CONTROL OF AIR POLLUTION 383  
 POWERS AND FUNCTIONS OF BOARDS 384  
 PREVENTION AND CONTROL OF AIR POLLUTION 386  
 TEST QUESTIONS 388
14. THE WATER (PREVENTION AND CONTROL OF POLLUTION) ACT, 1974 389  
 THE CONTROL AND STATE BOARDS FOR PREVENTION AND CONTROL OF WATER POLLUTION 389  
 JOINT BOARDS 390  
 POWERS AND FUNCTIONS OF BOARDS 391  
 PREVENTION AND CONTROL OF WATER POLLUTION 392  
 TEST QUESTIONS 394
15. THE INDUSTRIES (DEVELOPMENT AND REGULATION), ACT, 1951 395  
 OBJECT OF THE ACT 395  
 DEFINITIONS 395  
 THE CENTRAL ADVISORY COUNCIL AND DEVELOPMENT COUNCILS 396  
 THE SECOND SCHEDULE 397  
 LICENCING OF NEW INDUSTRIAL UNDERTAKINGS 398  
 DIRECT MANAGEMENT OR CONTROL OF INDUSTRIAL UNDERTAKINGS BY CENTRAL GOVERNMENT IN CERTAIN CASES 399  
 TEST QUESTIONS 400
16. THE INDUSTRIAL DISPUTES ACT, 1947 401  
 DEFINITION OF INDUSTRY 401  
 WHAT IS AN INDUSTRIAL DISPUTE ? 402  
 DEFINITIONS 403  
 THE FIRST SCHEDULE 405

REFERENCE OF CERTAIN INDIVIDUAL DISPUTES TO GRIEVANCE SETTLEMENT AUTHORITIES	407
PROCEDURE FOR SETTLEMENT OF INDUSTRIAL DISPUTES AND AUTHORITIES UNDER THE ACT	407
CONCILIATION MACHINERY	408
ADJUDICATION MACHINERY	409
VOLUNTARY REFERENCE OF DISPUTES TO ARBITRATION	409
AWARD AND SETTLEMENT	411
STRIKES AND LOCK-OUTS	412
LAY-OFF AND RETRENCHMENT	413
LAY-OFF	414
RETRENCHMENT	415
TEST QUESTIONS	416
<b>17. ENVIRONMENT PROTECTION ACT, 1986</b>	<b>417</b>
ENVIRONMENT AND ENVIRONMENTAL LAW	417
THE ENVIRONMENT (PROTECTION) ACT, 1986	418
DEFINITIONS	418
POWERS OF THE CENTRAL GOVERNMENT	419
PREVENTION, CONTROL AND ABATEMENT OF ENVIRONMENTAL POLLUTION	421
MISCELLANEOUS	425
<b>18. COMPETITION ACT, 2002</b>	<b>427</b>
DEFINITIONS	427
PROHIBITION OF CERTAIN AGREEMENT, ABUSE OF DOMINANT POSITION AND REGULATION OF COMBINATIONS	408
REGULATION OF COMBINATIONS	430
PROHIBITION OF ABUSE OF DOMINANT POSITION	432
REGULATION OF COMBINATIONS	432
COMPETITION COMMISSION OF INDIA	435
DUTIES, POWERS AND FUNCTIONS OF COMMISSION	437
DUTIES OF DIRECTOR GENERAL	446
PENALTIES	447
COMPETITION ADVOCACY	448
FINANCE ACCOUNTS AND AUDIT	448
TEST QUESTIONS	450
<b>19. THE MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ACT, 1969</b>	<b>451</b>
DEFINITIONS	451
ESTABLISHMENT AND CONSTITUTION OF THE COMMISSION	455
Inquiry by the commission	456
RESTRICTIVE TRADE PRACTICES	456
UNFAIR TRADE PRACTICES	458
TEST QUESTIONS	458
APPENDIX SCANNER	

## **Basics of Cost & Management Accounting**

for ICWA Inter Stage II (New Syllabus)

V.K. SAXENA, M.Com., F.I.C.W.A.  
Ex-Dy. General Manager (Finance)  
B.H.E.L., New Delhi

C.D. VASHIST, M.Com., F.I.C.W.A., I.C.A.S.  
Ex-Director (Cost) Department of  
Company Affairs, New Delhi

Fourth Edition	Knowledge Packed	Pp. xxvi + 1316
----------------	------------------	-----------------

### **Special Features**

- It includes over 628 typical examples selected from various professional examinations.
- It is a tailor-made book for students preparing for the paper Cost and Management Accounting of Stage Examination of the Institute of Cost and Works of India.
- It is a "two-in-one" book covering both theory and problems giving due examination-oriented weightage.
- Everywhere in this book, theoretical discussion is followed by examples to supplement the thought under consideration. This is followed by Typical Examples consisting of a variety of questions with answers from various professional examinations. Thorough practice of these Typical Examples will ensure success in the examination.
- Key examination points at the end of each chapter summarise the focal issues which have come to notice from the analysis and scrutiny of questions from different professional examinations.
- Everywhere presentation of subject material has been supplemented by visual aids in the form of diagrams and exhibits to facilitate profound understanding.
- Relevant extracts from "Management Accounting : Official Terminology (CIMA) have been included as Appendix in this book.
- No previous knowledge has been assumed anywhere in this book as basic principles have been explained fully.
- Relevant Points/Formulae/Formats have been given just before the Typical Examples in each chapter for the ready reference of readers.
- The comprehensive exercises at the end of each chapter represent a reliable questions bank from various examinations. These exercises contain a variety of theoretical and practical questions on the related chapters.

## **Principles of Cost and Management Accounting**

for ICWA Intermediate Examination (Revised Syllabus)

Dr. S. N. MAHESHWARI, M. Com., Ph.D  
Director, Delhi Institute of Advanced Studies, New Delhi

First Edn. Reprint	Knowledge Packed Pp. xxiv + 1170	ISBN 81-8054-344-7
--------------------	----------------------------------	--------------------

### **Distinctive Features**

- Covers comprehensively the requirements of the students preparing for ICWA Intermediate examinations as per the new syllabus.
- Provides complete conceptual clarity in a simple and lucid style.
- Contains adequate illustrative material (426 illustrations) which makes the study interesting and readily understandable.
- Contains 493 properly graded unsolved problems with short answers for exercise to develop a sense of confidence.

### **Contents**

#### **Section—A : Fundamentals**

Accounting • Nature and Scope • Computer & Accounting.

#### **Section—B : Financial Analysis :**

Financial Statements : Analysis and Interpretation • Accounting Ratio • Funds Flow Statement • Cash Flow Statement.

#### **Section—C : Planning and Control :**

Budgetary Control • Standard Costing • Variance Analysis • Marginal Costing & Profit Planning • Decisions Involving Alternative Choices.

#### **Section—D : Cost Concepts and Methods**

Cost Accounting : Meaning & Scope • Basic Cost Concepts • Material Cost Control • Valuation of Materials • Material Losses • Labour Cost Control • Labour Remuneration • Direct Expenses • Overheads—General • Overheads—Distribution • Single, Unit or Output Costing • Job and Batch Costing • Contract Costing • Process Costing • Operation Costing • Operating or Service Costing • Non-integral System of Accounting • Integral System of Accounting • Reconciliation of Cost and Financial Account • Cost Control and Cost Reduction • Uniform Costing and Inter-firm Comparison.

## Cost Accounting—Textbook

for C.A. Inter, I.C.W.A. Inter, C.S. Inter, B. Com. and M. Com.

V.K. SAXENA, M.Com., F.I.C.W.A.  
Dy. General Manager (Finance) Bharat Heavy  
Electricals Ltd., New Delhi

C.D. VASHIST, M.Com., F.I.C.W.A.,  
I.C.A.S. Ex-Director (Cost)  
Deptt. of Company Affairs, New Delhi.

Seventh Edn.

Knowledge Packed Pp. xxviii + 1342

ISBN 81-8054-289-0

### Special Features

- This book contains 672 selected typical problems from various recent examinations.
- This book covers both theory and problems giving due examination-oriented weightage.
- Key examination points at the end of each chapter summarise the focal issues from different examinations.

### Contents

Overview • Materials • Labour • Overheads • Cost Book-Keeping • Reconciliation of Cost & Financial Accounts • Job Costing and Batch Costing • Single or Output Costing • Contract Costing • Process Costing • Service Costing • Joint Products & By-products • Marginal Costing • Short-term Decision Making • Budgetary Control • Standard Costing • Uniform Costing and Inter-Firm Comparison • Miscellaneous

Appendix: Contents, Trend analysis, Index, Syllabuses. Preparing for Professional Examinations. Probs. from the Recent Examinations.

## Cost Accounting—Principles and Practice

S.P. IYENGAR, M.A., M.Com., LL.B.

Formerly Principal, S.S.M.R. College, Bangalore

10th Thoroughly Rev. Edn.

Pp. xiv + 1214

22 x 14 cm.

ISBN 81-8054-397-8

### Outstanding Features

- Written in simple language and lucid style.
- Pays equal attention to both theory and practice.
- Contains 425 Solved Illustrations, 682 theory questions and 642 practical exercises with answers, besides objective type questions.
- Illustrations and exercises have been properly graded.
- Illustrations, theoretical questions and exercises are from the latest question papers of Universities and Professional Bodies in India.
- Best suited for students of B.Com., B.Com. (Hons.), M.Com., B.B.A., P.E-II., I.C.W.A. Inter, I.C.S.I. Inter and other equivalent courses.

### Contents

Cost Accounting—Nature & Purpose • Cost Concepts & Procedures • Materials—Purchase Control, Inventory Control, Issue Control • Stores Costing • Materials Losses • Labour—Labour Cost Control • Labour Cost Accounting • Chargeable Expenses • Overheads—Manufacturing • Administration, Selling and Distribution Overheads • Methods of Costing—Job Costing • Contract Costing • Unit Costing • Process Costing • Operating Costing • Operations Costing • Cost Book-Keeping & Reconciliation • Integral Accounting • Uniform Costing • Cost Audit • Mechanisation of Cost Accounting • Management Accounting • Marginal Costing • Cost-Volume-Profit Analysis • Relevant Cost & Differential and Cost Reduction • Responsibility Accounting • Standard Costing • Cost Control and Cost Reduction • Management Reporting • Exercises • Scanner

## Cost Accounting—Problems and Solutions

for C.A. Inter, I.C.W.A. Inter, C.S. Inter, M. Com. Examinations

V.K. SAXENA      C.D. VASHIST

10th Revised Edn.

Knowledge Packed Pp. xxvi + 784

ISBN 81-8054-349-8

### Special Features

- This book contains 655 selected and handpicked problems from various professional examinations (viz., CA Inter, ICWA Inter and I.C.S.I. Inter) for the period 2000 to date.
- All the problems have been properly sectionalised and suitably grouped.
- Special treatment has been given to the key chapters such as Overheads, Process Costing, Marginal Costing and CVP Analysis, Budgetary Control and Variance Analysis.

## Problems & Solutions in Cost Accounting

for B. Com., C.A. Inter., I.C.W.A. Inter., M.B.A. and Company Secretaries Exams.

Dr. S.N. MAHESHWARI, M.Com., Ph.D.

Director, Delhi Institute of Advanced Studies, New Delhi

19th Rev. &amp; Updated Edn.

930 Solved Probs.

Pp. xvi + 923

### Special Features

- Contains a sufficiently large number of solved problems on each topic to enable students to have enough practice and develop a sense of confidence.
- Problems have been graded according to the intricacies involved.

### Contents

• Basic Concepts • Cost Sheet • Direct Materials • Direct Labour • Overheads • Single Output or Unit Costing • Job & Batch Costing • Contract Costing • Process Costing • Operating Costing • Cost Control Accounts • Reconciliation of Cost and Financial A/cs. • Integral Accounts • Budgetary Control • Standard Costing • Marginal Costing and Break-even Analysis • Decisions Involving Alternative Choices • Suggested Answers to Recent Examinations.

## Advanced Studies in Cost Accounting

for C.A., I.C.W.A., I.C.S.I., M.Com.

P. DAS GUPTA

8th Revised Reprint Edition

Pp. viii + 612

### Contents

Introduction • Material Cost • Labour Cost • Overhead Cost • Job & Batch Costing • Contract Costing • Unit Costing • Operating Costing • Process Costing • Joint Products & By-products • Control Accounts and Integrated Accounts • Reconciliation of Cost and Financial Accounts • Marginal Costing and Cost-Volume-Profit Analysis • Budgetary Control • Standard Costing • Uniform Costing • Cost Audit • Cost Reduction and Cost Control • Objective Type Questions.

## Information Systems & Technology

Dr. L.M. PRASAD • USHA PRASAD

First Edn. Reprint

Pages xxiv + 638

ISBN 81-8054-152-5

Providing information in a timely fashion is possible only when an organisation has developed effective information systems and managers as users know how information systems work in their organisation. Keeping this phenomenon in view, institutions offering management courses have made the study of Management Information Systems compulsory to their students. Similarly, many professional institutions like Institute of Cost and Works Accountants of India have made the study of Management Information Systems compulsory to their aspiring professionals. The present comprehensive book has been prepared primarily to serve the needs of such students.

Each chapter contains the following in that order: Textual material of the chapter • Key concepts used in the chapter • Leading questions • Mind stretching questions

### Contents

**Part I—Framework of Information Systems and Technology :** • An Overview of Management Information Systems • Decision Making and Information Systems • Technology for Information Systems • Computer Networks • Database Management Systems.

**Part II—Components of Information Systems :** • Transaction Processing Systems • Decision Support Systems • Executive Information Systems • Artificial Intelligence and Expert Systems.

**Part III—Developing Information Systems :** • Planning and Implementation of I.S. Strategy • System Development • System Analysis and Design • System Implementation and Maintenance • Social and Organisational Impact of I.S./I.T.

**Part IV—Computerised Systems in Business Applications:** • Computerised Systems in Financial and Management Accounting • Computerised Systems in Inventory Control • Enterprise Resource Planning.

**Part V—Information System Control and Security :** • Controls Applicable to Information Systems • Information Security • Detection of Computer Frauds • Audit of Information Systems • Cyber Laws • Managing Information Resources.

## Information Technology & Computer Applications

V.K. KAPOOR

Shri Ram College of Commerce, University of Delhi, Delhi

Fifth Rev. Edn.

Knowledge Packed Pp. xvi + 679

ISBN 81-7014-568-6

The book serves ideally as a single-source reference for students of C.A., ICWA, M.B.A. and C.S. for basic concepts as a self-study material, or the non-EDP executives to help them feel at home in a computer environment and as a refresher material for those holding computer-related jobs.

### Contents

Data Processing Fundamentals • Data Representation • Computer Hardware • Computer Software • Programming Languages • Electronic Data Processing Systems • File Organisation • Decision Tables • Flowcharts • Managerial Applications of Computers • Systems Analysis and Design • Data Processing Resources • Organisation of Data Processing Department • Data Processing Standards and Documentation • Control in EDP Environment • EDP & Audit • Management Information Systems (MIS).

## Feedback Prize Contest

NO ENTRY FEE

We propose to mail our readers a 'Supplement' relevant to the subject-matter of this book or 'A Word about your Career' or 'Pearls of Wisdom' or 'Secrets of Success' on receipt of your 'Feedback'. Further, you can win a prize too !! For this purpose please fill this coupon and send it along with your 'Feedback' to us at M/s. Sultan Chand & Sons, 23 Daryaganj, New Delhi-110 002, at an early date. To avoid duplication, please inform what you had received earlier. This is without obligation.

How did you come to know of this book: Recommended by your Teacher/Friend/  
Bookseller/Advertisement

Date of Purchase.....

Year/Edition of the book purchased by you .....

Month and Year of your next examination .....

Name & Address of the Supplier .....

Name of the Teacher who recommended you this book.....

Name and Address of your School/Institution .....

Your Name .....

(IN BLOCK LETTERS)

Your Residential Address .....

(IN BLOCK LETTERS)

Course for which you are studying .....

Please enclose latest Syllabus/Questions paper .....

You bought this book because .....

.....

PLEASE CUT ALONG THIS LINE AND MAIL TO US

# Feedback

Now You can win a prize too !!

Dear Reader

Reg. Business Laws (ICWA Inter, New Syllabus) by N.D. Kapoor

Has it occurred to you that you can do the students/the future readers a favour by sending your suggestions/comments to improve the book? In addition, a surprise gift awaits you if you are kind enough to let us have your frank assessment, helpful comments/ specific suggestions in detail about the book on a separate sheet as regards the following :

1. Which topics of your syllabus are inadequately or not discussed in the book from the point of view of your examination?

.....  
.....  
.....

2. Is there any factual inaccuracy in the book? Please specify.

.....  
.....  
.....

3. What is your assessment of this book as regards the presentation of the subject-matter, expression, precision and price in relation to the other books available on this subject?

.....  
.....  
.....

4. Which competing books you regard as better than this? Please specify their authors and publishers.

1. ....
2. ....
3. ....

5. Any other suggestion/comment you would like to make for the improvement of the book?

.....  
.....  
.....

Further, you can win a prize for the best criticism on presentation, contents or quality aspect of this book with useful suggestions for improvement. The prize will be awarded each month and will be in the form of our publications as decided by the Editorial Board.

Please feel free to write to us if you have any problem, complaint or grievance regarding our publications or a bright idea to share. We work for you and your success and your Feedback are valuable to us.

Thanking you,

Yours faithfully  
**Sultan Chand & Sons**

1

## Introductory

Man is by nature a social being. He comes into contact with other individuals in different capacities. For example, he comes into contact with landlord as a tenant, with Government as a taxpayer, with customers as a seller and with suppliers as a buyer. These contacts or associations are the inevitable consequence of modern civilisation. In all these associations, he is expected to observe a code of conduct or a set of rules. The object of these rules is to make human associations possible and to ensure that members of the society may live and work together in an orderly and peaceful manner.

### WHAT IS LAW ?

The word 'law' is a general term and has different connotations for different people, e.g.,

1. A citizen may think of law as a set of rules which he must obey.
2. A lawyer who 'practises law' may think of law as a vocation.
3. A legislator may look at law as something created by him.
4. A judge may think of law as a guide and principles to be applied in making decisions.
5. A social scientist may think of law as a means of social control.
6. A legal philosopher may consider law as 'dictate of reason' or 'right reasoning'.

Thus a man's perspective or point of view influences his notions about law and as such its meaning. It is, therefore, not possible to give a single, precise definition of law. It is often preceded by an adjective to give it a more precise meaning, e.g., civil law, criminal law, commercial/mercantile law, industrial law, international law. However, in the legal sense with which we are concerned in this book, 'law' includes all the *rules and principles which regulate our relations with other individuals and the State and which are enforced by the State*.

The State regulates the conduct of its people by a set of rules. It ordains, directly or indirectly, implicitly or explicitly, a general course of conduct to be followed by the people. Such *rules of human conduct, if recognised by the State and enforced by it on people, are termed as 'law'*.

In the words of Salmond, "Law is the body of principles recognised and applied by the State in the administration of justice." It represents a code of human conduct which is established and enforced by State. Law, in this sense, has two-fold aspect: it is an abstract body of rules and also a social machinery for securing order in the community.

(ii)

**Some important points**

The definitions of law given above contain the following important points :

1. *Law is a body of rules.* When we speak of 'the law', it means 'the whole of the law' of the land. This includes Statute Law, the Indian Contract Act, 1872, the Indian Partnership Act, 1932, the Arbitration Act, 1940, case law, customs and usages.

2. *Law is for the guidance of human conduct.*

3. *Law is imposed.* Law is generally imposed by some authority in whom special power is vested, like Municipal bodies, State Legislative Assemblies and Parliament. All Statute Law is imposed by the State. Case law laid down by the superior Courts is binding on all lower Courts. In that sense it is also imposed. Customs and usages, practised over a long period and followed by people, also acquire the force of law.

4. *Enforcement.* The chief characteristic of law is that it is enforced. This enforcement is carried out by the State. If a law cannot be enforced, it ceases to be a law.

5. *The State.* The existence of law presupposes a State. A State is a territorial division in which a community or people live subject to a uniform system of law administered by a sovereign authority. India comprises a Union of States and the Territories thereof as specified in the First Schedule to the Constitution.

6. *Content of law.* Law is a living thing. It is not static. As circumstances and conditions in a society change, laws are changed to fit the requirements of the society. As such, law prevailing in a society at any point of time must be in conformity with the general sentiments, customs and aspirations of its people. It is a living phenomenon having a real existence in relation to the facts of human affairs.

**Need for the knowledge of law**

'*Ignorantia juris non excusat*' is a familiar maxim. This means *ignorance of law is no excuse*. Although it is not possible for a layman to be aware of every branch of law, yet he must acquaint himself with the general principles of the law of the country. This book will familiarise him with general principles of law, constitutional law and law relating to transfer of property, arbitration, evidence and some other laws which are of particular importance to people engaged in economic and commercial activities.

**Function and purpose of law**

1. *Justice.* The goal of law is 'justice'. In this sense, law is means to an end ; it is not an end in itself. It is an instrument to secure *justice*. It is recognised and applied by the State in the administration of justice which means equal treatment to all situated alike. But those not situated alike, like minors compared to adults or women compared to men as regards working hours in factories, may be treated differently and this in no way distracts law from the idea of justice in the sense of equality of treatment. In fact, justice demands a fair treatment to all, keeping in mind different situations and demands of different people.

2. *Continuity and uniformity.* 'Continuity' ensures public expectation in the domain of justice of ascertainable result in future from those obtained in the past unless there is a change in the law of the land. Apart from justice, law also aims at 'uniformity'. In this sense, law should be definite, certain, known and permanent.

(iii)

so that the citizen knows beforehand what the law is and what the consequences of his act shall be. This also ensures '*stability*' and '*security of social order*'.

3. *Impartiality.* Law is necessarily impartial. It treats all like, and is not made for a particular person or for a particular case.

4. *Rule of law.* Another very important function of law is to ensure rule of law. Rule of law is always preferable to rule of men, however eminent and good-intentioned they may be. In India when Emergency was declared in 1975, this was sufficiently and unmistakably demonstrated.

**Law is not static**

Although origins of law in any society may be traced in antiquity, yet law is not static. As circumstances and conditions in a society change, laws are changed to fit the requirements of the society. As such, law prevailing in a society at any point of time must be in conformity with the general sentiments, customs and aspirations of its people. It is a living phenomenon having a real existence in relation to the fact of human affairs.

