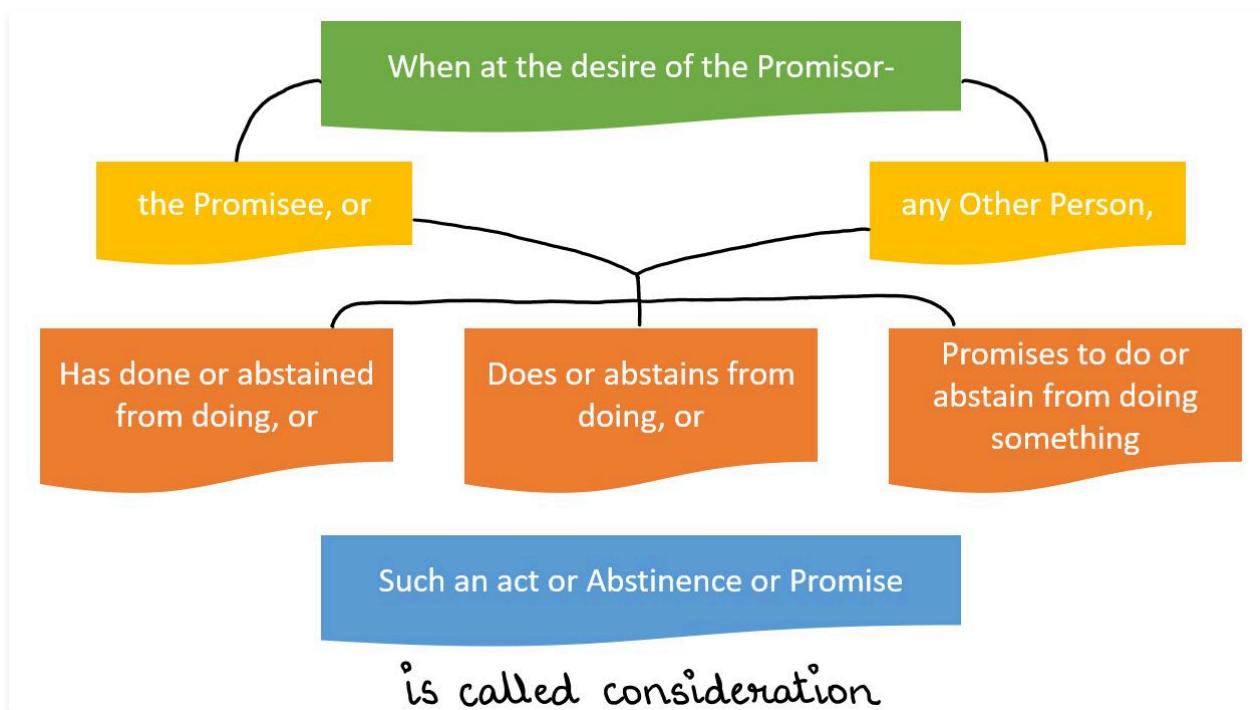


Auditing Course Material

Part 43 of 61 (Chapters 4201-4300)

9. Consideration

Section 2(d) of the Indian Contract Act defines consideration as "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 an act or abstinence or promise is called consideration for the promise".



In simple words, if someone does, or doesn't do, or promises something because the person making the promise asked them to, it is called consideration for the promise.

For example, if Sumit promises to pay Sachin Rs. 2,000 to mow his lawn, Sachin mowing the lawn is the consideration for Sumit's promise.