**SOURCES OF LAW**

'Source' means 'origin' from which something is ultimately derived and often refers to the causes operating before the thing itself comes into being. Jurists differ widely as to the origin of law. According to Austin, it originates from the Sovereign. Savigny traces its origin in *volkgeist* (*i.e.*, general awareness of the people) at any point of time. The theologians attribute its origin to God. The Hindus believe that Vedas, which are a primary source of Hindu law, are a revelation of God. The Mohammedan Law, emanating from Quran, is also believed to have been revealed by God. The sociologists trace the origin of law in numerous complex social factors working over a period of time in any society.

**SOURCES OF INDIAN LAW**

The modern Indian law is closely modelled on the English pattern and the bulk of the Indian law is based on the English law. There is an obvious historical reason for it. While administering this country, the British rulers applied in most of the cases their own laws. They also applied the personal law of the parties whenever disputes relating to private relationships of the parties arose. A detailed historical study is beyond the scope of this book. However, the main sources of Indian law are as follows :

1. English Law,
2. Customs or customary law,
3. Judicial decisions or law by precedents,
4. Statute law or legislation, and
5. Personal law of the parties, e.g., Hindu law or Mohammedan law.

**1. ENGLISH LAW**

The most important source of the Indian Law is the English Law which is composed of :

1. Common Law of England, or simply Common Law,
2. Equity, and
3. Statute Law.



**(1) Common Law of England**

The chief source of the English Law is Common Law as supplemented by Equity and Statute Law.

The expression 'Common Law of England' conveys those unwritten legal doctrines embodying English customs and English traditions which have been developed over centuries by the English Courts. It is unwritten. It is the basis of the English Law and is of considerable antiquity.

*Modified by Statute Law.* From time to time the Common Law has been modified by Statute Law, particularly to provide for new situations for which the Common Law has no remedy and to alter the existing law where changed circumstances have made it inadequate.

*Hardship in many cases.* The Common Law was found to work hardship in many cases. It did not always provide an adequate remedy to an injured party. Quite often, the injured party was interested not in monetary damages but in the specific performance of the contract (i.e., performance of the contract as originally agreed). Moreover, the Common Law could not meet all the needs of changing times. In Equity Law (or just Equity) means were found for ameliorating the harshness of the Common Law.

**(2) Equity**

*Synonymous with justice.* The term 'equity' has its origin in the Latin word 'Aequitas' which means 'fair' or 'justice according to natural law' or 'right' or simply 'natural justice'. This is the literal meaning of the term 'equity'. In its technical sense, it means a body of legal doctrines and rules emanating from the administration of justice, developed to enlarge, supplement or override a narrow rigid system of existing law of the land. In that sense equity, in its true and genuine meaning, is the soul and spirit of all law and is synonymous with justice.

**Equity in India**

In India there never existed separate equity Courts although equitable principles of law, i.e., justice, equity and good conscience, have been the guiding force behind most of the Statutes in our country and the decisions of the Courts. Particularly when law is silent on any point or there is some lacuna in a Statute, equity comes handy to the judges who exercise their discretion often on equitable considerations. The frequent use of the terms "good faith", "public interest", "public policy" in Statutes by the judges is based on principles of equity.

**(3) Statute Law**

It refers to Acts of Parliament. Statute Law refers to the law laid down in the Acts of Parliament. All Acts of Parliament are recorded in its Statute Book from which the term Statute Law derives its name. Unlike Common Law which is unwritten, Statute Law is written. Salmond prefers to call Statute Law as Enacted Law.

The authority of Parliament is supreme. It can, subject to natural limitations and those laid down by the Constitution, pass any law. It can also nullify the rule of the Common Law or Equity. As a matter of fact, many of the deficiencies together the existing rules of the Common Law and Equity have been removed by bringing

into a single Statute, thereby making the law manageable. Examples of such codification in the field of commercial/mercantile law are the Bills of Exchange Act, 1882, the Partnership Act, 1890, the Sale of Goods Act, 1893, the Marine Insurance Act, 1906, the Bankruptcy Act, 1914, and the Arbitration and Conciliation Act, 1996.

The English Law in its earlier stages of development had also been affected to a marked extent by the Roman Law. A reference was made to the Roman Law when the existing customs and usages failed to afford solution to a particular case. Law Merchant or Maritime usages (discussed below) also played a significant role in nurturing particularly the English Mercantile/Commercial Law.

**2. CUSTOMS OR CUSTOMARY LAW**

*A practice followed over a long period of time.* In primitive societies, customs used to be the only law that governed the conduct of the people. They developed out of necessity or convenience. When a particular practice was repeatedly followed, it became a custom. Traditionally much of the Common Law of England was based on what had become customary in the country at large, and in this sense custom is the mother of all institutions. As civilisation progressed, customs diminished in value as a further source of law, giving place to judicial precedents and legislation as the main source of law.

**Holland's Illustration.** Holland in his classic treatise "Jurisprudence", while defining a custom as "a generally observed course of conduct", gives a beautiful illustration to explain what a custom is. He says :

"One man crosses the common ground in the direction which is suggested whether by the purpose he has in view, or by mere accident. If others follow in the same track, which they are likely to do after it has once been trodden, a path is made.....Before a custom is formed, there is no juristic reason for its taking one direction rather than another, though doubtless there was some ground of expediency or religious scruple, or of accidental suggestion. A habitual course of action once formed gathers strength and sanctity every year ..... There can, in fact, be no doubt that customary rules existed among peoples long before nations or States had come into existence."

**3. JUDICIAL PRECEDENTS****Doctrine of stare decisis**

Precedent means something done or said that may serve as an example or rule to authorise or justify a subsequent act of the same or a similar kind.

*Adhering to earlier decisions.* Judicial precedents are an important source of law based on the principle that what has been decided in an earlier case is binding in a similar future case, unless there is a change in the circumstances. Both English Courts and Indian Courts follow the decisions given in their previous decided cases within more or less well-defined limits. This is called the *doctrine of precedents* or *doctrine of stare decisis* which means adherence to the earlier decision and not unsettling things which are already established. The doctrine of *stare decisis* is based on expediency and public policy. A departure from settled law should be made only if the interpretation accepted as good for long years results in a grievous wrong [Dwarka Singh v. Deputy Director of U.P., Mainpuri, A.I.R. (1981) NOC 105 All.]. To that extent the doctrine is not rigid and must not be applied at the cost of justice.

## JUDICIARY INTRODUCTORY

Every modern State has three organs, viz., legislative, executive and judiciary. These are the pillars on which the superstructure of the State (Government) is based. The organ of the State which makes laws is called 'legislative', the organ which executes the laws made by the legislative is known as 'executive.' The organ of the Government which administers justice is known 'judiciary'.

A sound judicial system must have a well-regulated system of courts which should follow a simple and systematic procedure. If a state does not have a good definite system of Law, the judges may administer law according to their whims and discretion.

### Functions of judiciary

1. To decide disputes according to law, prevailing in the country. If there is no existing law on the subject-matter of dispute, the judges can decide the dispute according to the best of their judgement and ask the Government for judicial legislation.

2. To give advisory opinion to the Government on interpretation of constitutional matters and to give an authoritative interpretation of certain laws.

3. To see that the Government acts within its constitutional limits.

4. To judicially review the various laws of the country.

Judiciary under all circumstances must be independent. This independence depends upon.

- (1) The incentives to the judges in the form of salary, allowances and accommodation, must encourage the meritorious persons to be part of the judiciary.

- (2) The method of selection of the judges must be foolproof, and

- (3) The judiciary should be independent of any outside pressure.

### Hierarchy of Courts

The general rule of doctrine of precedent as regards hierarchy of Courts is that each Court is absolutely bound by the decisions of the Courts superior to it. As regards higher Courts, they are, to a certain extent, bounded by their own decisions.

**Supreme Court.** This is the highest Court in India. Its decisions are binding on all Courts within the territory of India [Article 141 of the Constitution of India]. If on a subsequent occasion the Court is satisfied that its earlier decision was clearly erroneous, it may "correct the error, but before a previous decision is pronounced to be plainly erroneous, the Court must be satisfied with a fair amount of unanimity amongst its members that a revision of the said view is fully justified" [*Keshav Mills Co. Ltd. v. Commr. of Income-tax.* (1965) 2 S.C.R. 908]. Further the decisions of the Full Bench are binding on the smaller Benches of the Court.

In *Galaknath v. State A.I.R. (1967) S.C. 1643*, the Supreme Court by a 6-Judge Bench gave a decision that Fundamental Rights are not amendable. Six years later the Supreme Court in *Kesavananda Bharti v. State of Kerala* (1973) S.C.C. 225 by a 13-Judge Bench overruled the *Galaknath Case*.

**High Courts.** (a) In States, there are High Courts. The decisions of a High Court are binding on all the Courts below it, within its jurisdiction.

(b) The decisions of one High Court are not binding on other High Courts, although in practice they are cited in other High Courts. These decisions, therefore,

have only a persuasive value, but quite often, High Courts follow the rulings of each other on the ground of judicial uniformity, specially in the case of Central Acts.

(c) The appeals in High Courts are generally heard by a single judge. If the appeal involves a substantial or important point of law, it is referred to 2 judges (who constitute the Division Bench), or to a larger number (constituting of Full Bench). The decisions of a larger bench are binding on a smaller bench.

**Subordinate or District Courts.** These Courts are in districts. They are bound to follow the decisions of the higher Courts.

### Ratio Decidendi, obiter dictum and precedents sub silentio

**Ratio decidendi.** A decision of a Court can be seen from two aspects, viz.,

- (1) What does the case decide between the parties ? and
- (2) What principle or rule of law does it lay down ?

What the case decides between the parties is conclusive between those parties and is of immediate concern to them. As against persons not parties to the suit, the only part of the case which is conclusive is the general rule of law, for which it is authority. This rule of law or the underlying principle upon which the decision is founded and which gives it the element of authority is the *ratio decidendi*.

**Obiter dictum.** It means an incidental or collateral opinion which is uttered by a judge while delivering a judgement and which is not binding. It is a mere saying by the way, a chance remark, which is not binding upon future Courts, though it may be respected according to the reputation of the judge, the eminence of the Court and the circumstances in which it came to be pronounced. Salmond observed in this regard, "Indeed, *dicta* of the House of Lords or the Judges who are masters of their field like Lord Blackburn, may often in practice enjoy greater prestige..." (*Jurisprudence*, 12th ed., p. 177).

The reason for not regarding *obiter dictum* as binding is that it was probably made without a full consideration of the cases on the point, and that if it is very broad in terms, it was probably made without a full consideration of all the consequences that may follow from it.

The *ratio decidendi* is the rule acted on by the Court : *obiter dictum* has only a persuasive value and is suggestive of the trend of the Court's thinking.

**Precedents sub silentio.** This means that if a point is not raised in a case (even though the facts enabled it to be raised), a precedent on that point is not an authority or at any rate not a binding authority.

### 4. LEGISLATION

The term 'legislation' is used in different senses. In a wide sense, it includes all methods of law-making and, therefore, would include laws made by judges also. In the strict sense, it may be defined as the promulgation of legal rules by an authority (e.g., Parliament or a State Legislature) which has the power to do so.

In modern times, 'legislation' is the most important source of law in all countries.

### 5. PERSONAL LAW

Sometimes a point at issue between the parties to a dispute is not covered by any Statute or custom. In such cases, the Courts are required to apply the personal law of the parties. This practice was adopted in India during the early British Rule.

(viii)

As early as 1793, the Cornwallis Code provided that in suits regarding succession, inheritance, marriage, caste and all religious usages and institutions, the Hindu laws with respect to Hindus and Mohammedan laws with respect to Mohammedans, were to be considered to be the general rules by which the judges were to form their opinions and decide disputes. It was further enacted in 1795 that where the parties belonged to different religions, the law of the defendant was to be applied. If the defendant happened to be a European or non-Hindu or non-Mohammedan, the law of the plaintiff was to be applied. But with change in conditions, some of the personal laws of Hindus and Mohammedans were amended. After Independence, this process has been further accelerated with a view to bring about social reforms.

**TEST QUESTIONS**

1. Enumerate the principle sources of Indian Law. [C.S.E. December 1992]
2. Discuss how far are judicial decisions a source of law.
3. (a) How far is a 'custom' source of law ?  
(b) State the requisite elements of a valid custom. What are the reasons for the diminishing importance of custom as a source of law ? (June, 2000)
4. "Custom is a source of law provided it satisfies certain minimum requirements." Elucidate. [C.S.E. June 1991]
5. Define and distinguish between *ratio decidendi* and *obiter-dicta*. (C.S.E. December, 1999)
6. If a judicial pronouncement contains observations on possibilities (*obiter dicta*) but not arising out of the case decided, can they be considered to be part of the case law ?
7. Distinguish between binding precedents and persuasive precedents.
8. Examine the significance of an *obiter dictum*.
9. Examine the nature of judicial precedents in India with reference to decisions of (a) Supreme Court, and (b) High Courts of States.
10. "The basic rule of the doctrine of precedent is that the decisions of the higher Courts must be followed by the Courts subordinate to them." (C.S.E. June 1992)
11. Discuss the circumstances under which the binding force of precedent is destroyed or weakened.
12. What are requisites of a valid custom? (C.S.E. December 1988)
13. Discuss precedents as a source of law. (C.S.E. June 1988; June 1993)
14. Discuss legislation as a source of law. (C.S.E. June 1989)
15. Explain briefly the doctrine of *stare decisis*. (C.S.E. December 1989)
16. Explain the doctrine of '*stare decisis*'. How do you distinguish between '*ratio decidendi*' and '*obiter dicta*'? (S.C.E. December 1986)

**PART ONE—CONTRACT**

1-1

**Law of Contract—An Overview****OBJECT OF THE LAW OF CONTRACT**

The law of contract is the *branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them*. Its rules define the remedies that are available in a court of law against a person who fails to perform his contract, and the conditions under which the remedies are available. It is the most important branch of business law. It affects all of us in one way or the other. It is, however, of particular importance to people engaged in trade, commerce and industry as bulk of their business transactions are based on contracts. The law of contract introduces definiteness in business transactions.

**THE INDIAN CONTRACT ACT, 1872**

The law relating to contracts is contained in the Indian Contract Act, 1872. The Act deals with (1) the general principles of the law of contract (Secs. 1 to 75), and (2) some special contracts only (Secs. 124 to 238). The first six chapters of the Act (which embody the general principles) deal with the different stages in the formation of a contract, its essential elements, its performance or breach and the remedies for breach of contract. The remaining chapters deal with some of the special contracts, viz., indemnity and guarantee, bailment and pledge and agency.

The Act does not affect any usage or custom of trade (Sec. 1, para 1).

The references to Sections in Chapters 2-1 to 2-13 are to the Indian Contract Act, 1872, unless otherwise stated.

**The Act is not exhaustive**

The Indian Contract Act does not profess to be a complete and exhaustive code. It deals with the general principles of the law of contract and with some special contracts only. Some of the contracts not dealt with by the Act are those relating to partnership, sale of goods, negotiable instruments, insurance, bill of lading, etc. There are separate Acts which deal with these contracts.

**Law of contract is not the whole law of agreements nor the whole law of obligations**

There are several agreements which do not give rise to legal obligations. They are, therefore, not contracts. Similarly, there are certain obligations which do not

necessarily spring from an agreement, e.g., (i) torts or civil wrongs, (ii) quasi-contracts, (iii) judgments of Courts. These obligations are not contractual in nature. But even then they are enforceable.

Salmond has rightly observed that the law of contract is "not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations which have their sources in agreements." It excludes from its purview all obligations which are not contractual in nature and agreements which are social in nature.

### DEFINITION OF CONTRACT

A contract is an agreement made between two or more parties which the law will enforce. Sec. 2 (h) defines a contract as an agreement enforceable by law. This definition is based on Pollock's definition which is as follows : "Every agreement and promise enforceable at law is a contract."

Sir William Anson defines a contract as "a legally binding agreement between two or more persons by which rights are acquired by one or more to acts or forbearances (abstaining from doing something) on the part of the others."

According to Salmond, a contract is "an agreement creating and defining obligations between the parties."

### Agreement and its enforceability

If we analyse the definitions of contract we find that a contract, essentially consists of two elements, viz., (1) an agreement, and (2) its enforceability by law.

An agreement is defined as "every promise and every set of promises, forming consideration for each other." [Sec. 2 (e)]. A promise is defined thus : "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise." [Sec. 2 (b)]. This, in other words, means that an agreement is an accepted proposal. In order, therefore, to form an agreement, there must be a proposal or offer by one party and its acceptance by the other. To sum up :

Agreement = Offer + Acceptance.

### Consensus ad idem

The essence of an agreement is the meeting of the minds of the parties in full and final agreement ; there must, in fact, be consensus ad idem. The expression "agreement" as defined in Sec. 2 (e) is essentially and exclusively consensual in nature [Sunnam Sattiah v. State, A.I.R. (1980) A.P. 16], i.e., before there can be an agreement between two parties, there must be consensus ad idem. This means that the parties to the agreement must have agreed about the subject-matter of the idem, there can be no contract.

Example. A, who owns two horses named Rajhans and Hansraj, is selling horse Rajhans to B. B thinks he is purchasing horse Hansraj. There is no consensus ad idem and consequently no contract.

In order to determine whether, in any given agreement, there is existence of consensus ad idem, it is usual to employ the language of offer and acceptance. Thus if A says to B, "Will you purchase my black car for Rs. 10,000 ?" and B says "yes" to it, there is consensus ad idem and an agreement comes into existence.

### Obligation

An agreement, to become a contract, must give rise to a legal obligation or duty. The term 'obligation' is defined as a legal tie which imposes upon a definite person or persons the necessity of doing or abstaining from doing a definite act or acts. It may relate to social or legal matters. An agreement which gives rise to a social obligation is not a contract. It must give rise to a legal obligation in order to become a contract.

Examples. (a) A agrees to sell his car to B for Rs. 10,000. The agreement gives rise to an obligation on the part of A to deliver the car to B and on the part of B to pay Rs. 10,000 to A. This agreement is a contract.

(b) A promises to sell his white car to B for Rs. 10,000 received by him as the price of the car. The agreement gives rise to an obligation on the part of A to deliver the car to B. This agreement is also a contract.

### Agreement is a very wide term

An agreement may be a social agreement or a legal agreement. If A invites B to a dinner and B accepts the invitation, it is a social agreement. A social agreement does not give rise to contractual obligations and is not enforceable in a Court of law. It is only those agreements which are enforceable in a Court of law which are contracts.

Examples. (a) A invites his friend B to come and stay with him for a week. B accepts the invitation but when he comes to A, A cannot accommodate him as his wife had died the day before. B cannot claim any compensation from A as the agreement is a social one.

(b) A father promises to pay his son Rs. 100 every month as pocket allowance. Later he refuses to pay. The son cannot recover as it is a domestic agreement and there is no intention on the part of the parties to create legal relations.

To conclude : Contract = Agreement + Enforcement at law, Thus all contracts are agreements but all agreements are not necessarily contracts.

### ESSENTIAL ELEMENTS OF A VALID CONTRACT

According to Sec. 10, all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void. In order to become a contract, an agreement must have the following essential elements :

1. Offer and acceptance. There must be two parties to an agreement, i.e., one party making an offer and the other party accepting it. The terms of the offer must be definite and the acceptance of the offer must be absolute and unconditional. The acceptance must also be according to the mode prescribed and must be communicated to the offeror.

2. Intention to create legal relationship. When the two parties enter into an agreement, their intention must be to create legal relationship between them. If there is no such intention on the part of the parties, there is no contract between them. Agreements of a social or domestic nature do not contemplate legal relationship. As such they are not contracts.

Example. A husband promised to pay his wife a household allowance of £ 30 every month. Later the parties separated and the husband failed to pay the

amount. The wife sued for the allowance. Held, agreements such as these were outside the realm of contract altogether [Balfour v. Balfour, (1919) 2 K.B. 571].

In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is rebuttable which means that it must be shown that the parties did not intend to be legally bound.

**Examples.** (a) There was an agreement between R Company and C Company by means of which the former was appointed as the agent of the latter. One clause in the agreement was : "This agreement is not entered into..... as a formal or legal agreement, and shall not be subject to legal jurisdiction in the law courts." Held, there was no binding contract as there was no intention to create legal relationship [Rose & Frank Co. v. Crompton Bros., (1925) A.C. 445].

(b) In an agreement, a document contained a condition "that it shall not be attended by or give rise to any legal relationship, rights, duties, consequences whatsoever or be legally enforceable or be the subject of litigation, but all such arrangements, agreements and transactions are binding in honour only." Held, the condition was valid and the agreement was not binding [Jones v. Vernon's Pools Ltd. (1938) 2 All E.R. 626].

**3. Lawful consideration.** An agreement to be enforceable by law must be supported by consideration. 'Consideration' means an advantage or benefit moving from one party to the other. It is the essence of a bargain. In simple words, it means 'something in return'. The agreement is legally enforceable only when both the parties give something and get something in return. A promise to do something, getting nothing in return, is usually not enforceable by law. Consideration need not necessarily be in cash or kind. It may be an act or abstinence (abstaining from doing something) or promise to do or not to do something. It may be past, present or future. But it must be real and lawful [Secs. 2 (d), 23 and 25].

**4. Capacity of parties — competency.** The parties to the agreement must be capable of entering into a valid contract. Every person is competent to contract if he (a) is of the age of majority, (b) is of sound mind, and (c) is not disqualified from contracting by any law to which he is subject [Secs. 11 and 12]. Flaw in capacity to contract may arise from minority, lunacy, idiocy, drunkenness, etc., and status. If a party suffers from any flaw in capacity, the agreement is not enforceable except in some special cases.

**5. Free and genuine consent.** It is essential to the creation of every contract that there must be a free and genuine consent of the parties to the agreement. The consent of the parties is said to be free when they are of the same mind on all the material terms of the contract. The parties are said to be of the same mind when they agree about the subject-matter of the contract in the same sense and at the same time (Sec. 13). There is absence of free consent if the agreement is induced by coercion, undue influence, fraud, misrepresentation, etc. (Sec. 14).

**6. Lawful object.** The object of the agreement must be lawful. In other words, it means that the object must not be (a) illegal, (b) immoral, or (c) opposed to public policy [Sec. 23]. If an agreement suffers from any legal flaw, it would not be enforceable by law.

**7. Agreement not declared void.** The agreement must not have been expressly declared void by any law in force in the country [Secs. 24 to 30 and 56].

**8. Certainty and possibility of performance.** The agreement must be certain and not vague or indefinite (Sec. 29). If it is vague and it is not possible to ascertain its meaning, it cannot be enforced.

**Examples.** (a) A agrees to sell to B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

(b) O agreed to purchase a motor van from S "on hire-purchase terms". The hire-purchase price was to be paid over two years. Held, there was no contract as the terms were not certain about rate of interest and mode of payment. No precise meaning could be attributed to the words "on hire-purchase" since there was a wide variety of hire-purchase terms [Scammel v. Ouston, (1941) A.C. 251].

(c) A company agreed with V that on the expiration of V's existing contract, it would favourably consider an application by V for a renewal of his contract. Held, the agreement was not intended to bind the company to renew its contract with V and imposed no obligation on it to review it [Montreal Gas Co. v. Vasey, (1900) A.C. 595].

The terms of the agreement must also be such as are capable of performance. An agreement to do an act impossible in itself cannot be enforced [Sec. 56 (1)]. For example, where A agrees with B to put life into B's dead wife, the agreement is void as it is impossible of performance.

**9. Legal formalities.** A contract may be made by words spoken or written. As regards the legal effects, there is no difference between a contract in writing and a contract made by word of mouth. It is, however, in the interest of the parties that the contract should be in writing. There are some other formalities also which have to be complied with in order to make an agreement legally enforceable. In some cases, the document in which the contract is incorporated is to be stamped. In some other cases, a contract, besides being a written one, has to be registered. Thus where there is statutory requirement that a contract should be made in writing or in the presence of witnesses or registered, the required statutory formalities must be complied with (Sec. 10, para 2).

### TEST QUESTIONS

- What is the object and nature of the law of contract ?
- "The Indian Contract Act, 1872 is not a complete code dealing with all branches of the law of contract." Comment.
- "The parties to a contract, in a sense, make the law for themselves." Comment.
- Describe the essentials of a valid contract. When does an agreement become void ?
- (a) "The law of contract is not the whole law of agreements, nor is it the whole law of obligations." Discuss.  
(b) What tests would you apply to ascertain whether an agreement is a contract ?
- Make up an example to illustrate the correlative nature of rights and obligations arising from a contract.

### PRACTICAL PROBLEMS

Attempt the following problems, giving reasons :

- Over a cup of coffee in a restaurant, A invites B to a dinner at his house on next Sunday. B hires a taxi and reaches A's house at the appointed time, but A fails to perform his promise. Can B recover any damages from A ?

[Hint : No, (Balfour v. Balfour)].

- State whether there is any contract in the following cases :

- A engages B for a certain work and promises to pay such remuneration as shall be fixed by C. B does the work.

- (b) A and B promise to marry each other.
- (c) A takes a seat in a public vehicle.

- (d) A invites B to a card party. B accepts the invitation.

[Hint : (a) There is a contract between A and B and A is bound to pay the remuneration as shall be fixed by C. If C does not fix, or refuses to fix the remuneration, A is bound to pay a reasonable remuneration. (b) and (c) There is a contract between A and B. (d) There is no contract.]

3. A forced B to enter into a contract at the point of pistol. What remedy is available to B, if he does not want to be bound by the contract?

[Hint : He can repudiate the contract as his consent is not free].

4. M mows L's lawn without being asked by L to do so. L watches M do the work but does not attempt to stop him. Is L bound to pay any charges to M?

[Hint : Yes, L is bound to pay M a reasonable remuneration].

5. C orally offered to pay A, an auto mechanic, Rs. 50 testing a used car which C was about to purchase from D. A agreed and tested the car. C paid A Rs. 50 in cash for his services. Is the agreement between C and A (a) express or implied, (b) executed or executory, (c) valid, void, voidable or unenforceable?

[Hint : The agreement is (a) express, (b) executed, and (c) valid].

6. A promises to pay B Rs. 500 if he (B) beats C. B beats C, but A refuses to pay. Can B recover the amount?

[Hint : No, as the agreement is illegal].

7. A sent in a football pools coupon containing a condition that it "shall not be attended by or give rise to any legal relationship, rights, duties, consequences." He sued for £ 4,335 which he claimed to have won. Is the claim enforceable?

[No. (Appleton v. Littlewood Ltd., (1939) 1 All E.R. 464)].

8. D lived as a paying boarder with a family. He agreed with the members of the family to share prize money of a newspaper competition. The entry sent by D won a prize of £ 750. He refused to share the amount won. Can the members of the family recover their share?

[Hint : Yes, as there was a "mutuality in the agreement between the parties" and the parties had intended to be bound (Simpkins v. Pays, (1955) 3 All E.R. 10)].

1-2

## Classification of Contracts

Contracts may be classified according to their (1) validity, (2) formation, or (3) performance.

### 1. Classification according to validity

A contract is based on an agreement. An agreement becomes a contract when all the essential elements referred to above are present. In such a case, the contract is a valid contract. If one or more of these elements is/are missing, the contract is either voidable, void, or illegal or unenforceable.

Voidable contract. An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract [Sec. 2 (i)]. This happens when the essential element of free consent in a contract is missing. When the consent of a party to contract is not free, i.e., it is caused by coercion, undue influence, misrepresentation or fraud, the contract is voidable at the option of the party whose consent is not free, i.e., the aggrieved party (Sects. 19 and 19-A). The aggrieved party may either rescind or avoid or repudiate the contract if he so desires, or elect to be bound by it. A voidable contract continues to be valid till it is avoided by the party entitled to do so.

If the main agreement is void, the collateral transactions to it are not affected. In the above case, if B had entered into a void agreement with a minor, the contract between B and A would not have been affected.

Unenforceable contract. An unenforceable contract is one which cannot be enforced in a Court of law because of some technical defect such as absence of writing or where the remedy has been barred by lapse of time. The contract may be carried out by the parties concerned; but in the event of breach or repudiation of such a contract, the aggrieved party will not be entitled to the legal remedies.

### 2. Classification according to formation

A contract may be (a) made in writing or by word of mouth, or (b) inferred from the conduct of the parties or the circumstances of the case. These are the modes of formation of a contract.

Contracts may be classified according to the mode of their formation as follows :

Express contract. If the terms of a contract are expressly agreed upon (whether by words spoken or written) at the time of the formation of the contract, the contract is said to be an express contract. Where the offer or acceptance of any promise is made in words, the promise is said to be express (Sec. 9). An express promise results in an express contract.

Implied contract. An implied contract is one which is inferred from the acts or conduct of the parties or course of dealings between them. It is not the result of any express promise or promises by the parties but of their particular acts. It may also result from a continuing course of conduct of the parties. Where the proposal or acceptance of any promise is made otherwise than in words, the promise is said to be implied (Sec. 9). An implied promise results in an implied contract.

Examples. (a) There is an implied contract when A —

- (i) gets into a public bus, or
- (ii) takes a cup of tea in a restaurant, or
- (iii) obtains a ticket from an automatic weighing machine, or
- (iv) lifts B's luggage to be carried out of the railway station.

(b) A fire broke out in P's farm. He called upon the Upton Fire Brigade to put out the fire which the latter did. P's farm did not come under the free service zone although he believed to be so. Held, he was liable to pay for the service rendered as the service was rendered on an implied promise to pay [Upton Rural District Council v. Powell, (1942) All E. R. 220].

Quasi-contract. Strictly speaking, a quasi-contract is not a contract at all. A contract is intentionally entered into by the parties. A quasi contract, on the other hand, is created by law. It resembles a contract in that a legal obligation is imposed on a party who is required to perform it. It rests on the ground of equity that "a person shall not be allowed to enrich himself unjustly at the expense of the another."

Example. T, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

For a detailed discussion of quasi-contracts, refer to Chapter 2-10.

Example. A promises to sell his car to B for Rs. 20,000. His consent is obtained by use of force. The contract is voidable at the option of A. He may avoid the contract or elect to be bound by it.

A contract becomes voidable in the following two cases also :

(1) When a person promises to do something for another person for a consideration but the other person prevents him from performing his promise, the contract becomes voidable at his option (Sec. 53).

Example. A and B contract that B shall execute certain work for A for Rs. 1,00,000. B is ready and willing to execute the work accordingly but A prevents him from doing so. The contract is voidable at the option of B and if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

(2) When a party to a contract promises to perform an obligation within a specified time, any failure on his part to perform his obligation within the fixed time makes the contract voidable at the option of the promisee (Sec. 55, para 1).

When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is promisor. If the party rescinding the contract has received any benefit under the contract from another party to such contract he shall restore such benefit, so far as may be, to the person from whom it was received (Sec. 64). The party rightfully has sustained through the non-fulfilment of the contract (Sec. 65).

### Void agreement and void contract

Void agreement. An agreement not enforceable by law is said to be void [Sec. 2 (g)]. A void agreement does not create any legal rights or obligations. It is a nullity and is destitute of legal effects altogether. It is void ab initio, i.e., from the very beginning as, for example, an agreement with a minor or an agreement without consideration.

Void contract. A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Sec. 2 (j)]. A contract, when originally entered into, may be valid and binding on the parties, e.g., a contract to import goods from a foreign country. It may subsequently become void, e.g., when a war breaks out between the importing country and the exporting country.

It is illogical to talk of a void contract originally entered into, for what is supposed to be a contract is no contract at all. We may talk of such a contract as a void agreement.

Illegal agreement. An illegal agreement is one which transgresses some rule of basic public policy or which is criminal in nature or which is immoral. Such an agreement is a nullity and has much wider import than a void contract. All illegal agreements are void but all void agreements or contracts are not necessarily illegal. An illegal agreement is not only void as between the immediate parties but has this further effect that even the collateral transactions to it become tainted with illegality. A collateral transaction is one which is subsidiary, incidental or auxiliary to the principal or original contract.

Example. B borrows Rs. 5,000 from A and enters into a contract with an alien to import prohibited goods. A knows of the purpose of the loan. The transaction between B and A is collateral to the main agreement. It is illegal since the main agreement is illegal.

### Classification according to performance

To the extent to which the contracts have been performed, these may be classified as —

- (1) Executed contracts, or
- (2) Executory contracts.

 Executed contracts. 'Executed' means that which is done. An executed contract is one in which both the parties have performed their respective obligations.

Example. A agrees to paint a picture for B for Rs. 100. When A paints the picture and B pays the price, i.e., when both the parties perform their obligations, the contract is said to be executed.

In some cases, even though a contract may appear to be completed at once, its effects may still continue. Thus when a person buys a bun containing a stone and subsequently breaks one of his teeth, he has a right to recover damages from the seller [Chaproniere v. Mason, (1905) 21 T.L.R. 633].

 Executory contract. 'Executory' means that which remains to be carried into effect. An executory contract is one in which both parties have yet to perform their obligations. Thus in the above example, the contract is executory if A has not yet painted the picture and B has not paid the price. Similarly, if A agrees to engage B as his servant from the next month, the contract is executory.

A contract may sometimes be partly executed and partly executory. Thus if B has paid the price to A and A has not yet painted the picture, the contract is executed as to B and executory as to A.

Another classification of contracts according to the performance is as follows :

Unilateral or one-sided contract. A unilateral or one-sided contract is one in which only one party has to fulfil his obligation at the time of the formation of the contract, the other party having fulfilled his obligation at the time of the contract or before the contract comes into existence. Such contracts are also known as contracts with executed consideration.

*Example.* *A* permits a railway coolie to carry his luggage and place it in a carriage. A contract comes into existence as soon as the luggage is placed in the carriage. But by that time the coolie has already performed his obligation. Now only *A* has to fulfil his obligation, i.e., pay the reasonable charges to the coolie.

Bilateral contract. A bilateral contract is one which the obligations on the part of both the parties to the contract are outstanding at the time of the formation of the contract. In this sense, bilateral contracts are similar to executory contracts and are also known as contracts with executory consideration.

#### TEST QUESTIONS

1. Illustrate the distinction between void, voidable and illegal agreements. Discuss the validity of agreements collateral to such agreements.

2. Distinguish between the following classes of contracts :

(a) Express and implied contracts. (b) Executed and executory contracts. (c) Valid, void and voidable contracts. (d) Void agreements and void contracts.



## Offer and Acceptance

### OFFER

At the inception of every agreement, there must be a definite offer by one person to another and its unqualified acceptance by the person to whom the offer is made. An offer is a proposal by one party to another to enter into a legally binding agreement with him. A person is said to have made a proposal, when he "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." [Sec. 2 (a)]. For example, *A* says to *B*, "Will you purchase my car for Rs. 50,000 ?" *A*, in this case, is making an offer to *B* as he signifies to *B* his willingness to sell his car to *B* for Rs. 50,000 with a view to obtaining *B*'s assent to purchase the car.

The person making the offer is known as the offeror, proposer, or promisor and the person to whom it is made is called the offeree or proposee. When the offeree accepts the offer, he is called the acceptor or promisee [See. 2 (c)].

#### How an offer is made

An offer may be made by express words, spoken or written. This is known as an express offer. For example, when *A* says to *B*, "Will you purchase my house at Meerut for Rs. 50,000 ?" or when *A* advertises in a newspaper offering Rs. 50 to anyone who returns his lost dog, there is an express offer.

An offer may also be implied from the conduct of the parties or the circumstances of the case. This is known as an implied offer. Thus when a transport company runs a bus on a particular route, there is an implied offer by the transport company to carry passengers for a certain fare. The acceptance of the offer is complete as soon as a passenger boards the bus [*Wilkie v. London Passenger Transport Board*, (1947) 1 All E.R. 258, C.A.]. Likewise when a weighing machine is installed on a railway platform or a public place, there is an implied offer by the owner of the machine. Any one by putting the required coin in the slot of the weighing machine can accept this offer.

When an offer is made to a definite person, it is called a specific offer. It can be accepted only by the person to whom it is made.

When an offer is made to the world at large, it is called a general offer.

*Example.* *A* company advertised in several newspapers that a reward of £ 100 would be given to any person who contracted influenza after using the smoke balls of the company according to its printed directions. One Mrs. Carlill used the smoke balls according to the directions of the company but contracted influenza. Held, she could recover the amount as by using the smoke balls she had accepted the offer [*Carlill v. Carbolic Smoke Ball Co.*, (1893) 1 Q.B. 256].

Where an offer is made to the world at large, any person or persons with notice of the offer may come forward and accept the offer. When the offer is accepted by a particular person, there is a contract between the offeror and that particular person. If a large number of persons accept the offer, there are as many contracts as the number of persons accepting the offer. Where a reward has been offered for giving a specific piece of information, e.g., conviction of the thief of a certain property, or finding of a specific thing, acceptance can be made only by the first person who gives the information and no further acceptance of the offer is possible [*Lancaster v. Walsh*, (1838) 4 M. & W. 16].

#### LEGAL RULES AS TO OFFER

**1. Offer must be such as in law is capable of being accepted and giving rise to legal relationship.** A social invitation, even if it is accepted, does not create legal relations because it is not so intended. An offer, therefore, must be such as would result in a valid contract when it is accepted.

**2. Terms of offer must be definite, unambiguous and certain and not loose and vague.** If the terms of an offer are vague or indefinite, its acceptance cannot create any contractual relationship.

**Example.** (a) *A* offered to take a house on lease for three years at £ 285 per annum if the house was "put into thorough repair and drawing rooms handsomely decorated according to the present style". *Held*, the offer was too vague to result in a contractual relation [*Taylor v. Portington*, (1855) All E.R. 128].

(b) *A* says to *B*, "I will sell you a car." *A* owns three different cars. The offer is not definite.

But if the agreement contains a machinery for ascertaining a vague term, the agreement is not void on the ground of its being vague.

**Example.** *F* sold a piece of land to a motor company subject to an agreement that the company should buy all their petrol from *F* at a price to be agreed by the parties from time to time. Any dispute was to be submitted to arbitration. The price was never agreed and the company refused to buy. *Held*, there was a binding contract to buy petrol of reasonable quality at a reasonable price to be determined in case of dispute by arbitration [*Foley v. Classique Coaches Ltd.*, (1934) 2 K.B. 1].

#### 3. An offer may be distinguished from :

(i) **A declaration of intention and an announcement.** A declaration by a person that he intends to do something gives no right of action to another. Such a declaration only means that an offer will be made or invited in future and not that an offer is made now. An advertisement for a concert or an auction sale does not amount to an offer to hold such concert or auction sale [*Executive Engineer, Sundargarh v. Mohan Prasad Sahu*, A.I.R. (1990) Ori. 26].

**Example.** An auctioneer advertised in a newspaper that a sale of office furniture would be held. A broker came from a distant place to attend that auction, but all the furniture was withdrawn. The broker thereupon sued the auctioneer for his loss of time and expenses. *Held*, a declaration of intention to do a thing did not create a binding contract with those who acted upon it, so that the broker could not recover [*Harris v. Nickerson* (1873) L.R. 8 Q. B. 286].

(ii) **An invitation to make an offer or do business.** Display of goods by a

#### OFFER AND ACCEPTANCE

shopkeeper in his window, with prices marked on them, is not an offer but merely an invitation to the public to make an offer to buy the goods at the marked prices. Likewise quotations, catalogues, advertisements in a newspaper for sale of an article, or circulars sent to potential customers do not constitute an offer. They are instead an *invitation* to the public to make an offer.

**Example.** Goods are sold in a shop under the 'self-service' system. Customers select goods in the shop and take them to the cashier for payment of the price. The contract is made, not when a customer selects the goods, but when the cashier accepts the offer to buy and receives the price [*Pharmaceutical Society of Great Britain v. Boots Cash Chemists*, (1953) 1 Q.B. 401].

Newspaper advertisements are not offers. A recognised exception to this is a general offer of reward to the public. Thus when *A* advertises in a newspaper that he would pay Rs. 100 to anyone who finds and returns her lost dog, the offer is addressed to the first person who by performing the required act with knowledge of the offer of reward, creates an agreement.

**4. Offer must be communicated.** An offer, to be complete, must be communicated to the person to whom it is made. Unless an offer is communicated to the offeree by the offeror or by his duly authorised agent, there can be no acceptance of it.

An acceptance of an offer, in ignorance of the offer, is no acceptance and does not confer any right on the acceptor.

**Example.** *S* sent his servant, *L*, to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. *L* traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. *Held*, he was not entitled to the reward [*Latman v. Gauri Dutt*, (1913) 11 All. L.J. 489].

**5. Offer must be made with a view to obtaining the assent.** The offer to do or not to do something must be made with a view to obtaining the assent of the other party addressed and not merely with a view to disclosing the intention of making an offer.

**6. Offer should not contain a term the non-compliance of which may be assumed to amount to acceptance.** Thus a man cannot say that if acceptance is not communicated by a certain time, the offer would be considered as accepted. For example, where *A* writes to *B*, "I will sell you my horse for Rs. 5,000 and if you do not reply, I shall assume you have accepted the offer." There is no contract if *B* does not reply. *B* is under no obligation to speak. However, if *B* is in possession of *A*'s horse at the time the offer is made and he continues to use the horse thereafter, *B*'s silence and his continued use of horse amount to acceptance on his part of the terms of *A*'s offer.

**7. A statement of price is not an offer.** A mere statement of price is not construed as an offer to sell [*Harvey v. Facey*, (1893) App. Cas 552].

**Example.** Three telegrams were exchanged between Harvey and Facey.

- "Will you sell us your Bumper Hall Pen ? Telegraph lowest cash price—answer paid." (Harvey to Facey).
- "Lowest price for Bumper Hall Pen £ 900." (Facey to Harvey).
- "We agree to buy Bumper Hall Pen for the sum of £ 900 asked by you." (Harvey to Facey).

*Held*, there was no concluded contract between Harvey and Facey [*Harvey v. Facey*, (1893) A.C. 552].

The first telegram asked two questions : (i) the willingness of Facey to sell, and (ii) the lowest price. Facey replied only to the second question and gave his lowest price, i.e., he supplied mere information and no offer had been made by him to sell. There could be a contract only if he had accepted Harvey's last telegram.

#### Special terms in a contract

Where any special terms are to be included in a contract, these must be duly brought to the notice of the offeree at the time when the proposal is made. If it is not done and if the contract is subsequently entered into, the offeree will not be bound by them. Also these terms should be presented in such a manner that a reasonable man can become aware of them before he enters into a contract.

**Example.** A hotel put up a notice in a bed room, exempting the proprietor from liability for loss of client's goods. Held, the notice was not effective as it came to the knowledge of the client only when the contract to take a room had already been entered into [Olley v. Marlborough Court Ltd., (1949) 1 K.B. 532].

Certain conditions are attached to transactions like purchase of a ticket for a journey or deposit of luggage in a cloak room. Wherever on the face of a ticket the words "For conditions see back" are printed, the person concerned is as a matter of law held to be bound by the conditions subject to which the ticket is issued whether he takes care to read them or not. The fact that he did not or could not read does not alter the legal position.

**Example.** P deposited a bag in the cloak room of railway station. On the face of the ticket issued to him, was written "See back". One of the printed conditions limited the liability of the company for loss of a package to £ 10. The bag was lost and P claimed £ 24.50, as its value. Held, P was bound by the conditions on the back of the ticket even if he had not read them [Parker v. S.E. Rail. Co., (1877) 2 C.P.D. 416].

If conditions are printed on the back of a ticket, but there are no words at all on the face of it to draw the attention of the person concerned to those conditions, he is not bound by them. However, if the conditions are contained in a voucher or receipt for payment of money which is normally not supposed to contain the conditions of the contract, they do not bind the person receiving the voucher or receipt.

**Example.** C hired a deck chair from Municipal Council. He paid a hire of 2d. for 2 sessions of 3 hours. He was given a ticket which he put in his pocket unread. The ticket contained the following condition : "The Council will not be liable for any accident or damage arising from hire of chair." When C sat in the chair, it broke and injured him. Held, the Council was liable to P in damages for personal injury. Slesser, L.J. observed : "In my opinion this ticket is no more than a receipt, and is quite different from a railway ticket which contains upon it the terms upon which a railway company agrees to carry passengers." [Chapleton v. Barry Urban District Council, (1940) 1 K.B. 352].