Essential Characteristics of a valid consideration

Requirements of Valid Consideration

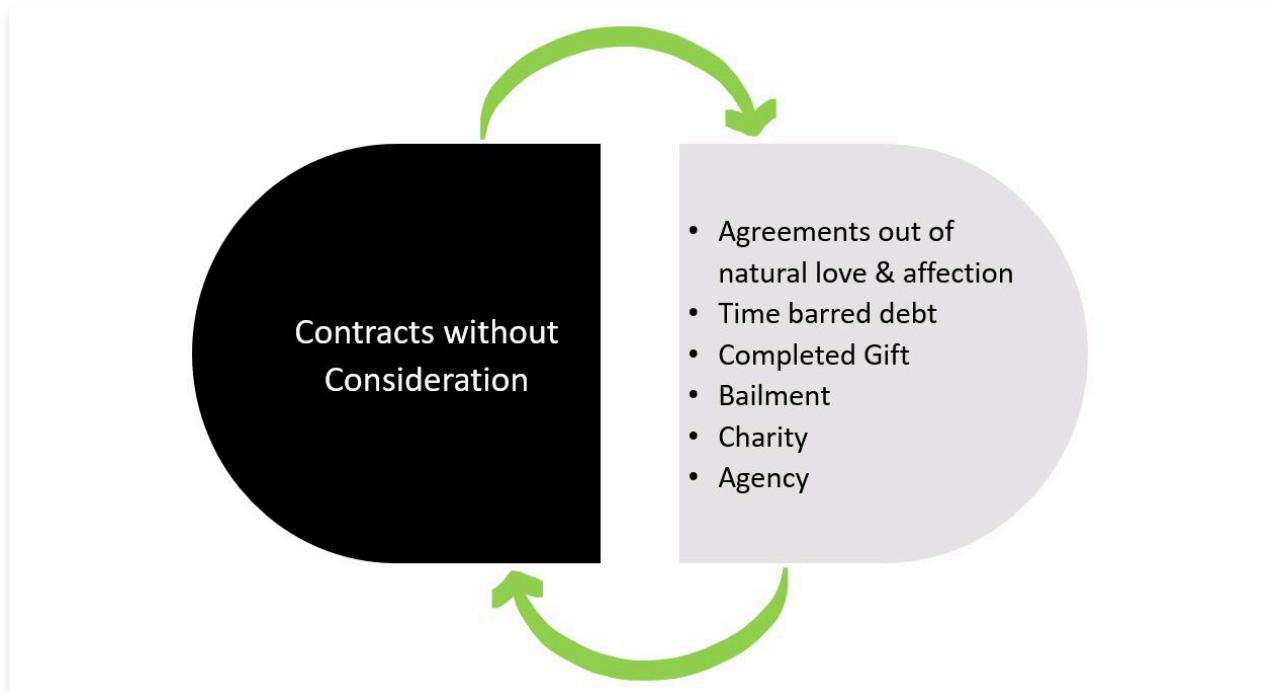
Move at the desire of the Promisor	Past or Present or Future	Promisee or any other person
Adequacy of consideration	Not be unlawful, immoral, or opposed to public policy	Other than the Promisor's existing obligation
Real and not illusionary		

The essential characteristics of a valid consideration are as follows:

- Consideration must move at the desire of the promisor.

- It may proceed from the promisee or any other person on his behalf.
 - It may be executed or executory. It may be past, present or future.
 - It must be real and have some value in the eyes of law.
 - It must not be something which the promisor is already legally bound to do.
 - It must not be unlawful, immoral or opposed to public policy.
 - Inadequacy of consideration does not invalidate the contract. Thus, it need not be proportionate to the value of the promise of the other.
 - It may comprise of some benefit, profit, right or interest accruing to one or some loss, detriment, obligation or responsibility undertaken by the other.
-

9. Consideration



The general rule is that an agreement made without consideration is void. However, the Indian Contract Act contains certain exceptions to this rule.

In the following cases, the agreement though made without consideration, will be valid and enforceable.

1. Natural love and affection

Following conditions must be fulfilled:

- (i) It must be made out of natural love and affection between the parties.
- (ii) Parties must stand in near relationship to each other.
- (iii) It must be in writing.
- (iv) It must also be registered under the law.

For example, a husband, by a registered agreement promised to pay his earnings to his wife. It was held that the agreement though without consideration, was valid.

2. Compensation for past voluntary services

In order that a promise to pay for the past voluntary services be binding, the following essential factors must exist:

- (i) The services should have been rendered voluntarily.
- (ii) The services must have been rendered for the promisor.
- (iii) The promisor must be in existence at the time when services were rendered.
- (iv) The promisor must have intended to compensate the promisee.

For example, P finds R's wallet and gives it to him. R promises to give P Rs. 10,000. This is a valid contract.

3. Promise to pay time barred debt

Where a promise in writing signed by the person making it or by his authorised agent, is made to pay a debt barred by limitation, it is valid without consideration.

For example, A is indebted to C for Rs. 60,000 but the debt is barred by the limitation Act. A signs a written promise now to pay Rs. 50,000 in final settlement of the debt. This is a contract without consideration, but enforceable for Rs. 50,000 only.

4. Agency

No consideration is necessary to create an agency.

5. Completed gift

In case of complete gifts, the rule no consideration no contract does not apply. Thus, gifts do not require consideration.

6. Bailment

No consideration is required to affect the contract of bailment.