Ordinarily, the acceptance of a document containing the contract implies acceptance of all the terms contained in the document. Exceptions are, however, made in the following cases :

- (1) When there is a misrepresentation or fraud.
- (2) When the notice of the terms is insufficient.

**Example.** A purchased a ticket which had on its face "Dublin to White Haven". On the back of the ticket, there was a term that the carrying company was not liable for losses of any kind. But there was nothing on the face of the ticket to draw A's notice to the terms and conditions on the back of the ticket. Held, A was not bound by these terms and conditions [Henderson v. Stevenson, (1875) L.R. 2 H.L. App. Cas. 470].

3. When there is nothing to lead the purchase of a ticket to believe that there are additional terms.

#### Cross Offers

When two parties make identical offers to each other, in ignorance of each other's offer, the offers are cross offers. In such a case, the Court will not construe one offer as the offer and the other as the acceptance and as such there can be no concluded contract [Tinn v. Hoffmann, (1873) 29 L.T. 271].

#### ACCEPTANCE

A contract emerges from the acceptance of an offer. Acceptance is the act of assenting by the offeree to an offer. In other words, it is the manifestation by the offeree of his willingness to be bound by the terms of the offer. It is "to an offer what a lighted match is to a train of gunpowder. It produces something which cannot be recalled, or undone". This means when the offeree signifies his assent to the offeror, the offer is said to be accepted. An offer when accepted becomes a promise [Sec. 2 (b)].

Acceptance may be express or implied. It is express when it is communicated by words spoken or written or by doing some required act. It is implied when it is to be gathered from the surrounding circumstances or the conduct of the parties.

**Example.** At an auction sale, S is the highest bidder. The auctioneer accepts the offer by striking the hammer on the table. The is an implied acceptance.

Acceptance of an offer requires more than a tacit (implied) formation of intention to accept. To give evidence of that intention, there must be some overt (apparent) act, or words spoken or written must be used.

Acceptance means in general communicated acceptance (Anson).

#### Who can accept ?

**Acceptance of particular offer.** When an offer is made to a particular person, it can be accepted by him alone. If it is accepted by any other person, there is no valid acceptance. The rule of law is clear that if you propose to make a contract with A, B cannot substitute himself for A without your consent.

**Example.** Boulton bought a hose-pipe business from Brocklehurst. Jones to whom Brocklehurst owed a debt, placed an order with Brocklehurst for the supply of certain goods. Boulton supplied the goods even though the order was not addressed to him. Jones refused to pay Boulton for the goods because he, by entering into contract with Brocklehurst, intended to set off his debt against Brocklehurst. Held, the offer was made to Brocklehurst and it was not in the power of Boulton to step in and accept and therefore there was no contract [Boulton v. Jones, (1857) 2 H. and N. 564].

Under a quasi-contract, Boulton can however recover the goods from Jones.

**Acceptance of general offer.** When an offer is made to world at large, any person to whom the offer is made can accept it [Carlill v. Carbolic Smoke Ball Co., (1893) 1 Q.B. 256].

## LEGAL RULES AS TO ACCEPTANCE

The acceptance of an offer is the very essence of a contract. To be legally effective, it must satisfy the following conditions :

1. It must be absolute and unqualified, i.e., it must conform with the offer. An acceptance, in order to be binding, must be absolute and unqualified [Sec. 7 (1)] in respect of all terms of the offer, whether material or immaterial, major or minor. If the parties are not *ad idem* on all matters concerning the offer and acceptance, there is no contract.

*Example.* (a) A made an offer to B to purchase a house with possession from 25th July. The offer was followed by an acceptance suggesting possession from 1st August. *Held*, there was no concluded contract [Routledge v. Grant (1828) 4 Bing. 653].

(b) M offered to sell a piece of land to N at £ 280. N accepted and enclosed £ 80 with a promise to pay the balance by monthly instalments of £ 50 each. *Held*, there was no contract between M and N, as the acceptance was not unqualified [Neale v. Merret, (1930) W.N. 189].

2. It must be communicated to the offeror. To conclude a contract between the parties, the acceptance must be communicated in some perceptible form. A mere resolve or mental determination on the part of the offeree to accept an offer, when there is no external manifestation of the intention to do so, is not sufficient [Bhagwan Dass Kedia v. Girdhari Lal, A.I.R. (1966) S.C. 543]. In order to result in a contract, the acceptance must be a "matter of fact".

*Example.* (a) A tells B that he intends to marry C, but tells C nothing of his intention. There is no contract, even if C is willing to marry A.

(b) F offered to buy his nephew's horse for £ 30 saying : "If I hear no more about it I shall consider the horse is mine at £ 30." The nephew did not write to F at all, but he told his auctioneer who was selling his horses not to sell that particular horse because it had been sold to his uncle. The auctioneer inadvertently sold the horse. *Held*, F had no right of action against the auctioneer as the horse had not been sold to F, his offer of £ 30 not having been accepted [Felthouse v. Bindley, (1862) 11 C.B. (N.S.) 869].

3. It must be according to the mode prescribed or usual and reasonable mode. If the acceptance is not according to the mode prescribed, or some usual and reasonable mode (where no mode is prescribed), the offeror may intimate to the offeree within a reasonable time that the acceptance is not according to the mode prescribed and may insist that the offer must be accepted in the prescribed mode only. If he does not inform the offeree, he is deemed to have accepted the acceptance [Sec. 7 (2)].

*Example.* A makes an offer to B and says : "If you accept the offer, reply by wire." B sends the reply by post. It will be a valid acceptance, unless A informs B that the acceptance is not according to the mode prescribed.

4. It must be given within a reasonable time. If any time limit is specified, the acceptance must be given within that time. If no time limit is specified, it must be given within a reasonable time.

*Example.* On June 8 M offered to take shares in R company. He received a letter of acceptance on November 23. He refused to take the shares. *Held*, M was entitled to refuse as his offer had lapsed as the reasonable period during which it could be accepted had elapsed [Ramsgate Victoria Hotel Co. v. Montefiore, (1886) L.R. 1 Ex. 109].

## OFFER AND ACCEPTANCE

5. It cannot precede an offer. If the acceptance precedes an offer, it is not a valid acceptance and does not result in a contract.

*Example.* In a company, shares were allotted to a person who had not applied for them. Subsequently when he applied for shares, he was unaware of the previous allotment. The allotment of shares previous to the application is invalid.

6. It must show an intention on the part of the acceptor to fulfil terms of the promise. If no such intention is present, the acceptance is not valid.

7. It must be given by the party or parties to whom the offer is made.

8. It must be given before the offer lapses or before the offer is withdrawn.

9. It cannot be implied from silence. The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer, unless the offeree has by his previous conduct indicated that his silence means that he accepts.

*Example.* A wrote to B, "I offer you my car for Rs. 10,000. If I don't hear from you in seven days, I shall assume that you accept." B did not reply at all. There is no contract.

Acceptance given by a person other than the offeree or by a person who is not authorised to give acceptance is ineffective in law. Likewise information received from an unauthorised person is ineffective [Powel v. Lee, (1908) 24 T.L.R. 606].

### Acceptance subject to contract

Where an offeree accepts an offer "subject to contract" or "subject to formal contract" or "subject to contract to be approved by solicitors", the matter remains in the negotiation stage and the parties do not intend to be bound until a formal contract is prepared and signed by them.

*Example.* C and D signed an agreement for the purchase of a house by D "subject to a proper contract" to be prepared by C's solicitors. A document was prepared by C's solicitors and approved by D's solicitors, but D refused to sign the document. *Held*, there was no contract as the agreement was only conditional [Chillingworth v. Esche, (1924) 1 Ch. 97].

Unless there is an agreement to the contrary, a contract is made between two parties either when a formal contract is signed by them or, if each party is to sign a separate counterpart of the contract, when the separate counterparts so signed are exchanged.

*Example.* E bought certain property from B "subject to a contract". The terms of the formal contract were agreed and each party signed his counterpart. E posted his counterpart but B in the meantime changed his mind and did not post his counterpart. *Held*, there was no binding contract between the parties [Eccles v. Bryant, (1948) Ch. 93].

### Agreement to agree in future

If the parties have not agreed upon the terms of their contract but have made an agreement to agree in future, there is no contract. Lord Wensleydale observed that "an agreement to be finally settled must comprise all the terms which the parties intend to introduce into the agreement. An agreement to enter into an agreement upon terms to be afterwards settled between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of agreement are settled : until those terms are settled, he is at liberty to retire from the bargain." [Ridgeway v. Wharton, (1857) 6 H.L.C. 238].

*Example.* An actress was engaged by a theatrical company for a certain period. One of the terms of the agreement was that if the play was shown in London, she would be engaged at a salary to be mutually agreed upon. Held, there was no contract [*Loftus v. Roberts*, (1902) 18 T.L.R. 532].

#### COMMUNICATION OF OFFER, ACCEPTANCE AND REVOCATION

An offer, its acceptance and their revocation (withdrawal) to be complete must be communicated. When the contracting parties are face to face and negotiate in person, a contract comes into existence the moment the offeree gives absolute and unqualified acceptance to the proposal made by the offeror. When the parties are at a distance and the offer and acceptance and their revocation are made through post, i.e., by letter or telegram, the rules contained in Secs. 3 to 5 apply. These rules are as follows :

##### Mode of communication (Sec. 3)

The communication of an offer, its acceptance and their revocation respectively are deemed to be made by any (a) act, or (b) omission, of the party offering, accepting or revoking. Such act or omission must, however have the effect of communicating such offer, acceptance or revocation. In other words, offer, acceptance or revocation may be communicated by words spoken or written, or by conduct. Thus installation of a weighing machine at a public place is an offer, putting of a coin in the slot of the machine is the acceptance of the offer, and switching off the machine amounts to revocation of the offer.

##### When is communication complete (Sec. 4) ?

*Communication of offer* (Sec. 4, para 1). The communication of an offer is complete when it comes to the knowledge of the person to whom it is made.

*Example.* A proposes, by a letter, to sell a house to B at a certain price. The letter is posted on 10th July. It reaches B on 12th July.

The communication of the offer is complete when B receives the letter, i.e., on 12th July.

*Communication of acceptance* (Sec. 4 para 2). The communication of an acceptance is complete—

as against the proposer when it is put into a course of transmission to him, so as to be out of the power of the acceptor ;

as against the acceptor when it comes to the knowledge of the proposer.

*Example.* B accepts A's proposal, in the above case, by a letter sent by post on 13th instant. The letter reaches A on 15th instant. The communication of the acceptance is complete, as against A, when the letter is posted, i.e., on 13th, as against B, when the letter is received by A, i.e., on 15th.

*Communication of revocation* (Sec. 4, Para 3). Revocation means 'taking back' "recalling" or "withdrawal". It may be a revocation of offer or acceptance. The communication of a revocation is complete—

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

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

*Example.* A proposes, by a letter, to sell a house to B at a certain price. The letter is posted on 15th May. It reaches B on 19th May. A revokes his

offer by telegram on 18th May. The telegram reaches B on 20th May. The revocation is complete as against A when the telegram is despatched, i.e., on 18th. It is complete as against B when he receives it, i.e., on 20th.

##### Time for revocation of offer and acceptance (Sec. 5)

*Time for revocation of proposal* (Sec 5, para 1). A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

*Time for revocation of acceptance* (Sec. 5, para 2). An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

*Example.* A proposes by a letter sent by post to sell his house to B. The letter is posted on the 1st of the month. B accepts the proposal by a letter sent by post on the 4th. The letter reaches A on the 6th.

A may revoke his offer at any time before B posts his letter of acceptance, i.e., 4th, but not afterwards.

B may revoke his acceptance at any time before the letter of acceptance reaches A, i.e., 6th, but not afterwards.

##### Loss of letter of acceptance in postal transit

Acceptance is complete as against the offeror as soon as the letter of acceptance is posted. The contract is complete even if the letter of acceptance goes astray or is lost through an accident in the post. But in order to bind the offeror, it is important that the letter of acceptance is correctly addressed, sufficiently stamped and posted. If it is not correctly addressed and sufficiently stamped, the communication of acceptance is not complete within the meaning of Sec. 4 even if it is posted. Lord Cottenham L.C., in delivering the judgement in the House of Lords in *Dunlop v. Higgins*, (1849) 1 H.L.C. 381 enunciated the principle in the following words :

"If the letter of acceptance is posted in due time, the acceptor is not responsible for any casualties in the post office . . . . If the party accepting the offer puts his letter into post on the correct day, has he not done everything he was bound to do ? How can he be responsible for that over which he has no control ?"

##### Contracts over telephone or telex or oral communication

Modern business is mostly done through telephone or telex. A contract by telephone, or telex has the same effect as an oral agreement entered into between the parties when they are face to face. But the offeree must make sure that his acceptance is properly received, i.e., heard and understood by the offeror.

*Example.* A makes an offer to B across a river or a courtyard. B shouts back accepting A's offer, but A does not hear B's reply as it was drowned by an aircraft flying overhead. There is no contract at that moment. If B wishes to make a contract, he must wait till the aircraft is gone and then shout back his acceptance so that A can hear what B says. Until A hears B's reply, there is no contract.

An example given in *Entores v. Miles Far East Corporation*, (1955) 2 All E.R. 493 is enlightening in this connection :

"Now take a case where two people make a contract by telephone. Suppose, for instance, that I make an offer to a man by telephone, and, in

the middle of his reply, the line goes 'dead' so that I do not hear his words of acceptance. There is no contract at that moment. The other man may not know the precise moment when the line failed. But he will know that the telephone conversation was abruptly broken off, because people usually say something to signify the end of the conversation. If he wishes to make a contract, he must, therefore, get through again so as to make sure that is heard."

The principle of the *Entores* case was endorsed by the Supreme Court in *Bhagwan Dass Kedia v. Girdharilal*, A.I.R. (1966) S.C. 543.

#### When does an offer come to an end?

An offer may come to an end by revocation or lapse, or rejection.

**Revocation or lapse of offer.** Sec. 6 deals with various modes of revocation of offer. According to it, an offer is revoked—

1. By communication of notice of revocation by the offeror at any time before its acceptance is complete as against him [Sec. 6 (1)].

*Example.* At an auction sale, A makes the highest bid for B's goods. He withdraws the bid before the fall of the hammer. The offer has been revoked before its acceptance.

2. By lapse of time if it is not accepted within the prescribed time. If however, no time is prescribed, it lapses by the expiry of a reasonable time [Sec. 6(2)].

*Example.* S offered to sell wool to B on Thursday and agreed to give him three days' time to accept. B accepted the offer on Monday, but by that time S had sold the wool. *Held*, the offer had lapsed [*Head v. Diggon*, (1828) 3 M. & R. 97].

3. By non-fulfilment by the offeree of a condition precedent to acceptance [Sec. 6 (3)].

*Example.* S, a seller, agrees to sell certain goods subject to the condition that B, the buyer, pays the agreed price before a certain date. If B fails to pay the price by that date, the offer stands revoked.

4. By death or insanity of the offeror provided the offeree comes to know of it before acceptance [Sec. 6 (4)]. If he accepts an offer in ignorance of the death or insanity of the offeror, the acceptance is valid.

In addition to the above cases dealt with in Sec. 6, an offer is also revoked—

5. If a counter-offer is made to it. 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.

*Example.* An offeree agreed to accept half the quantity of goods offered by the offeror on the same terms and conditions as would have applied to the full contract. *Held*, there was no contract as there was a counter-offer to the offer [*Tinn v. Hoffman*, (1873) 29 L.T. 71].

6. If an offer is not accepted according to the prescribed or usual mode, provided the offeror gives notice to the offeree within a reasonable time that the acceptance is not according to the prescribed or usual mode. If the offeror keeps quiet, he is deemed to have accepted the acceptance [Sec. 7 (2)].

7. If the law is changed. An offer comes to an end if the law is changed so as to make the contract contemplated by the offer illegal or incapable of performance.

An offer can, however, be revoked subject to the following rules :

1. It can be revoked at any time before its acceptance is complete as against the offeror.

2. Revocation takes effect only when it is communicated to the offeree.
3. If the offeror has agreed to keep his offer open for a certain period, he can revoke it before the expiration of that period only—
  - (a) if the offer has in the meantime not been accepted, or
  - (b) if there is no consideration for keeping the offer open.

#### TEST QUESTIONS

1. What is an 'offer'? When is it complete? State the rules of a valid offer.
2. Discuss briefly the law relating to communication of offer, acceptance and revocation. When may an offer and acceptance be revoked?
3. What essential conditions are necessary to convert a proposal into a promise?
4. How can an offer be accepted? State briefly the rules relating to the communication of acceptance. Can there be a tacit acceptance of an offer? How can an offer be accepted by acting upon it?
5. How and on what grounds does a proposal stand revoked? Is there any limit in time after which revocation of a proposal cannot be made?
6. Explain what is meant by (i) lapse of an offer, and (ii) a counter-offer.
7. (a) Is an agreement to agree in future a contract?  
(b) "There cannot be a contract to make a contract." Comment.
8. Is an offer made in haste or under great emotional excitement a valid offer?
9. Illustrate how silence by the offeree may sometimes constitute an acceptance of an offer.
10. If the letter of acceptance of an offer is lost in postal transit, is the offeror bound by the acceptance?
11. "An acceptance to be effective must be communicated to the offeror." Are there any exceptions to this rule?
12. Comment on the following statements :
  - (a) A mere mental acceptance not evidenced by words or conduct is, in the eyes of the law, no acceptance.
  - (b) Acceptance is to offer what a lighted match is to a train of gunpowder. It produces something which cannot be recalled or undone.
  - (c) A contract is formed when the acceptor has done something to signify his intention to accept, not when he has made up his mind to do so.
  - (d) The offer and the acceptance bring the parties together, but the law requires some further evidence of their intention to create an obligation.
  - (e) Performance of the conditions of a proposal is an acceptance of the proposal.
  - (f) An agreement may be made in any manner whatsoever provided the parties are in communication.
  - (g) Whereas an offer is not held to be made until it is brought to the knowledge of the offeree, acceptance may, in certain circumstances, be held to be made though it has not come to the knowledge of the offeror.

#### PRACTICAL PROBLEMS

Attempt the following problems, giving reasons :

1. Are the following offers valid?
  - (a) A garment store gave the following advertisement in a newspaper : "Special sale for tomorrow only. Men's Night Suits reduced from Rs. 200 to Rs. 100." **No**.
  - (b) P says to Q, "I will sell you a camera." P owns three different types of cameras of various prices. **No**.
  - (c) An auctioneer displays a refrigerator before a gathering in an auction sale. **Yes**.
  - (d) A advertises in *The Statesman* that he would pay Rs. 200 to anyone who finds and returns his lost dog. **No**.

[Hint : In cases (a), (b) and (c) there is no offer. In case (d) there is a valid offer. Any person can accept it by performing the act with knowledge of the reward (*Fitch v. Snedaker*)].

2. A tells B in the course of a conversation with him that he will give Rs. 10,000 to anyone who marries his daughter with his consent. B marries A's daughter with A's consent. Is he entitled to recover this amount ?

[Hint: No, as what A tells B is a statement of intention (*Re Ficus*)].

3. A sees a rare book displayed in a shop. It is labelled "First Edition Rs. 15." A enters the shop and puts Rs. 15 on the counter and asks for the book. The book-seller does not agree to sell saying that the real price of the book is Rs. 50 and that it had been marked as Rs. 15 by mistake. Is the bookseller bound to sell the book for Rs. 15 ?

[Hint : No (*Pharmaceutical Society of Great Britain v. Boots Cash Chemists*)].

4. A sent a telegram to B, "Will you sell your car ? Quote lowest price." B sent a reply "Lowest price Rs. 25,000". A sent a second telegram to B, "I agree to buy your car for Rs. 25,000." B thereafter refuses to sell. (a) Can A compel B to do so ? (b) Is there a contract between A and B ?

[Hint : (a) No. (b) No (*Harvey v. Facey*)].

5. A sent a letter to B offering to sell his house to B. The next day, A wrote another letter revoking his offer. Meanwhile, B had accepted A's offer by return of post. What is B's remedy, if any, against A : (a) If A's letter of revocation reaches B before B's letter of acceptance reaches A ; (b) If B's letter of acceptance is lost in the post ; (c) If B's letter of acceptance is posted an hour after the posting of A's letter of revocation ?

[Hint : In all the three cases there is a concluded contract between A and B (i.e., as soon as the letter of acceptance is posted by B (Sec. 4)).]

6. B offered to sell his house to A for Rs. 50,000. A accepted the offer by post. On the next day, A sent a telegram withdrawing the acceptance which reached B before the letter. (a) Is the revocation of acceptance valid ? (b) Would it make any difference if both the letter communicating acceptance and the telegram communicating revocation of acceptance, reach B at the same time ?

[Hint : (a) Yes. (b) If A opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded (Sec. 4)].

7. On the 5th of a month A makes an offer to B, by a letter which reaches B on the 6th. On the 7th, B posts his letter of acceptance. Meanwhile, on the 6th A posts a letter to B revoking the offer. On seeing it B sends a telegram to A on the 8th confirming the acceptance given through his letter of the 7th. Discuss the legal effects of the three letters and the telegram.

[Hint : The contract is concluded between A and B on 7th when B posts the letter of acceptance. It is assumed that the letter of A revoking offer reaches B after B has posted the letter of acceptance. The telegram only confirms acceptance already given (Secs. 4 and 5)].

8. A offers, by a letter, to sell a certain article to B who receives the letter the next day. B immediately posts his letter of acceptance. The same evening A posts a letter revoking the offer. A's letter of revocation and B's letter of acceptance cross in the post. Is there a contract between A and B ?

[Hint : Yes (Secs. 4 and 5)].

9. A offers by a letter to sell his car to B for Rs. 15,000. B, at the same time, offers by a letter to buy A's car for Rs. 15,000. The two letters cross each other in the post. Is there a concluded contract between A and B ?

[Hint : No (*Tinn v. Hoffmann*)].

10. S offers to sell B his car Rs. for 50,000. T, standing nearby, says, "I will take it if B does not take it." B is not interested in the car. (a) Does a contract arise between S and T ? (b) What will be the position if T says to S "Here is the money, I take the car."

[Hint : (a) No (b) S may or may not accept T's offer].

1-4

## Consideration

Consideration is one of the essential elements to support a contract. Subject to certain exceptions, an agreement made without consideration is *nudum pactum* (a *nude contract*) and is *void*.

Consideration is a technical term used in the sense of *quid pro quo* (i.e., something in return). When a party to an agreement promises to do something, he must get "something" in return. This "something" is defined as *consideration*. In the words of Pollock, "*consideration is the price for which the promise of the other is bought*, and the promise thus given for value is enforceable." (Pollock on Contracts, 13th ed., p. 113).

*Example.* A agrees to sell his car to B for Rs. 10,000. Car is the consideration for B and price is the consideration for A.

### DEFINITION OF CONSIDERATION

In the English case of *Currie v. Misa*, (1875) L.R. 10 Ex. 153, consideration was defined by Lush J. as follows :

"A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." But to this definition there should be added that "the benefit accruing or the detriment sustained was in return for a promise given or received."

The definition in *Currie v. Misa*, in effect, means that consideration must result in a *benefit* to the promisor, and a *detriment* or *loss* to the promisee, or a detriment to both, e.g., when A lends his bicycle to B and promises to return it after use, this results in a benefit to B (as he gets the use of the bicycle) and a detriment to A (as he parts with his bicycle) which is consideration to support B's promise to return the bicycle.

*Abdul Aziz v. Masum Ali*, (1914) 36 All. 268. The secretary of a Mosque Committee filed a suit to enforce a promise which the promisor had made to subscribe Rs. 500 to the re-building of a mosque. Held, "the promise was not enforceable because there was no consideration in the sense of benefit", as "the person who made the promise gained nothing in return for the promise made", and the secretary of the Committee to whom the promise was made, suffered no detriment as nothing had been done to carry out the repairs. Hence the suit was dismissed.

*Kedar Nath v. Gauri Mohamed*, (1886) 14 Cal. 64. The facts of this case were almost similar to those of the previous case, but the secretary in this case incurred a liability on the strength of the promise. Held, the amount could be

recovered, as the promise resulted in a sufficient detriment to the secretary. The promise could, however, be enforced only to the extent of the liability (detriment) incurred by the secretary. In this case, the promise, even though it was gratuitous, became enforceable because on the faith of the promise the secretary had incurred a detriment.

Sec. 2 (d) defines consideration as follows :

"When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."

Consideration if we analyse this definition, may be :

(1) An *act*, i.e., doing of something. In this sense consideration is in an affirmative form.

*Example.* A promises B to guarantee payment of price of the goods which B sells on credit to C. Here selling of goods by B to C is consideration for A's promise.

The act must not however be one which one is under a legal duty to perform. This point has been explained later in this Chapter.

(2) An *abstinence* or *forbearance*, i.e., abstaining or refraining from doing something. In this sense consideration is in a *negative* form.

*Example.* A promises B not to file a suit against him if he (B) pays him Rs. 500. The abstinence of A is the consideration for B's payment.

The act or abstinence which forms the consideration may be a past, present or future one.

(3) A *return promise*.

*Example.* A agrees to sell his horse to B for Rs. 10,000. Here B's promise to pay the sum of Rs. 10,000 is the consideration for A's promise to sell the horse, and A's promise to sell the horse is the consideration for B's promise to pay the sum of Rs. 10,000.

### Need for consideration

The reason why the law enforces only those promises which are made for consideration is the *gratuitous* or *voluntary promises are often made rashly and without due deliberation*. The law looks with disfavour upon an exchange of promises which would result in one of the parties obtaining "something for nothing". It supplies no means nor affords any remedy to compel the performance of an agreement made without sufficient consideration. If A promises to pay B Rs. 100 for nothing, B neither doing nor promising to do anything in return to compensate A for his money, A's promise has no force in law. Likewise, an offer made containing a promise not to revoke it and keep it open does not prevent the offeror from revoking the offer if it is not supported by consideration [*Sharad Trading Co. v. State*, A.I.R. (1980) M.P. 91].

### LEGAL RULES AS TO CONSIDERATION

1. **It must move at the desire of the promisor.** An act constituting consideration must have been done at the desire or request of the promisor. If it is done at the instance of a third party or without the desire of the promisor, it will not be a good consideration.

### CONSIDERATION

*Example.* B spent some money on the improvement of a market at the desire of the Collector of the district. In consideration of this D who was using the market promised to pay some money to B. *Held*, the agreement was void being without consideration [*Durga Prasad v. Baldeo*, (1880) 3 All. 221].

2. **If may move from the promisee or any other person.** Consideration may move from the promisee or any other person, i.e., even a stranger. This means that as long as there is consideration for a promise it is immaterial who has furnished it. But the stranger to consideration will be able to sue only if he is a party to the contract.

*Example.* An old lady, by a deed of gift, made over certain property to her daughter D, under the direction that she should pay her aunt, P (sister of the old lady), a certain sum of money annually. The same day D entered into an agreement with P to pay her the agreed amount. Later, D refused to pay the amount on the plea that no consideration had moved from P to D. *Held*, P was entitled to maintain suit as consideration had moved from the old lady, sister of P, to the daughter, D [*Chinnaya v. Ramayya*, (1882) 4 Mad. 137].

3. **It may be an act, abstinence or forbearance or a return promise.** This has already been explained. Thus it may be noted that the following are good considerations for a contract :

(1) *Forbearance to sue.* If a person who could sue another for the enforcement of a right agrees not to pursue his claim, this constitutes a good consideration for a promise by the other person. This results in a benefit to the person not sued and a detriment to the person who could sue.

*Example.* D is ready to sue her husband for maintenance allowance. On husband's agreeing to pay her a monthly allowance by way of maintenance, she forbears to sue. *Held*, the wife's forbearance to sue amounts to consideration for the husband's agreement for payment of maintenance allowance [*Debi Radha Rani v. Ram Dass*, A.I.R. (1941) Pat. 282].

(2) *Compromise of a disputed claim.* Compromise is a kind of forbearance. As such the same principle, as discussed above, applies to the *bona fide* compromise of a disputed claim even though ultimately it might appear that the claim was wholly unfounded. But, originally, the claim should be reasonable and the person claiming should honestly believe that it is a valid claim. He should also act *bona fide*. If it turns out that the claim was frivolous and the claimant was not acting *bona fide*, the other party can claim compensation.

(3) *Composition with creditors.* A debtor who is financially embarrassed may call a meeting of his creditors and request them to accept a lesser amount in satisfaction of their debt. If the creditors agree to it, the agreement is binding both upon the debtor and the creditors as this amounts to a compromise of the claims of the creditors.

4. **It may be past, present or future.** The words used in Sec. 2(d) are : "... has done or abstained from doing (past), or does or abstains from doing (present), or promises to do or to abstain from doing (future) something ..." This means consideration may be past, present or future.

(1) *Past consideration.* When consideration by a party for a present promise was given in the past, i.e., before the date of the promise, it is said to be past consideration.

*Example.* A renders some service to B at latter's desire. After a month

*B promises to compensate A for the services rendered to him. It is past consideration. A can recover the promised amount.*

(2) *Present or executed consideration.* When consideration is given simultaneously with promise, i.e., at the time of the promise, it is said to be present consideration. In a cash sale, for example, consideration is present or executed.

*Example. A receives Rs. 50 in return for which he promises to deliver certain goods to B. The money A receives is the present consideration for the promise he makes to deliver the goods.*

(3) *Future or executory consideration.* When consideration from one party to the other is to pass subsequently to the making of the contract, it is future or executory consideration.

*Example. D promises to deliver certain goods to P after a week; P promises to pay the price after a fortnight. The promise of D is supported by the promise of P. Consideration in this case is future or executory.*

5. *It need not be adequate.* Consideration, as already explained, means "something in return". This "something in return" need not necessarily be equal in value to "something given". The law simply provides that a contract should be supported by consideration. So long as consideration exists, the Courts are not concerned as to its adequacy, provided it is of some value.

Anson (*The English Law of Contract*, 26th ed., p. 87) observes in this connection : Consideration need not be adequate to the promise, but it must be of some value in the eye of the law. The Courts will not make bargains for the parties to a suit and, if a man gets what he contracted for, will not inquire whether it was an equivalent to the promise which he gave in return.

According to Explanation 2 to Sec. 25, an agreement to which the consent of the promisor is freely given is *not void merely because the consideration is inadequate*. However the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was *freely given*.

*Example. A agrees to sell a horse worth Rs. 10,000 for Rs. 100. A's consent to agreement was freely given. The agreement is a contract notwithstanding the inadequacy of the consideration. But, if A says that his consent was not freely given, the inadequacy of the consideration is a fact which the Court should take into account in considering whether or not A's consent was freely given.*

6. *It must be real and not illusory.* Although consideration need not be adequate, it must be real, competent and of some value in the eyes of the law. There is no real consideration in the following cases :

#### (1) Physical impossibility.

*Examples. (a) A promises to put life into B's dead wife should B pay him Rs. 500. A's promise is physically impossible of performance.*

*(b) A charter party contained a clause that a particular ship would sail on a specified day. This date had already expired when the contract was entered into. The consideration in this case is physically impossible [Hall v. Cazenove, (1804) 4 East 477].*

#### (2) Legal impossibility.

*Example. A owes Rs. 100 to B. He promises to pay Rs. 20 to C, the servant of B, who in return promises to discharge A from the debt. This is legally*

impossible because C cannot give discharge for a debt due to B, his master [*Harvey v. Gibbons*, (1675) 2 Lev. 161].

#### (3) Uncertain consideration.

*Example. A engages B for doing a certain work and promises to pay a "reasonable" sum. There is no recognised method of ascertaining the "reasonable" remuneration. The promise is unenforceable as consideration is uncertain.*

#### (4) Illusory consideration.

*Example. Two of the crew of a ship deserted it half way through a voyage. The captain thereby promised to divide the salary of the deserters among the rest of the crew if they worked the vessel home. Held, they could not recover the amount as the consideration was illusory. They were already under an obligation to bring the vessel home [Stilk v. Myrick, (1809) 2 Camp. 37].*

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, since it adds nothing to the pre-existing legal or contractual obligation. Likewise, a promise to perform a public duty by a public servant is not a consideration.

*Examples. (b) A promised to pay B, who had received summons to appear at a trial in a civil suit, a certain sum being a compensation for the loss of time during his attendance. Held, the promise was without consideration for B was under a duty imposed by law to appear and give evidence [Collins v. Godefroy, (1831) 1 B. & Ad. 956].*

But where a person being already under a legal or contractual duty to do something undertakes to do something more than he is bound to do under the original contract, this will be a good consideration for the promise.

8. *It must not be illegal, immoral or opposed to public policy* (Sec. 23). The consideration given for an agreement must not be unlawful. Where it is unlawful, the Courts do not allow an action on the agreement. This point is explained in detail in the Chapter on "Legality of Object".

## STRANGER TO CONTRACT

It is a general rule of law that only the parties to a contract may sue and be sued on that contract. This rule is known as the doctrine of *privity of contract*. "Privity of contract" means relationship subsisting between the parties who have entered into contractual obligations. It implies a mutuality of will and creates a legal bond or tie between the parties to a contract.

There are two consequences of the doctrine of privity of contract :

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

(2) A contract cannot confer rights or impose obligation arising under it on any person other than the parties to it. Thus, if there is a contract between A and B, C cannot enforce it.

*Exceptions.* The following are the exceptions to the rule that a stranger to a contract cannot sue :

(1) *A trust or charge.* A person (called beneficiary) in whose favour a trust or other interest in some specific immovable property has been created, can enforce it even though he is not a party to the contract.

*Examples.* (a) A husband who was separated from his wife executed a separation deed by which he promised to pay to the trustees all expenses for the maintenance of his wife. *Held*, the agreement created a trust in favour of the wife and could be enforced [*Gandy v. Gandy*, (1884) 30 Ch. D. 57].

(b) A had a son SA and B had a daughter DB. A agreed with B that in consideration of the marriage of DB with SA, he (A) would pay to DB, his daughter-in-law, an allowance of Rs. 500 a month in perpetuity. He charged certain properties with the payment with the power to DB to enforce it. *Held*, DB, although no party to the agreement, was clearly entitled to recover the arrears of the allowance [*Khwaaja Mohd. Khan v. Hussani Begum*, (1910) 32 All. 410].

(2) *Marriage settlement, partition or other family arrangements.* When an arrangement is made in connection with marriage, partition or other family arrangements and a provision is made for the benefit of a person, he may sue although he is not party to the agreement.

(3) *Acknowledgement or estoppel.* Where the promisor by his conduct, acknowledges or otherwise constitutes himself as an agent of a third party, a binding obligation is thereby incurred by him towards the third party.

*Example.* A receives some money from T to be paid over to P. A admits of this receipt to P. P can recover the amount from A who shall be regarded as the agent of P.

(4) *Assignment of a contract.* The assignee of rights and benefits under a contract not involving personal skill can enforce the contract subject to the equities between the original parties. Thus the holder in due course of a negotiable instrument can realise the amount on it even though there is no contract between him and the person liable to pay.

(5) *Contracts entered into through an agent.* The principal can enforce the contracts entered into by his agent provided the agent acts within the scope of his authority and in the name of the principal.

(6) *Covenants running with the land.* In cases of transfer of immovable property, the purchaser of land with notice that the owner of the land is bound by certain conditions or covenants created by an agreement affecting the land shall be bound by them although he was not a party to the original agreement which contained the conditions or covenants.

#### A CONTRACT WITHOUT CONSIDERATION IS VOID — EXCEPTIONS

The general rule is *ex nudo pacto non oritur actio*, i.e., an agreement made without consideration is void. Secs 25 and 185 deal with the exceptions to this rule. In such cases the agreements are enforceable even though they are made without consideration. These cases are :

1. *Love and affection* [Sec. 25 (1)] Where an agreement is expressed in writing and registered under the law for the time being in force for the registration of documents and is made on account of natural love and affection between parties standing in a near relation to each other, it is enforceable even if there is no consideration. In simple words, a written and registered agreement based on natural love and affection between near relatives is enforceable even if it is without consideration [*Ram Dass v. Krishan Dev*, A.I.R. (1986) H.P. 9].

*Examples.* (a) F, for natural love and affection, promises to give his son, S, Rs. 1,000. F puts his promise to S in writing and registers it. This is a contract.

(b) By a registered agreement, V, on account of natural love and affection

for his brother, R, promises to discharge his debt to B. If V does not discharge the debt, R may discharge it and then sue V to recover the amount.

Nearness of relationship, however, does not necessarily import natural love and affection.

*Example.* 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 her for maintenance, but no consideration moved from the wife. *Held*, the agreement was void for want of consideration [*Rajlukhy v. Bhoothnath*, (1900) C.W.N. 488], as the essential requirement that the agreement is made on account of natural love and affection between the parties was missing.

2. *Compensation for voluntary services* [Sec. 25(2)]. A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable, even though without consideration. In simple words, a promise to pay for a past voluntary service is binding.

*Examples.* (a) A finds B's purse and gives it to him. B promises to give A Rs. 50. This is a contract.

(b) A supports B's infant son. B promises to pay A's expenses in so doing. This is a contract.

(c) A says to B, "At the risk of your life you saved me from a serious accident. I promise to pay you Rs. 1,000." There is a contract between A and B.

3. *Promise to pay a time-barred debt* [Sec. 25 (3)]. A promise by a debtor to pay a time-barred debt is enforceable provided it is made in writing and is signed by the debtor or by his agent generally or specially authorised in that behalf. The promise may be to pay the whole or any part of the debt. The debt must be such "of which the creditor might have enforced payment but for the law for the limitation of suits".

A debt is barred by limitation if it remains unpaid or unclaimed for a period of three years. Such a debt becomes legally irrecoverable.

*Example.* D owes C Rs. 1,000 but the debt is barred by the Limitation Act. D signs a written promise to pay C Rs. 500 on account of the debt. This is a contract.

4. *Completed gift* (Expl. 1 to Sec. 25). The rule "No consideration, no contract" does not apply to completed gifts. According to Expl. 1 to Sec. 25, nothing in Sec. 25 shall affect the validity, as between the donor and donee, of any gift actually made.

5. *Agency* (Sec. 185). No consideration is necessary to create an agency.

6. *Charitable subscription* where the promisee on the strength of the promise makes commitments, i.e., changes his position to his detriment. Refer to *Kedar Nath v. Gauri Mohamed* discussed earlier in this Chapter.

#### TEST QUESTIONS

- Define consideration. Why is it essential in a contract ? What are the legal rules regarding consideration ?
- Give some instances of consideration, other than the payment of money, sufficient to support a contract.
- Define consideration and point out the salient features of the term 'consideration' as defined in the Indian Contract Act.
- Discuss types of consideration. What will happen if consideration is missing in an agreement ?

5. Explain consideration as an element of a valid contract and discuss the effect of (i) total absence, and (ii) inadequacy, of consideration.
6. "Insufficiency of consideration is immaterial ; but an agreement without consideration is void." Comment.
7. Will you regard the following as good consideration to support a contract :  
(a) Forbearance to sue ; (b) Compromise of disputed claims ; and (c) Performance of pre-existing legal and/or contractual obligation.
8. "A contract without consideration is void." Comment.
9. Explain the term 'consideration' and state the exceptions to the rule : "No consideration, no contract."
10. "A stranger to a contract cannot sue." Are there any exceptions to this rule ?

### PRACTICAL PROBLEMS

Attempt the following problems, giving reasons :

1. A promises a subscription of Rs. 10,000 to the National Defence Fund. He does not pay. Is there any legal remedy against him ?

[Hint : No (*Abdul Aziz v. Masum Ali*)]

2. Can A recover in the following cases ?

(a) B gets into difficulties while swimming in the river Ganga and cries for help. A hears the cry, removes his coat and dives into water and rescues B. B, who is full of gratitude, promises to pay A Rs. 200 but fails to do so.



(b) B writes to A, "At the risk of your own life, you saved me from a serious motor accident. I promise to pay you Rs. 1,000."

(c) While B is away on holiday, a storm damages the roof of B's house, and his neighbour, A, carries out the necessary repairs. On his return, B promises to pay A Rs. 200 for the work done and materials supplied.

(d) A finds B's purse and gives it to him. B promises A to give him Rs. 100.

(e) A, who is B's friend, seeks the help of a few persons in putting down a fire in B's house. B promises to give A Rs. 100 for his timely help.

[Hint : Yes. A can recover the amount from B in all the cases (Sec. 25 (2)).]

3. A owes B Rs. 1,000 but the debt is barred by limitation. A gives a letter to B agreeing to pay him Rs. 500 on account of the debt. Is this a valid agreement ?

[Hint : Yes (Sec. 25(3)).]

4. A, being in dire need of money, sells his new car purchased two months ago at a cost inadequacy of consideration. Will he succeed ?

[Hint : No].

5. A, B and C enter into a contract under which A promises both B and C that if B will dig A's garden, he (A) will give Rs. 50 to C. Can C compel A to pay the money on B's digging A's garden according to the terms of the contract ? Give reasons.

[Hint : Yes].

6. A's uncle in a sudden display of generosity promises him a watch as gift on his next birthday. If the uncle fails to give the watch, can A do anything about it legally ?

[Hint : No].

7. A's scaffolding fell down on his neighbour, B, who was injured. B threatened to bring suit against A unless the latter paid him Rs. 500 within ten days as compensation for his injuries. A promised but later refused to pay, claiming that there was no consideration for his promise. Can B recover the amount ?

[Hint : Yes]

8. A's car breaks down on G.T. Road. He asks B, a passing motorist, to tow the car to the nearest garage. B tows the car and in return A promises to pay B at the garage Rs. 200 as payment for his trouble. Is A bound by his promise ?

[Hint : Yes (Sec. 25(2))].

1-5

## Capacity to Contract

The parties who enter into a contract must have the capacity to do so. 'Capacity' here means competence of the parties to enter into a valid contract. According to Sec. 10, an agreement becomes a contract if it is entered into between the parties who are competent to contract. According to Sec. 11, every person is competent to contract who (a) is of the age of majority according to the law to which he is subject, (b) is of sound mind, and (c) is not disqualified from contracting by any law to which he is subject. Thus Sec. 11 declares the following persons to be incompetent to contract :

1. Minors.

2. Persons of unsound mind, and

3. Persons disqualified by any law to which they are subject.

### 1. MINORS

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

(1) where a guardian of a minor's person or property has been appointed under the Guardians and Wards Act, 1890, or

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

The rules governing minors' agreements are based on two fundamental rules :

(1) Law protects minors against their own inexperience and against the possible improper designs of those more experienced.

(2) In pursuing the above object, the law should not cause unnecessary hardship to persons who deal with minors.

**Minor's agreements.** The position of a minor as regards his agreements may be summed up as under :

(1) An agreement with or by a minor is void and inoperative ab initio. The Privy Council affirmed this view most emphatically in *Mohiri Bibi v. Dharmodas Ghose*, (1903) 30 Cal. 539. In this case, a minor mortgaged his house in favour of a money-lender to secure a loan of Rs. 20,000 out of which the mortgagee (the money-lender) paid the minor sum of Rs. 8,000. Subsequently the minor sued for setting aside the mortgage, stating that he was underage when the executed the mortgage. Held, the mortgage was void and, therefore, it was cancelled. Further the money-lender's request for the repayment of the amount advanced to the minor as part of the consideration for the mortgage was also not accepted.

32  
 (2) He can be a promisee or a beneficiary. Incapacity of a minor to enter into a contract means incapacity to bind himself by a contract. There is nothing which debars him from becoming a beneficiary, e.g., a payee, indorsee or a promisee in contract. Such contracts may be enforced at his option, but not at the option of other party. The law does not regard him as incapable of accepting a benefit.

Example. (a) A mortgage was executed in favour of a minor. Held, he could get a decree for the enforcement of the mortgage [Raghavachariar Srinivas, (1917) 40 Mad. 30].

(b) A minor, under a contract of sale delivered goods to the buyer. Held, he was entitled to maintain a suit for the recovery of price [Abdul Ghaffar Prem Piare Lal, A.I.R. (1934) Lah. 480].

(3) His agreement cannot be ratified by him on attaining the age of majority. Consideration which passed under the earlier contract cannot be implied into a contract which the minor enters on attaining majority. Thus consideration given during minority is no consideration. If it is necessary, a fresh contract may be entered into by the minor on attaining majority provided it is supported by fresh consideration.

However, services rendered at the desire of the minor expressed during his minority and continued at the same request after his majority form a good consideration for a subsequent express promise by him in favour of the person who rendered the services [Sindha v. Abraham, (1895) 20 Bom. 755].

(4) If he has received any benefit under a void agreement, he cannot be asked to compensate or pay for it. Sec. 65 which provides for restitution in case of agreements discovered to be void does not apply to a minor.

Example. M, a minor, obtains a loan by mortgaging his property. He is not liable to refund the loan. Not only this, even his mortgaged property cannot be made liable to pay the debt.

(5) He can always plead minority. Even if he has, by misrepresenting his age induced the other party to contract with him, he cannot be sued either in contract or in tort for fraud because if the injured party were allowed to sue for fraud, it would be giving him an indirect means of enforcing the void agreement.

Example. S, a minor, by fraudulently representing himself to be of full age induced L to lend him £ 400. He refused to repay it and L sued him for the money. Held, the contract was void and S was not liable to repay the amount [Leslie v. Shiell, (1914) 3 K.B. 607].

The Court may, where a loan or some property is obtained by the minor by some fraudulent representation and the agreement is set aside, direct him, on equitable considerations, to restore the money or property to the other party. Whereas the law gives protection to the minors, it does not give them liberty "to cheat men".

(6) There can be no specific performance of the agreements entered into by him as they are void ab initio. A contract entered into on his behalf by his parent/guardian or the manager of his estate can be specifically enforced by or against the minor provided the contract is (a) within the scope of the authority of the parent/guardian/manager, and (b) for the benefit of the minor.

(7) He cannot enter into a contract of partnership. But he may be admitted to the benefits of an already existing partnership with the consent of the other partners.

(8) He cannot be adjudged insolvent. This is because he is incapable of contracting debts.

(9) He is liable for 'necessaries' supplied or necessary services rendered to him or anyone whom he is legally bound to support.

(10) He can be an agent. An agent is merely a connecting link between his principal and a third party. As soon as the principal and the third party are brought together, the agent drops out. A minor binds the principal by his acts without incurring any personal liability.

(11) His parents/guardian are/is not liable for the contract entered into by him even though the contract is for the supply of necessaries to the minor. But if the minor is acting as an agent for the parents/guardian, the parents/guardian shall be liable under the contract.

(12) A minor is liable in tort (a civil wrong), but where a tort arises out of a contract a minor is not liable in tort as this would be an indirect way of enforcing an invalid contract [Leslie v. Shiell, (1914) 3 K.B. 607].

#### Minors' liability for necessities

A minor is liable to pay out of his property for 'necessaries' supplied to him or to anyone whom he is legally bound to support (Sec. 68). The claim arises not out of contract but out of what are called quasi-contracts. Again, it is only the property of the minor which is liable for meeting the liability arising out of such contracts. He is not personally liable. The law has provided this exception intentionally because if it were not so, it would be impossible for minors even to live.

The term 'necessaries' is not defined in the Indian Contract Act. The English Sale of Goods Act, 1893, defines it in Sec. 2 as "goods suitable to the condition in life of such infant or other person, and to his actual requirement at the time of sale and delivery." Such goods need not necessarily belong to a class of useful goods, but they must be (i) suitable to the position and financial status of the minor, and (ii) necessities both at the time of sale and the time of delivery.

#### Necessaries include—

(a) Necessary goods. Necessary goods are not restricted to articles which are required to maintain a bare existence, such as bread and clothes, but include articles which are reasonably necessary to the minor having regard to his station in life. A watch and a bicycle may well be considered to be necessities. An engagement ring may be a necessary, but not a vanity bag bought for the minor's fiancee.

Example. I, a minor, bought eleven fancy waistcoats from N. He was at that time adequately provided with clothes. Held, the waistcoats were not necessities, and I was not liable to pay for any of them [Nash v. Inman, (1908) 2 K.B. 1].

(b) Services rendered. Certain services rendered to a minor have been held to be necessities. These include : education, training for a trade, medical advice, provision of a funeral for deceased husband of a minor widow, and a house given to a minor on rent for the purpose of living and continuing his studies. As regards contracts which are not for the supply of necessities but which are undoubtedly beneficial to the minor, the private estate of the minor is liable.

Example. G, a minor, entered into a contract with R, a noted billiards player, to pay him a certain sum of money to learn the game and play matches with him during his world tour. R spent time and money in making arrangements for billiards matches. Held, G was liable to pay as the agreement was one for necessities as it was in effect "for teaching, instruction, and employment and was reasonable and for the benefit of the infant." [Roberts v. Gray, (1913) 1 K.B. 520].

*Loans incurred to obtain necessaries.* A loan taken by a minor to obtain necessities also binds him and is recoverable by the lender as if he himself had supplied the necessities [Martin v. Gale, (1876) 4 Ch. D. 428]. But the minor is not personally liable. It is only his estate which is liable for such loans.

### 2. PERSONS OF UNSOUND MIND

One of the essential conditions of competency of parties to a contract is that they should be of sound mind. Sec. 12 lays down a test of soundness of mind. It reads as follows :

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

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

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

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

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

Soundness of mind of a person depends on two facts : (i) his capacity to understand the contents of the business concerned, and (ii) his ability to form a rational judgment as to its effect upon his interests. If a person is incapable of both, he suffers from unsoundness of mind. Whether a party to a contract is of sound mind or not is a question of fact to be decided by the Court. There is a presumption in favour of sanity. If a person relies on unsoundness of mind, he must prove it sufficiently to satisfy the Court.

#### Contracts of persons of unsound mind

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

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

*Drunken or intoxicated persons.* A drunken or intoxicated person suffers from temporary incapacity to contract, i.e., at the time when he is so drunk or intoxicated that he is incapable of forming a rational judgment. The position of a drunken or intoxicated person is similar to that of lunatic.

#### Agreements entered into by persons of unsound mind are void

They are, however, liable for necessities supplied to them or to anyone whom they are legally bound to support. But even in such cases, no personal liability attaches to them. It is only their estate which is liable (Sec. 68).

### 3. OTHER PERSONS

*Alien enemies.* An alien (the subject of a foreign state) is a person who is not a

#### CAPACITY TO CONTRACT

subject of the Republic of India. He may be (i) an alien friend, or (ii) an alien enemy.

Contracts with an *alien friend* (an alien whose State is at peace with the Republic of India), subject to certain restrictions, are valid. But an alien friend cannot acquire property in an Indian ship. Similarly he cannot be employed as Master or any other Chief Officer of such a ship. Contracts with an *alien enemy* (an alien whose State is at war with the Republic of India) may be studied under two heads, namely —

- (a) contracts during the war, and
- (b) contracts made before the war.

During the continuance of the war, an alien enemy can neither contract with an Indian subject nor can he sue in an Indian Court. He can do so only after he receives a licence from the Central Government.

Contracts made before the war may either be suspended or dissolved. They will be dissolved if they are against the public policy or if their performance would benefit the enemy. For this purpose even an Indian who resides voluntarily in a hostile country, or who is carrying on business there would be treated as an alien enemy.

*Foreign sovereigns, their diplomatic staff and accredited representatives of foreign States.* They have some special privileges and generally cannot be sued unless they of their own submit to the jurisdiction of our law Courts. They can enter into contracts and enforce those contracts in our Courts. But an Indian citizen has to obtain a prior sanction of the Central Government in order to sue them in our law Courts. An ex-king can, however, be sued against in our Courts without any such sanction [Mighell v. Sultan of Johore, (1894) 1 Q.B. 149].

The Central Government grants permission to sue a foreign sovereign or ambassador, etc., (i) when he has instituted a suit in a Court against the person desiring to sue him ; or (ii) where he himself or through his agent carries on trade within the jurisdiction of the Court ; or (iii) where he is in possession of immovable property in the jurisdiction of the Court and is to be sued with reference to such property ; or (iv) when he has expressly waived the privilege accorded to him.

*Corporations.* A corporation is an artificial person created by law, having a legal existence apart from its members. It may come into existence by a Special Act of the Legislature or by registration under the Companies Act, 1956. As regards a statutory corporation, i.e., a corporation formed by a Special Act of the Legislature, its contractual capacity is limited by the Statute governing it. As regards a corporation formed under the Companies Act, 1956 (commonly known as a joint stock company), its contractual capacity is regulated by the terms of its Memorandum of Association and the provisions of the Companies Act. If it exceeds its powers, whether expressly conferred on it or derived by reasonable implication from its objects clause in the Memorandum, the contract is *ultra vires* the company and is void. Further it cannot enter into contracts of a strictly personal nature as it is an artificial and not a natural person.

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

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

### TEST QUESTIONS

1. State briefly the law relating to competence of parties to a contract.
2. What do you understand by 'capacity to contract'? What is the effect of agreements made by persons not qualified to contract?
3. What do you know about contracts entered into with a minor from the legal point of view in India? Do you know of any contracts with a minor to be valid? What are they?
4. What are necessaries? When is a minor liable on a contract for necessities?
5. What is the legal effect of a minor's misrepresentation of his age while entering into an agreement?
6. Discuss with suitable illustrations the law relating to validity of contracts by minors.
7. Examine the legal position of (i) a minor promisor, (ii) a minor promisee, and (iii) a minor agent.
8. Name some persons, other than minors, who are not competent to contract.

### PRACTICAL PROBLEMS

Attempt the following problems, giving reasons:

1. A minor fraudulently represented to a money-lender that he was of full age and executed a mortgage deed for Rs. 10,000. Has the money-lender any right of action against the minor for the money lent or for damages for fraudulent misrepresentation?

[Hint : No (*Mohiri Bibi v. Dharmodas Ghose ; Leslie v. Shield*)].

2. A minor is supplied with necessities of life by a grocer. He makes out a promissory note in favour of the grocer. Is the grocer entitled to claim payment under the promissory note (a) from minor personally, (b) against his estate?

[Hint : (a) No, (b) Yes (Sec. 68)].

3. A executed a pronote in favour of B while he was a minor. The pronote was renewed by A in favour of B when he attained the age of majority. B brings a suit against A on the basis of the second pronote. Will he succeed?

[Hint : No].

4. A renders some services to B during his minority at the request of B. B, on attaining majority, enters into an agreement with A to compensate him (A) for services rendered during B's minority. Is the agreement valid?

[Hint : No (*Indran Ramaswamy v. Anthiappa Chettiar*)].

5. A sold some articles from his shop to B on credit, not knowing that B was a minor. The time fixed for payment expired and no payment was made. Some time later when B attained majority, A sued him for price. Will he succeed?

[Hint : No].

6. A supplies some articles of food to B, the wife of C who is a lunatic. C has assets worth Rs. 5,000. (a) On non-payment, can A proceed against the assets of C? (b) Would your answer be the same if C instead of being a lunatic is a minor?

[Hint : (a) Yes (Sec. 68), (b) Yes].

7. M, a minor aged 17, broke his right arm in a hockey game. He engaged a physician to set it. Does the physician have a valid claim for his services?

[Hint : Yes, but it is only M's estate which will be liable (Sec. 68)].

1-6

## Free Consent

It is essential to the creation of a contract that the parties are *ad idem*, i.e., they agree upon the same thing in the same sense at the same time and that their consent is free and real. Sec. 10 also says that "all agreements are contracts if they are made by the free consent of the parties..."

**Meaning of "consent" and "free consent" (Secs. 13 and 14)**

**Consent.** It means acquiescence or act of assenting to an offer. "Two or more persons are said to consent when they agree upon the same thing in the same sense." (Sec. 13).

**Free consent.** Consent is said to be free when it is not caused by—

- (1) Coercion as defined in Sec. 15, or
- (2) Undue influence as defined in Sec. 16, or
- (3) Fraud as defined in Sec. 17, or
- (4) Misrepresentation as defined in Sec. 18, or
- (5) Mistake, subject to the provisions of Secs. 20, 21 and 22 (Sec. 14).

When there is no consent, there is no contract. Salmond describes it as *error in consensus*. If there is no *consensus ad idem*, there is no contract. One such circumstance which interferes with *consensus ad idem* is mistake.

**Example.** An illiterate woman executed a deed of gift in favour of her nephew under the impression that she was executing a deed authorising her nephew to manage her lands. The evidence showed that the woman never intended to execute such a deed of gift, nor was the deed ever read or explained to her. **Held**, the deed was void and inoperative [*Bala Debi v. S. Majumdar*, A.I.R (1956) Cal. 575].

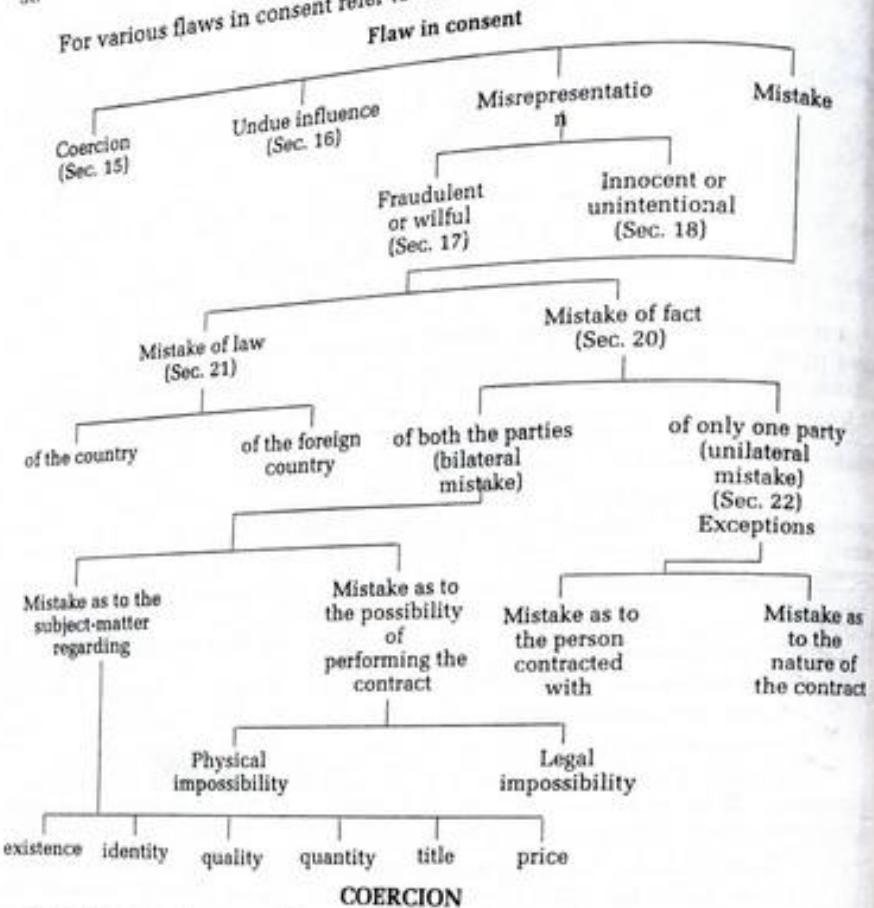
In the above case the consent of the woman is altogether absent. Had she known the true position, she would not have signed the document. A deed executed by a person in such circumstances is a mere nullity.

But where there is consent, but it is not free, i.e., where it is caused by coercion, undue influence, fraud or misrepresentation, the contract is voidable at the option of the party whose consent is so caused (Secs. 19 and 19-A).

**Example.** A is forced to sign a promissory note at the point of pistol. A knows what he is signing but his consent is not free. The contract in this case is voidable at his option.

The consent, in the above example, is not altogether missing. It is there, but it is not free. Salmond calls it as *error in causa*, i.e., error in the inducing cause. Such an error results from coercion, undue influence, fraud, or misrepresentation.

For various flaws in consent refer to the chart on the next page.



When a person is compelled to enter into a contract by the use of force by the other party or under a threat, "coercion" is said to be employed. Coercion is the committing, or threatening to commit, any act forbidden by the Indian Penal Code, 1860 or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. It is immaterial whether the Indian Penal Code, 1860 is or is not in force in the place where the coercion is employed (Sec. 15).

The threat amounting to coercion need not necessarily proceed from a party to the contract. It may proceed even from a stranger. Likewise, it may be directed against any body—not necessarily the other contracting party. The intention of the person using coercion should, however, be to cause any person to enter into an agreement.

Coercion includes fear, physical compulsion and menace to goods.

Examples. (a) A threatens to shoot B if he (B) does not release him (A) from a debt which A owes to B. B releases A under the threat. The release has been brought about by coercion.

## FREE CONSENT

(b) A threatens to kill B if he does not lend Rs. 1,000 to C. B agrees to lend the amount to C. The agreement is entered into under coercion.

Consent is said to be caused by coercion when it is obtained by :

1. Committing or threatening to commit any act forbidden by the Indian Penal Code, 1860.

Examples. (a) A young girl of 13 years was forced to adopt a boy to her husband who had just died by the relative of the husband who prevented the removal of his body for cremation until she consented. Held, the consent was not free but was induced by coercion. Consequently the adoption was set aside [Ranganayakamma v. Alwar Setty, (1889) 13 Mad. 214].

(b) A threatens to shoot B if he does not lend him Rs. 500. B lends the amount. The threat amounts to coercion.

2. Unlawful detaining or threatening to detain any property.

Examples. (a) An agent refused to hand over the account books of a business to the new agent unless the principal released him from all liabilities. The principal had to give a release deed as demanded. Held, the release deed was given under coercion and was voidable at the option of the principal [Muthia v. Muthu Karuppa, (1927) 50 Mad. 786].

(b) The Government gave a threat of attachment against the property of P for the recovery of the fine due from T, the son of P. P paid the fine. Held, the contract was induced by coercion [Bansraj v. The Secretary of State, (1939) A.W.R. 247].

## Effect of coercion

When consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused (Sec. 19).

According to Sec. 72, a person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it.

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

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

## Threat to commit suicide—Does it amount to coercion?

The question whether a threat to commit suicide amounts to coercion arose in Chikham Amiraju v. Seshamma, (1917) 41 Mad. 33. In this case, a person held out a threat of committing suicide to his wife and son if they did not execute a release in favour of his brother in respect of certain properties. The wife and son executed the release deed under the threat. Held, "the threat of suicide amounted to coercion within Sec. 15 and the release deed was, therefore, voidable." In another case, Purabi Bannerjee v. Basudev Mukerjee, A.I.R. (1969) Cal. 293, it was observed that "one committing suicide places himself or herself beyond the reach of the law, and necessarily beyond the reach of any punishment too. But it does not follow that suicide is not forbidden by the Penal Code. Sec. 306 of the

Penal Code punishes abetment of suicide. Sec. 309 punishes an attempt to commit suicide. Thus suicide as such is no crime, as indeed, it cannot be. But its attempt is; its abetment too is. So, it may very well be said that the Penal Code does forbid suicide."

As such, a threat to commit suicide amounts to coercion.

**Duress.** In the English Law, the near equivalent of the term "coercion" is "duress". Duress involves actual or threatened violence over the person of another (or his wife, parent, or child) with a view to obtaining his consent to the agreement. If the threat is with regard to the goods or property of the other party, it is not duress.

### UNDUE INFLUENCE

Sometimes a party is compelled to enter into an agreement against his will as a result of unfair persuasion by the other party. This happens when a special kind of relationship exists between the parties such that one party is in a position to exercise undue influence over the other. Sec. 16 (1) defines "undue influence" as follows :

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

A person is deemed to be in a position to dominate the will of another—

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

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

(c) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress. Such a relation exists, for example, between a medical attendant and his patient [Sec. 16(2)].

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

(b) A spiritual guru induced his devotee to gift to him the whole of his property in return of a promise of salvation of the devotee. Held, the consent of the devotee was given under undue influence [Mannu Singh v. Umadet Pandey, (1890) 12 All. 523].

#### Effect of undue influence

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

**Example.** 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.

#### Relationships which raise presumption of undue influence

The following relationships usually raise a presumption of undue influence, viz., (i) parent and child, (ii) guardian and ward, (iii) trustee and beneficiary, (iv) religious adviser and disciple, (v) doctor and patient, (vi) solicitor and client, and (vii) fiance and fiancee. The presumption of undue influence applied whenever the relationship between the parties is such that one of them is, by reason of confidence reposed in him by the other, able to take unfair advantage over the other.

#### Burden of proof

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

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

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

(iii) the transaction is unconscionable (unreasonable).

Where a person, who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence lies upon the person in a position to dominate the will of the other [Sec 16(3)].

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

**Rebutting the presumption.** The presumption of undue influence can be rebutted by showing that—

(a) **Full disclosure of facts was made** by the influencing party to the party alleged to have been influenced at the time of entering into the contract.

(b) **The price was adequate.** Inadequacy of consideration is only an evidence of undue influence. It is, however, not conclusive.

(c) **That the weaker party was in receipt of independent advice, before making the promise.** The mere fact that independent advice was received will not necessarily save the transaction. The advice, it must be shown, was competent and based on knowledge of all relevant facts.

#### Difference between coercion and undue influence

##### Coercion

1. The consent is given under the **threat of an offence** (i.e., committing or threatening to commit an act forbidden by the Indian Penal Code or detaining or threatening to detain property unlawfully).

2. Coercion is mainly of a **physical character**. It involves mostly use of physical or violent force.

##### Undue influence

1. The consent is given by a person who is so situated in relation to another that the other person is in a position to dominate his will. In other words, consent is given under **moral influence**.

2. Undue influence is of **moral character**. It involves use of moral force or mental pressure.

3. There must be intention of causing any person to enter into an agreement.
4. It involves a criminal act.
3. Here the influencing party uses its position to obtain an unfair advantage over the other party.
4. No criminal act is involved.

## MISREPRESENTATION AND FRAUD

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

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

- (i) an innocent or unintentional misrepresentation, or
- (ii) an intentional, deliberate or wilful misrepresentation with an intent to deceive or defraud the other party.

The former is called "misrepresentation" and the latter "fraud".

## MISREPRESENTATION

Misrepresentation is a false statement which the person making it honestly believes to be true or which he does not know to be false. It also includes non-disclosure of a material fact or facts without any intent to deceive the other party.

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

(b) A company's prospectus contained a representation that it had statutory powers to run its tramways by steam provided the consent of a Government authority was obtained. The directors issued a prospectus stating therein that the company had the right to use steam power. They honestly believed that the permission for the use of steam power would be granted. The permission was refused. The company was then wound up. Held, the directors were guilty of misrepresentation and not of fraud [Derry v. Peek, (1889) 14 App. Cas. 337].

Sec. 18 defines "misrepresentation". According to it, there is misrepresentation—

1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
2. When there is any breach of duty by a person which brings an advantage to the person committing it by misleading another to his prejudice.
3. When a party causes, however innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

### Consequences of misrepresentation

The aggrieved party, in case of misrepresentation by the other party, can—

- (1) avoid or rescind the contract ; or
- (2) accept the contract but insist that he shall be placed in the position in which the would have been if the representation made had been true (Sec. 19).

## FREE CONSENT

*Loss of right of rescission.* The aggrieved party loses the right to rescind or avoid the contract for misrepresentation or fraud—

- (1) if he, after becoming aware of the misrepresentation or fraud, takes a benefit under the contract or in some other way affirms it.

*Example.* A induced B to buy his lorry on the false representation that it was "in excellent condition". On discovering that the lorry was in a very bad shape when B used it, he wanted to return it to A. A, however, agreed to bear half the cost of repairs to which B agreed. On a subsequent journey when the lorry completely broke down, B wanted to rescind the contract. Held, B could not do so as his acceptance of the offer of A to bear half the cost of repairs impliedly amounted to final acceptance of the sale [Long v. Lloyd, (1958) 1 S.L.R. 753].

- (2) if *restitutio in integrum* (i.e., restoration to the original position) of the parties is not possible, e.g., where the subject-matter of the contract has been consumed or destroyed. Further, if a contract cannot be rescinded in *toto* (entirely, wholly), it cannot be rescinded at all.

- (3) if a third party has acquired rights in the subject-matter of the contract in good faith and for value.

*Example.* A purchases goods from B by fraud and pawns them with C. B cannot rescind the contract on learning of the fraud so as to be able to recover the goods from C [Phillips v. Brooks, (1919) K.B. 243].

## FRAUD

Fraud exists when it is shown that—

- a false representation has been made (a) knowingly, or (b) without belief in its truth, or (c) recklessly, not caring whether it is true or false, and the maker intended the other party to act upon it, or

- there is a concealment of a material fact or that there is a partial statement of a fact in such a manner that the withholding of what is not stated makes that which is stated false.

The intention of the party making fraudulent misrepresentation must be to deceive the other party to the contract or to induce him to enter into a contract.

According to Sec. 17, "fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance (intentional active or passive acquiescence), or by his agent with intent to deceive or to induce a person to enter into a contract :

- The suggestion that a fact is true when it is not true and the person making the suggestion does not believe it to be true :

- The active concealment of a fact by a person having knowledge or belief of the fact :

- A promise made without any intention of performing it :

- Any other act fitted to deceive :

- Any such act or omission as the law specially declares to be fraudulent.

### Essential elements of fraud

1. There must be a representation or assertion and it must be false. Without a representation or assertion there can be no fraud except in cases where silence may itself amount to fraud or where there is an effective concealment of a fact.

*Example.* The prospectus of a company did not refer to the existence of a document disclosing liabilities. This gave the impression that the company was prosperous. If the existence of the document had been disclosed the impression would have been quite different. *Held*, non-disclosure amounted to fraud and anyone who purchased shares on the faith of this prospectus could avoid the contract [Peek v. Gurney, (1873) L.R. 6 H.L. 377].

2. *The representation must relate to a material fact which exists now or existed in the past.* A mere opinion, commendatory or puffing expression or hearsay or flourishing description, is not regarded as representation of fact.

*Examples.* (a) A sells some spoons to B and makes the following statements :

(i) The spoons are as good as that of X. This is a statement of opinion.

(ii) The spoons have as much silver in them as that of X. This is a statement of fact.

(iii) The spoons are the best available in the market for the price. This is a puffing statement.

(b) A, while negotiating with B for the sale of certain goods, tells him that the goods cost him Rs. 2,000. This is a statement of fact. But if he states that the goods are worth Rs. 2,000, this is a statement of opinion.

3. *The representation must have been made before the conclusion of the contract with the intention of inducing the other party to act upon it.* Not only must the representation be false and made with the knowledge of its falsity, but it must also be made with an intent to deceive the other party.

4. *The representation or statement must have been made with a knowledge of its falsity or without belief in its truth or recklessly, not caring whether it is true or false.* Further, the representation amounting to fraud must have been made either by a party to the contract or with his connivance or by his agent.

*Example.* A company issued a prospectus giving false information about the unbounded wealth of Nevada. A shareholder who had taken shares on the faith of the prospectus wanted to avoid the contract. *Held*, he could do so as the false representation in the prospectus amounted to fraud [Reese River Silver Mining Co. v. Smith, (1869) L.R. 4 H.L. 64].

5. *The other party must have been induced to act upon the representation or assertion.* A mere falsehood is not enough to give a right of action. It must have induced the other party to act upon it. The other party cannot shut his eyes to the obvious defects or flaws which he could have easily ascertained by reasonable investigation or inspection.

*Example.* A bought shares in a company on the faith of a prospectus which contained an untrue statement that one B was a director of the company. A had never heard of B and, therefore, the statement was immaterial from his point of view. A's claim for damages in this case was dismissed because the untrue statement had not induced A to buy the shares [Smith v. Chadwick, (1884) 9 App. Cas. 187].

6. *The other party must have relied upon the representation and must have been deceived.* A mere attempt at deceit by one party is not fraud unless the other party is actually deceived. If a representation does not come to the notice of a party, it cannot be said to have misled that party because it does not lead that party at all.

*Example.* T bought a cannon from H. The cannon was defective but H had plugged it. T did not examine the cannon, but when he used it, it burst. *Held*, as the plug had not deceived T, he was liable to pay [Horsefull v. Thomas, (1862) 1 H. & C. 90].

7. *The other party, acting on the representation or assertion, must have subsequently suffered some loss.* It is a common rule of law "that there is no fraud without damage". As such "fraud without damage" or "damage without fraud" does not give rise to an action on deceit.

### Consequences of fraud

A contract induced by fraud is voidable at the option of the party defrauded. Until it is avoided, it is valid. The party defrauded has, however, the following remedies :

1. He can rescind the contract (Sec. 19, para 1). Where he does so, he must act within a reasonable time. If in the interval, while he is deliberating, an innocent third party has acquired an interest in the property for value, he cannot rescind the contract.

*Example.* A purchases certain goods from B by making a misrepresentation. A sells the goods to X before B avoids the contract. B loses the right to avoid the contract.

2. He can insist on the performance of the contract on the condition that he shall be put in the position in which he would have been if the representation made had been true (Sec. 19 para 2).

3. He can sue for damages.

### Silence as to facts

The general rule is that a person before entering into a contract need not disclose to the other party the material facts which he knows, but he must refrain from making active concealment (like concealing a crack on the surface of a table by filling it and repolishing it). This means mere silence is not fraud.

*Example.* Before letting his house, a landlord failed to tell the tenant that it was ruinous condition. *Held*, he was not liable in deceit as the tenant should have inspected the house [Keates v. Lord Cadogan, (1851) 10 C.B. 591].

Explanation to Sec. 1 also lays down that mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.

*Statutory exceptions.* There are two statutory exceptions to the above rule :

1. Where the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak.

*Example.* F sells by auction to D, his daughter, who has just come of age, a horse which F knows to be unsound. Here, the relation between the parties would make it F's duty to tell that the horse is unsound. If F does not do so, it will amount to fraud.

2. Where silence is, in itself, equivalent to speech.

*Example.* A says to B, "If you do not deny it, I shall assume that the horse that you are selling to me is sound." If B says nothing his silence is equivalent to speech.

*Other exceptions.* 1. If a representation becomes false due to change of circumstances at the time when the contract is entered into, although it was true at the time when it was made, it is the duty of the person who made the representation to communicate the change of circumstances.

2. If a seller fails to inform the buyer as to a latent defect (*i.e.*, a defect known to the seller and not apparent on an ordinary inspection), his silence amounts to fraud.

3. If a trustee does not make full disclosure of facts to the beneficiary while entering into a contract with him as to the property of which he is the trustee, his silence as to any material facts amounts to fraud.

### **Distinction between fraud and misrepresentation**

1. *Intention.* In misrepresentation, there is a mis-statement or concealment of material fact or facts essential to the contract *without* any intention to deceive the other party. In fraud, the intention is to deceive the other party. Misrepresentation is innocent, fraud is deliberate or wilful.

2. *Belief.* In case of misrepresentation, the person making the suggestion believes it to be true, while in case of fraud he does not believe it to be true.

3. *Rescission and damages.* In misrepresentation, the aggrieved party can rescind the contract or sue for restitution (Sec. 64). There can be no suit for damages. In fraud, the remedy available to the aggrieved party is not limited to rescission alone. He can also claim damages.

4. *Discovery of truth.* In case of misrepresentation, the aggrieved party cannot avoid the contract if it had the means to discover the truth with ordinary diligence. But in case of fraud, where there is active concealment the contract is voidable even though the aggrieved party had the means of discovering the truth with ordinary diligence.

### **MISTAKE**

Mistake may be defined as an erroneous belief about something. It may be mistake of law or a mistake of fact.

#### **Mistake of law**

Mistake of law may be—(1) mistake of law of the country, or (2) mistake of law of a foreign country.

(1) *Mistake of law of the country.* *Ignorantia juris non excusat*, *i.e.*, ignorance of law is no excuse, is a well settled rule of law. A party cannot be allowed to get any relief on the ground that it had done a particular act in ignorance of law. A mistake of law is, therefore, no excuse, and the contract cannot be avoided [Soll v. Butcher, (1950) 1 K.B. 671].

*Example.* A and B enter into a contract on the erroneous belief that a particular debt is barred by the Indian Law of Limitation. This contract is not voidable.

But if a person enters into a contract by making a mistake of law through the inducement of another, whether innocent or otherwise, the contract may be avoided.

(2) *Mistake of law of a foreign country.* Such a mistake is treated as mistake of fact and the agreement in such a case is void (Sec. 21).

#### **Mistake of fact**

Mistake of fact may be (1) a bilateral mistake, or (2) a unilateral mistake.

##### **1. Bilateral mistake**

Where both the parties to an agreement are under a *mistake as to a matter*,

### **FREE CONSENT**

*fact essential* to the agreement, there is a bilateral mistake. In such a case, the agreement is void (Sec. 20). The following two conditions have to be fulfilled for the application of Sec. 20 :

(i) *The mistake must be mutual*, *i.e.*, both the parties should misunderstand each other and should be at cross-purposes.

*Example.* A agreed to purchase B's motor-car which was lying in B's garage. Unknown to either party, the car and garage were completely destroyed by fire a day earlier. The agreement is void.

(ii) *The mistake must relate to a matter of fact essential to the agreement.* As to what facts are essential in an agreement will depend upon the nature of the promise in each case.

*Example.* A man and a woman entered into a separation agreement under which the man agreed to pay a weekly allowance to the woman, mistakenly believing themselves lawfully married. *Held*, the agreement was void as there was mutual mistake on a point of fact which was material to the existence of the agreement [Galloway v. Galloway, (1914) 30 T.L.R. 531].

But an erroneous opinion as to the value of a thing which forms the subject-matter of an agreement is not to be deemed a mistake as to a matter of fact (Explanation to Sec. 20).

*Example.* A buys an old painting for Rs. 5,000 thinking that it is an excellent piece of art. Actually the painting is a new one and is worth only Rs. 500. A cannot avoid the contract on the ground of mistake.

The various cases which fall under bilateral mistake are as follows:

(1) *Mistake as to the subject-matter.* Where both the parties to an agreement are working under a mistake relating to the subject-matter, the agreement is void. Mistake as to the subject-matter covers the following cases :

(i) *Mistake as to the existence of the subject-matter.* If both the parties believe the subject-matter of the contract to be in existence, which in fact at the time of the contract is non-existent, the contract is void.

*Example.* A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void.

(ii) *Mistake as to the identity of the subject-matter.* It usually arises where one party intends to deal in one thing and the other intends to deal in another.

*Example.* W agreed to buy from R a cargo of cotton "to arrive ex-peerless from Bombay". There were two ships of that name sailing from Bombay, one sailing in October and the other in December. W meant the former ship but R meant the latter. *Held*, there was a mutual or a bilateral mistake and there was no contract [Raffles v. Wichelhaus, (1864) 2 H. and C. 906].

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

*Example.* A who inspected fifty rifles in B's shop inquired from him the price of the rifles. Later, he wired B, "send three rifles". By mistake of the telegraph clerk the message transmitted to B was "send the rifles". B sent fifty rifles. A, however, accepted three rifles and sent back the rest. *Held*, there was no contract. But A had to pay for the three rifles on the basis of an implied contract [Henkel v. Pape, (1807) L.R. Ex. 7].

(iii) *Mistake as to the quality of the subject-matter.* If the subject-matter is

something essentially different from what the parties thought it to be, the agreement is void.

**Example.** Table napkins were sold at an auction by a description "with the crest of Charles I and the authentic property of that monarch". In fact the napkins were Georgian. *Held*, the agreement was void as there was a mistake as to the quality of the subject-matter [Nicholson & Venn v. Smith Marriott, (1947) 177 L.T. 180].

(iv) **Mistake as to the quantity of the subject-matter.** If both the parties are working under a mistake as to the quantity of the subject-matter, the agreement is void.

**Example.** A silver bar was sold under a mistake as to its weight. There was a difference in value between the weight of the bar as it was and as it was supposed to be. *Held*, the agreement was void [Cox v. Prentice, (1815) 3 M. & S. 344].

(v) **Mistake as to the title to the subject-matter.** If the seller is selling a thing which he is not entitled to sell and both the parties are acting under a mistake, the agreement is void.

**Example.** A person took a lease of a fishery which unknown to either party, already belonged to him. *Held* the lease was void [Cooper v. Phibbs, (1867) L.R. 2 H.L. 149].

(vi) **Mistake as to the price of the subject-matter.** If there is a mutual mistake as to the price of the subject-matter, the agreement is void.

**Example.** C wrote to W offering to sell certain property for £ 1,250. He had earlier declined an offer from W to buy the same property for £ 2,000. W who knew that this offer of £ 1,250 was a mistake for £ 2,250, immediately accepted the offer. *Held*, W knew perfectly well that the offer was made by mistake and hence the contract could not be enforced [Webster v. Cecil, (1861) 30 Beav. 62].

(2) **Mistake as to the possibility of performing the contract.** Consent is nullified if both the parties believe that an agreement is capable of being performed when in fact this is not the case (Sec. 56, para 1). The agreement, in such a case, is void on the ground of impossibility.

Impossibility may be—

(i) **Physical impossibility.**

**Example.** A contract for the hire of a room for witnessing the coronation procession of Edward VII was held to be void because, unknown to the parties, the procession had already been cancelled [Griffith v. Brymer, (1903) 19 T.L.R. 434].

(ii) **Legal impossibility.** A contract is void if it provides that something shall be done which cannot, as a matter of law, be done.

## 2. Unilateral mistake

When in a contract only one of the parties is mistaken regarding the subject-matter or in expressing or understanding the terms or the legal effect of the agreement, the mistake is a unilateral mistake. According to Sec. 22, a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact. A unilateral mistake is not allowed as a defence in avoiding a contract unless the mistake is brought about by the other party's fraud or misrepresentation.

**Examples.** (a) A offers to sell his house to B for an intended sum of Rs. 44,000. By mistake he makes an offer in writing of Rs. 40,000. He cannot plead mistake as a defence.

(b) H bought oats from S a sample of which had been shown to H. H erroneously thought that oats were old. The oats were, however, new. *Held*, H could not avoid the contract [Smith v. Hughes, (1871) L.R. 6 Q.B. 597].

## Exceptions

A unilateral mistake is generally not allowed as a defence in avoiding a contract. But in certain cases, the consent is given by a party under an error or mistake which is so fundamental as goes to the root of the agreement. In such cases the agreement is void. Thus in the following cases, even though there is a unilateral mistake, the agreement is void.

(1) **Mistake as to the identity of the person contracted with.** It is a fundamental rule of law that if one of the parties represents himself to be some person other than he really is, there is a mistake as to the identity of the person contracted with. If, for example, A intends to contract with B but finds he has contracted with C, there is no contract if the identity of B was a material element of the contract and C knows it. Likewise if A makes an offer to B, C cannot give himself any rights in respect of the contract by accepting the offer. If he does so, the agreement will be void.

**Example.** Blenkarn ordered by letter goods from Lindsay and signed it in such a way that Lindsay believed it came from the well-known firm of Blenckiron & Co. *Held*, there was no contract between Lindsay and Blenkarn as Lindsay never intended to deal with Blenkarn, having never heard of him [Cundy v. Lindsay, (1878) 3 A.C. 459].

It should be noted that the principle holds good only when the identity of the contracting party is of importance.

**Example.** S wanted to go to the first night of a play. B, the managing director of the theatre, gave instructions that a ticket was not to be sold to S as he had in the past published virulent criticism of its production. S knew this and asked one of his friends to buy a ticket for him. He was, however, refused admission by the manager of the theatre. *Held*, there was no contract as the theatre company never intended to contract with S [Said v. Butt, (1920) 3 K.B. 497].

Where, however, the seller is prepared to enter into contract with anyone who enters the shop, so that the identity of the purchaser is immaterial, a mistake as to the purchaser's identity will not make the contract void.

**Example.** A man, called North, entered a jeweller's shop and selected some articles of jewellery. He wrote a cheque for £ 3,000 saying that he was Sir George Bullough and gave the latter's address. The jeweller accepted the cheque from North in good faith believing that the person was Sir George Bullough. North later pledged the jewellery with a pawnbroker. The jeweller held that there was never any contract between him and North. *Held*, the jeweller held contracted to sell and deliver to the person who came to his shop even though he believed he was Sir George Bullough [Phillips v. Brooks, (1919) 2 K.B. 243]. The mistake in this case was not about identity but only about the attributes of the buyer.

It should be noted that mistake as to an attribute of the other party, as distinguished from mistake as to his identity, does not necessarily negative consent. If D induces P to enter into a contract with him by falsely representing

that he is a rich man, the contract is not void for mistake but at the most voidable for fraud.

*Example.* *P* received an order from "H. & Co." which was described as substantial firm having big establishments. In fact, "H & Co." belonged to person called *W*, almost a pauper. *P* supplied the goods to "H & Co." *W* took possession of the goods and failed to pay. He then sold the goods to *D*. *Held* the property in the goods had passed to *W* as *W* and "H & Co." were one and the same person. *P* had not made any mistake as to the identity of the contracting party. *P* had only made a mistake as to the attribute, i.e., creditworthiness of the person who placed the order. The property in the goods passed to *W* so that he could pass a good title to *D* [King's Norton Metal Co. Ltd. v. Edridge Merrett & Co. Ltd., (1897) 14 T.L.R. 98].

(2) *Mistake as to the nature of contract.* If a person enters into a contract in the mistaken belief that he is signing a document of a different class and character altogether, there is a mistake as to the nature of contract and the contract is void. He can successfully plead *non est factum* (*it is not his deed, i.e., document*). The very basis of the contract, i.e., consent, is missing in this case. Thus, where in signing a document the mind of the signer does not go with the signature, there is a mistake which would vitiate the contract.

*Example.* *M*, an old man of poor sight, indorsed a bill of exchange thinking that it was a guarantee. *Held*, there was no contract on the ground that the mind of the signer did not accompany the signature [Foster v. Mackinnon, (1869) L.R. 4 C.P. 701].

### TEST QUESTIONS

1. "Two or more persons are said to consent when they agree upon the same thing in the same sense." Explain this statement and give illustrations.

2. "An agreement requires a meeting of the minds." Comment.

3. Discuss the law relating to the effect of mistake on contracts.

4. "It is a rule of law that if a person intends to contract with *A*, *B* cannot give himself any right under the contract." Discuss.

5. What is misrepresentation? Distinguish it from fraud.

6. What remedies are available to a person induced to enter into a contract by misrepresentation which is not fraudulent, (b) fraud?

7. "A mere silence as to facts is not fraud." Discuss.

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

9. Define fraud and point out its effects on the validity of an agreement. Give suitable examples to illustrate your answer.

10. (a) "An attempt at deceit which does not deceive is not fraud." Explain.

(b) It is the duty of a contracting party to disclose all material facts to the other party? When does non-disclosure of material facts amount to fraud?

11. When is a contract said to be induced by "undue influence"? When is a party deemed to be in position to dominate the will of another? What is the effect of undue influence on a contract?

12. (a) When is consent said to be given under "coercion"? What is its effect on the contract? Also discuss the position of the parties to a contract entered into under coercion.

(b) Does a threat to commit suicide amount to coercion?



Attempt the following problems, giving reasons:

1. *A* sold some land to *B*. At the time of sale both the parties believed in good faith that the area of the land sold was 10 hectares. It, however, turned out that the area was 7 hectares only. How is the contract of sale affected? Give reasons.

[Hint : The agreement is void (Sec. 20)].

2. *A* agreed to sell *B* a specific cargo of corn per S.S. Malwa supposed to be on its way from London to Bombay. It turned out that before the day of the bargain the ship had been cast away, and the goods lost. Discuss the rights of *A* and *B*.

[Hint : The agreement is void (Couturier v. Hastie)].

3. *L*, the owner of a gold mine in West Africa, sold the mine to *M*. During the preliminary discussion *L* had made certain statements about the mine which were incorrect, though *L* honestly believed them to be true. After having worked the mine for six months *M* discovered the true position. What remedies, if any, will *M* have?

[Hint : *M* can only claim damages. The contract cannot be rescinded because the parties cannot be restored to their original positions (Lagunas Nitrate Co. v. Lagunas Syndicate, (1899) 2 Ch. 392)].

4. *C* offers to sell to *D* a painting which *C* knows is a good copy of a well-known masterpiece. *D* thinking that the painting is an original one and that *C* must be unaware of this, immediately accepts *D*'s offer. Does this result in a contract?

[Hint : Yes. The doctrine of *Caveat Emptor* (let the buyer beware) will apply].

5. *A* and *B*, being traders, enter into a contract. *A* has private information of a change in prices which would affect *B*'s willingness to proceed with the contract. Is *A* bound to inform *B*?

[Hint : No. The doctrine of *Caveat Emptor* will apply].

6. A man, by the name of Sham, called at a jeweller's shop and chose a costly ring. He tendered in payment a cheque which he signed in the name of Ram Nath, a person of credit. He took the ring and pledged it to Bholu Nath, who had no notice of the fraud. Can the jeweller recover the ring from Bola Nath?

[Hint : No (Phillips v. Brooks)].

7. A woman fraudulently represented to a firm of jewellers that she was the wife of a certain baron and thus obtained two pearl necklaces on credit on some pretext with a view to buying them. She sold those necklaces to *X*, a third person. Can the jewellers recover the necklace from *X*?

[Hint : Yes (Cundy v. Lindsay)].

8. *A*, an old man of feeble sight, signed a bill of exchange thinking it was a guarantee. There was no negligence on the part of *A*. Is *A* liable?

[Hint : No (Foster v. Mackinnon)].

9. *A* tells his wife that he would commit suicide, if she did not transfer her personal assets to him. She does so under this threat. Can the wife avoid the contract?

[Hint : Yes (Chikham Amiraju v. Seshamma)].

10. *A* is enfeebled by age and illness. *B*, his medical attendant, uses his personal influence over him and induces him to pay an unreasonable fee for his professional services. (a) Can *A* avoid the contract? (b) If so, on what plea?

[Hint : (a) Yes. (b) *A* can avoid the contract on the plea of undue influence; Sec. 16 (2)].

11. *A* advances money to his son *B* during his minority. Upon *B*'s coming of age, *A* obtains by misuse of parental influence, a bond from *B* for a greater amount than the sum due in respect of the advance. Is *B* bound by the bond?

[Hint : No. The contract is voidable at the option of *B* as it is induced by undue influence (Sec. 16 (2))].

## 1-7

# Legality of Object

A contract must not only be based upon mutual assent of competent parties but must also have a lawful object. If the object of an agreement is the performance of an unlawful act, the agreement is unenforceable. Sec. 23 declares that the 'object' or the 'consideration' of an agreement is not lawful in certain cases. The words 'object' or the 'consideration' in Sec. 23 are not used synonymously. They are distinct in meaning. The word 'object' means purpose or design. In some cases, consideration for an agreement may be lawful but the purpose for which the agreement is entered into may be unlawful. In such cases the agreement is void. As such both the object and the consideration of an agreement must be lawful, otherwise the agreement is void.

## When consideration or object is unlawful (Sec. 23)

The *consideration* or *object* of an agreement is unlawful—

1. *If it is forbidden by law.* If the object or the consideration of an agreement is the doing of an act forbidden by law, the agreement is void. An act is forbidden by law when it is punishable by the criminal law of the country or when it is prohibited by special legislation or regulations made by a competent authority under powers derived from the Legislature.

*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.

2. *If it is of such a nature that, if permitted, it would defeat the provisions of some law.* If the object or the consideration of an agreement is such that, though not directly forbidden by law, it would defeat the provisions of any law, the agreement is void.

*Example.* A's estate is sold for arrears of revenue under the provisions 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.

3. *If it is fraudulent.* An agreement which is made for a fraudulent purpose is void. Thus an agreement in fraud of creditors with a view to defeating their rights is void.

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

## LEGALITY OF OBJECT

4. *If it involves or implies injury to the person or property of another.* 'Injury' means 'wrong', 'harm', or 'damage'. 'Person' means one's body. 'Property' includes both movable and immovable property.

*Examples.* (a) B borrowed Rs. 100 from L and executed a bond promising to work for L without pay for a period of two years. In case of default, B was to pay interest (at a very exorbitant rate) and the principal sum at once. Held, the contract was void as it involved injury to the person of B [Ram Saroop v. Bansi Mandar, (1915) 42 Cal. 742].

(b) An agreement between some persons to purchase shares in a company, and thus by fraud and deceit to induce other persons to believe, contrary to that fact, that there is a *bona fide* market for the shares, is void [Gherulal Parakh v. Mahadeo Dass, A.I.R. (1959) S.C. 781].

5. *If the Court regards it as immoral.* An agreement, the consideration or object of which is immoral, e.g., an agreement between a husband and wife for future separation, is unlawful [Sumitra Devi v. Sulekha Kundu, A.I.R. (1976) Cal. 197].

*Examples.* (a) A married woman was given money to enable her to obtain divorce from her husband and then to marry the lender. Held, the agreement was immoral and the lender could not recover the money [Baivijli v. Nansa Nagar, (1885) Bom 152].

(b) A agrees to let her daughter to B for concubinage (state of living together as man and wife without being married). The agreement is unlawful, being immoral.

However, agreements for immediate separation between a husband and wife are enforceable. The principle underlying this is preservation of the peace and reputation of families. Similarly agreements in respect of past separation are also valid.

An agreement is unlawful for immorality in the following cases :

(1) *Where the consideration is an act of sexual immorality,* e.g., illicit cohabitation or prostitution. For example, where A agrees to let her daughter on hire to B for concubinage, the agreement is unlawful, being immoral. But a promise to compensate a woman who has rendered services in the past, whether immoral or otherwise, forms a good consideration for the contract to compensate her [Dhiraj Kaur v. Bikramjit Singh, (1881) 3 All. 787].

(2) *Where the object of the agreement is the furtherance of sexual immorality,* e.g., lending money to a prostitute to help her in her trade.

*Examples.* (a) A firm of coach-builders hired out a carriage to a prostitute, knowing that it was to be used by the prostitute to attract men. Held, the coach builders could not recover the hire as the agreement was unlawful [Pearce v. Brooks, (1866) L.R. 1 Ex. 213].

(a) A let a flat to B, a woman whom he knew to be a prostitute. Held, the agreement was unlawful if A knew the purpose that B's object was to use the flat for immoral proposes [Uphill v. Wright, (1911) 1 K.B. 506].

6. *Where the Court regards it as opposed to public policy.* The agreements opposed to public policy have been discussed in detail later in this Chapter.

## UNLAWFUL AND ILLEGAL AGREEMENTS

An *unlawful agreement* is one which, like a void agreement, is not enforceable by law. It is void *ab initio* and is destitute of legal effects altogether. It affects only the immediate parties and has no further consequences. An *illegal agreement*, on

the other hand, is not only void as between the immediate parties but has this further effect that the collateral transactions to it also become tainted with illegality.

**Examples.** (a) *L* lends Rs. 5,000 to *B* to help him to purchase some prohibited goods from *T*, an alien enemy. If *B* enters into an agreement with *T*, the agreement will be illegal and the agreement between *B* and *L* shall also become illegal, being collateral to the main transaction which is illegal. *L* cannot, therefore, recover the amount. He can recover the amount if he did not know of the purpose of the loan.

(b) An agreement to commit a crime or tort, e.g., an agreement to assault *A* [*Allen v Rescous* (1870) 2 Lev. 174] or an agreement to publish a libel is illegal [*Apthorp v. Neville & Co.*, (1907) 23 T.L.R. 575].

Every illegal agreement is unlawful, but every unlawful agreement is not necessarily illegal. It is sometimes difficult to decide as to whether an act is illegal or unlawful as many of the illegal and the unlawful acts lie on the borderline. It may, however, be observed that illegal acts are those which involve the commission of a crime or contain an element of obvious moral turpitude and where the wicked attribute is reasonably obvious. A crime is something more than a mere disobedience to a law. As such illegal agreements include acts opposed to public morals, e.g., an agreement for illicit cohabitation, or an agreement to defraud the revenue or commit a crime, or an agreement which tends to endanger the public safety. On the other hand, unlawful acts are those which are less rigorous in effect and involve a "non-criminal breach of law". These acts do not affect public morals, nor do they result in the commission of a crime. These are simply disapproved by law on some ground of public policy. These include agreements in restraint of trade, marriage or legal proceedings, etc.

#### Effects of illegality

The general rule of law is that no action is allowed on an illegal agreement. This is based on the following two maxims :

1. *Ex turpi causa non oritur actio*. No action arises from a base cause. The effect of this is that the law discourages people from entering into illegal agreements which arise from base causes.

2. *In pari delicto, potior est conditio defendantis*. In cases of equal guilt, the defendant is in a better position.

The effects of illegality may be summed up as under :

1. The collateral transactions to an illegal agreement become tainted with illegality and are treated as illegal even though they would have been lawful by themselves.

2. No action can be taken (a) for the recovery of money paid or property transferred under an illegal agreement, and (b) for the breach of an illegal agreement.

3. In cases of equal guilt in an illegal agreement, the position of the defendant is better than that of the plaintiff. The plaintiff (i.e., the innocent party) may, however, sue to recover money paid or property transferred :

(1) Where the plaintiff is not in *pari delicto* (equally guilty) with the defendant, e.g., where he was induced to enter into an agreement by fraud, undue influence or coercion.

(2) Where the plaintiff does not have to rely on the illegal transaction [*Sojat Singh v. Sardara Ali*, (1960) A.C. 167].

(3) Where a substantial part of the illegal transaction has not been carried out, and he is truly and genuinely repentant [*Bigos v. Boustead*, (1951) All E.R. 92]. This way, the law encourages repentance even in bad men.

#### AGREEMENTS OPPOSED TO PUBLIC POLICY

An agreement is said to be opposed to public policy when it is *harmful to the public welfare*. Public policy is that principle of law which holds that no subject can lawfully do that which has a mischievous tendency to be injurious to the interests of the public, or which is against the public good or public welfare [*Egerton v. Brownlow*, (1853) 4 H.L.C 1].

Some of the agreements which are, or which have been held to be, opposed to public policy and are unlawful are as follows :

1. *Agreements of trading with enemy*. An agreement made with an alien enemy in time of war is illegal on the ground of public policy. This is based upon one of the two reasons : either that the further performance of the agreement could involve commercial intercourse with the enemy, or that the continued existence of agreement would confer upon the enemy an immediate or future benefit. Contracts which are entered into before the outbreak of war are either suspended or dissolved according as the intention of the parties can or cannot be carried out by postponing performance till the end of hostilities.

2. *Agreements to commit a crime*. Where the consideration in an agreement is to commit a crime, the agreement is opposed to public policy. The Court will not enforce such an agreement. Likewise an agreement to indemnify a person against consequences of his criminal act is opposed to public policy and hence unenforceable.

**Examples.** (a) *A* promises to indemnify *B* in consideration of his beating *C*. The agreement is opposed to public policy.

(b) *A* promises to indemnify a firm of printers and publishers of a paper against the consequences of any libel which it might publish in its paper. *Held*, *A*'s promise could not be enforced in a law Court where the firm was compelled to pay damages for a published libel [*W.H. Smith & Sons v. Clinton*, (1908) 26 T.L.R. 34].

3. *Agreements which interfere with administration of justice*. An agreement the object of which is to interfere with the administration of justice is unlawful, being opposed to public policy. It may take any of the following forms :

(a) *Interference with the course of justice*. An agreement which obstructs the ordinary process of justice is unlawful. Thus an agreement for using improper influence of any kind with the judges or officers of justice is unlawful. But an agreement to refer present or future disputes to arbitration is valid.

(b) *Stifling prosecution*. It is in public interest that if a person has committed a crime, he must be prosecuted and punished. "You shall not make a trade of felony (a grave crime)." [*Williams v. Bayley*, (1866) 1 H.L. 200]. Hence an agreement not to prosecute an offender is an agreement for stifling prosecution and is unlawful. Thus where *A* promises to drop a prosecution which he has instituted against *B* for robbery, and *B* promises to restore the stolen property, the agreement is unlawful. But a compromise in case of compoundable offences is valid.

4. *Agreements in restraint of legal proceedings*. Sec. 28 which deals with these agreements renders void two kinds of agreements, viz.,

(a) *Agreements restricting enforcement of rights*. An agreement which wholly

or partially prohibits any party from enforcing his rights under or in respect of any contract is void to that extent.

(b) *Agreements curtailing period of limitation.* Agreements which curtail the period of limitation prescribed by the Law of Limitation are void because their object is to defeat the provisions of law.

Similarly an agreement purporting to oust the jurisdiction of Courts is contrary to public policy. But an agreement between two or more parties to refer to arbitration any disputes which have arisen or which may arise between them is perfectly valid.

5. *Trafficking in public offices and titles.* Agreements for the sale or transfer of public offices and titles or for the procurement of a public recognition like Padma Vibhushan or Param Veer Chakra for monetary consideration are unlawful, being opposed to public policy. Such agreements, if enforced, would lead to inefficiency and corruption in public life. Similarly, an agreement to pay money to a public servant to induce him to act corruptly or to retire and thus make way for the appointment of the promisor or an agreement with voters to procure their votes for monetary consideration are void on the ground of public policy.

*Example.* A promised to obtain an employment to B in a public office and B promised to pay A Rs. 1,000. Held, the agreement was against public policy and illegal [Parkinson v. College of Ambulance, Ltd. (1925) 3 K.B. 1].

6. *Agreements tending to create interest opposed to duty.* If a person enters into an agreement whereby he is bound to do something which is against his public or professional duty, the agreement is void on the ground of public policy.

7. *Agreements in restraint of parental rights.* A father, and in his absence the mother, is the legal guardian of his/her minor child. This right of guardianship cannot be bartered away by an agreement. A father is entitled by law to the custody of his legitimate child. He cannot enter into an agreement which is inconsistent with his duties arising out of such custody. If he enters into any such agreement, it shall be void on the ground of public policy.

8. *Agreements restricting personal liberty.* Agreements which unduly restrict the personal freedom of the parties to it are void as being against public policy.

*Example.* A debtor agreed with his money-lender that he would not, without the lender's written consent, leave his job, or borrow money, or dispose of his property, or change his residence. Held, the agreement was void [Horwood v. Millar's Timber & Trading Co., (1917) 1 K.B. 305].

9. *Agreements in restraint of marriage.* Every agreement in restraint of the marriage of any person, other than a minor, is void (Sec. 26). This is because the law regards marriage and married status as the right of every individual.

10. *Marriage brokerage or brocage agreements.* An agreement by which a person, for a monetary consideration, promises in return to procure the marriage of another is void, being opposed to public policy. Similarly, an agreement to pay money to the parent or guardian of a minor in consideration of his/her consenting to give the minor in marriage is void, being opposed to public policy.

11. *Agreements interfering with marital duties.* Any agreement which interferes with the performance of marital duties is void, being opposed to public policy. Such agreements have been held to include the following :

(a) A promise by a married person to marry, during the lifetime or after the death of spouse [Roshan v. Mahomed, (1887) P.R. 46].

(b) An agreement in contemplation of divorce, e.g., an agreement to lend

money to a woman in consideration of her getting a divorce and marrying the lender [Tikyat v. Manohar, 28 Cal. 751].

(c) An agreement that the husband and wife will always stay at the wife's parents' house and that the wife will never leave her parental house.

12. *Agreements to defraud creditors or revenue authorities.* An agreement the object of which is to defraud the creditors or the revenue authorities is not enforceable, being opposed to public policy. A contract by which an employee gets an expense allowance grossly in excess of the expenses actually incurred by him is illegal and a fraud on revenue authorities.

13. *Agreements in restraint of trade.* An agreement which interferes with the liberty of a person to engage himself in any lawful trade, profession or vocation is called an 'agreement in restraint of trade'. Public policy requires that every man should be at liberty to work for himself and should not be at liberty to deprive himself of the fruit of his labour, skill or talent by any contract that he enters into [S.B. Fraser & Co. v. The Bombay Ice Mfg. Co. (1904) 29 Bom. L.R. 107]. As such, every agreement, by which anyone is restrained from exercising a *lawful profession, trade or business* of any kind, is to that extent void (Sec. 27).

*Exceptions.* The following are the exceptions to the rule that "an agreement in restraint of trade is void".

(1) *Sale of goodwill.* A seller of goodwill of a business may be restrained from carrying on (i) a similar business, (ii) within specified local limits, (iii) so long as the buyer or any person deriving title to the goodwill from him carries on a like business : provided (iv) that such limits appear to the Court reasonable regard being had to the nature of the business (Exception to Sec. 27).

"Limits" means "local limits" and the duration of the restraint is so long as the buyer or any person deriving title to the goodwill from him carries on the like business [Hukmi Chand v. Jaipur Ice & Oil Mills Co., A.I.R. (1980) Raj. 155].

(2) *Partners' agreements.* (a) A partner shall not carry on any business other than that of the firm while he is a partner [Sec. 11 (2) of the Indian Partnership Act, 1932].

(b) An outgoing partner may agree with his partners not to carry on a business similar to that of the firm within a specified period or within specified local limits [Sec. 36 (2) of the Indian Partnership Act, 1932].

(c) Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits (Sec. 54 of the Indian Partnership Act, 1932).

(d) Where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business. But, subject to agreement between him and buyer, he may not (a) use the firm name, (b) represent himself as carrying on the business of the firm, or (c) solicit custom of persons who were dealing with the firm before its dissolution [Sec. 55 (2) of the Indian Partnership Act, 1932].

(e) Any partner may, upon the sale of goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits [Sec. 55 (3) of the Indian Partnership Act, 1932].

In cases (b) (c) and (e), the Courts will enforce such agreements only if the restrictions imposed are reasonable.

**Service contracts**

Sometimes an employee, by the terms of his service agreement, is prevented from accepting—

- (i) any other engagement during his employment, and/or
- (ii) a similar engagement after the termination of his services.

As regards the first restraint, it is valid and is not in restraint of trade if it is to operate while the employee is contractually bound to serve his employer. The doctors, for example, are usually debarred from private practice during the term of their employment.

As regards the second restraint, it is void if its object is merely to restrain competition by an employee in his employer's business. Therefore, a restraint on an employee not to engage in a similar business, or not to accept a similar engagement, after the termination of his services, is void. In *Brahamputra Tea Company v. Scarth*, (1885) 11 Cal. 545, it was held that an agreement restraining an employee from taking service or engaging in any similar business for a period of 5 years after the termination of his service was void.

If a restraint is intended to protect an employer against an employee making use of trade secrets learned by him in the course of his employment, the restraint is valid provided it is not for any other purpose also.

However, an employer cannot prevent an employee from earning his living by the exercise of his skill and the use of his knowledge. In *Herbert Morris, Ltd. v. Saxelby*, (1916) 1 A.C. 688, it was observed : "A man's aptitudes, his skill, his dexterity, his manual or mental ability..... are not his master's property ; they are his own property ; they are himself. There is no public interest which compels the rendering of those things dormant or sterile or unavailing."

**Example.** *A*, a tailor, employed as his assistant *L* under a contract by which *L* agreed on the termination of his employment not to carry on business as a tailor within sixteen kilometres of *A*'s establishment. *Held*, the agreement was void [*Aftwood v. Lamont*, (1920) 3 K.B. 571].

**TEST QUESTIONS**

1. Under what circumstances is the object or consideration of a contract deemed unlawful ? Illustrate with examples.
2. What is an illegal agreement ? What are the effects of illegality ?
3. "No action is allowed on an illegal agreement." What are the exceptions to this rule ?
4. "In cases of equal guilt, the position of the defendant is better than that of the plaintiff." Comment.
5. What are immoral agreements ? Why are they bad in law ?
6. Discuss the doctrine of public policy. Give examples of agreements contrary to public policy. Explain the statement that the categories of public policy are closed.
7. Name several types of agreement which are illegal because they are contrary to public policy.
8. "An agreement in restraint of trade is void." Examine this statement mentioning exceptions, if any.
9. "A person ought not to be allowed to restrain himself by contract from exercising any lawful craft or business at his own discretion in his own way." Discuss.

**PRACTICAL PROBLEMS**

Attempt the following problems, giving reasons :

1. *A* is an employee of *B & Co.* After leaving the service, he agrees with *B & Co.* that he shall not employ himself in any similar concern within a distance of 1,000 kilometers of the town. Is this restraint valid ?

[Hint : No, unless it is intended to protect *B & Co.* against *A* making use of trade secrets learned by him in the course of his employment (*Forster & Sons, Ltd v. Suggett*). However, *B & Co.* cannot prevent *A* from earning his living by the exercise of his skill and the use of his knowledge (*Herbert Morris, Ltd. v. Saxelby*)].

2. *A* borrows Rs. 500 from *B* to purchase certain smuggled goods from *C*. Can *B* recover the amount from *A* if he (a) knows of *A*'s purpose for which he borrows money, (b) does not know of *A*'s purpose ?

[Hint : (a) No. (b) Yes].

3. *A* grants lease of certain premises at Calcutta to *B* for one year, knowing that the premises will be used for the purpose of (a) prostitution, or (b) installing machinery for minting base coins, at a monthly rental of Rs. 500. *B* does not pay the rent. Can *A* recover the rent ?

[Hint : No (*Pearce v. Brooks*)].

4. *X* promises to drop prosecution which he has instituted against *R* for robbery and *R* promises to restore the value of things taken. Can *X* enforce this promise ? If so, give reasons.

[Hint : No (Sec. 23, page 64 ; *Williams v. Bayley*)].

5. *G* pays Rs. 500 to *A*, a civil servant employed in a Government department, in consideration of *A*'s promise that a Government contract which is at the disposal of his department will be placed with *G*. Before this can be done, *A* is transferred to another department. *G* now wishes to reclaim from *A* Rs. 500 paid to him. Will *G* succeed ?

[Hint : No].

6. *A* promises to pay Rs. 500 to *B* who is an intended witness in a suit against *A* in consideration of *B*'s absconding himself at the trial. *B* absconds but fails to get the money. Can he recover ?

[Hint : No, as the agreement is unlawful, being opposed to public policy].

✓ *A*, a Bombay doctor, employed another doctor, *B*, as an assistant for a period of three years on a salary of Rs. 5,000 per annum. The agreement between *A* and *B* provided that after the termination of his employment *B* should not practise as a doctor in Bombay within a radius of one kilometre of *A*'s dispensary for a period of one year and if *B* did so, he should pay Rs. 20,000 to *A* as liquidated damages. Immediately after the termination of his employment *B* began to practise as a doctor next door to *A*'s dispensary. *A* thereupon sued *B* for the recovery of Rs. 20,000. How would you decide ?

[Hint : *A* cannot recover Rs. 20,000 from *B* as the agreement between them is void, being in restraint of trade (Sec. 27)].

8. *A* advances Rs. 2,000 to *B*, a married woman, to enable her to obtain a divorce from her husband. *B* agrees to marry *A* as soon as she obtained divorce. *B* obtains the divorce but refuses to marry *A*. Can *A* recover the amount ?

[Hint : No (*Tikyat v. Manohar*)].

9. *A* sells his grocery business, including goodwill, to *B* for a sum of Rs. 50,000. It is agreed that *A* is not to open another grocery store in the whole of India for the next ten years. *A* opens another store in the same city two months later. What are the rights of *A* ?

[Hint : *B* cannot take any legal action against *A* (Sec. 27)].