Bailment is the delivery of goods from one person to another for some purpose. This delivery is made upon contract that post accomplishment of the purpose, the goods will either be returned or disposed of, according to the directions of the person delivering them.

For example, Mr. A hand over the keys of his godown to Mr. Y as Mr. Y had deposited his goods in the same. Mr. Y gets possession of godown but not the ownership. As soon as Mr. Y lifts his goods from godown, he is liable to hand over the keys back to Mr. A.

7. Charity

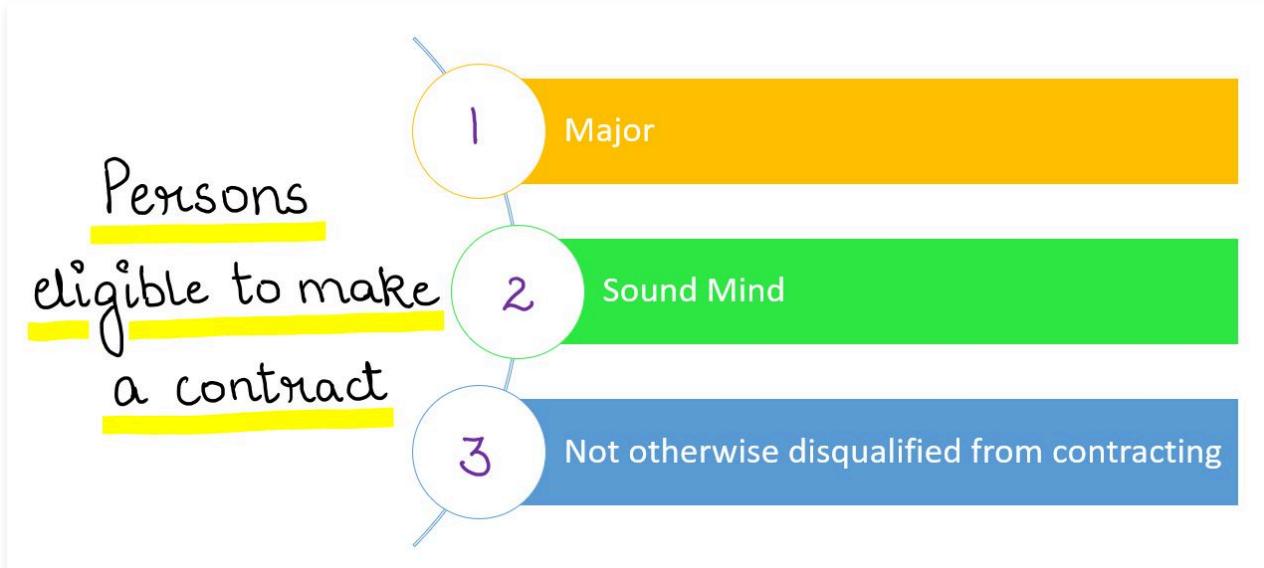
If a promisee undertakes the liability on the promise of the person to contribute to charity, then the contract shall be valid.

For example, Mr. G promised Mr. K, the secretary of committee of temple to donate Rs. 1,00,000 for renovation of that temple. On the faith of his promise, secretary has incurred some cost for renovation. Now secretary can claim from Mr. G even the contract was without consideration.

10. Capacity of Parties

Capacity refers to the competence of the parties to make a contract. It is one of the essential elements to form a valid contract.

Who is competent to contract



Every person is competent to contract:

1. who has attained the age of majority

Every person domiciled in India shall attain the age of majority on the completion of 18 years of age and not before.

Following points need to be considered in relation to position of a party to contract, being a minor.

- A minor is not competent to contract and any agreement with or by a minor is *void ab-initio* (void from the very beginning).
- A minor cannot ratify the agreement on attaining majority, as the original agreement is *void ab initio* and a void agreement can never be ratified.
- Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to him.
- A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership.
- A minor cannot be declared insolvent, as he is incapable of contracting debts and dues are payable from the personal properties of minor and he is not personally liable.
- A minor can act as an agent. But he will not be liable to his principal for his acts. A minor can draw, deliver and endorse negotiable instruments without himself being liable.
- A minor, being incompetent to contract, cannot be a shareholder of the company.

2. who is of sound mind

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

Position of Person of Sound Mind

Person who is usually of Unsound Mind but occasionally of Sound Mind

May make a Contract when he is of Sound Mind

Person who is usually of Sound Mind but occasionally of Unsound Mind

May not make a Contract when he is of Unsound Mind

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

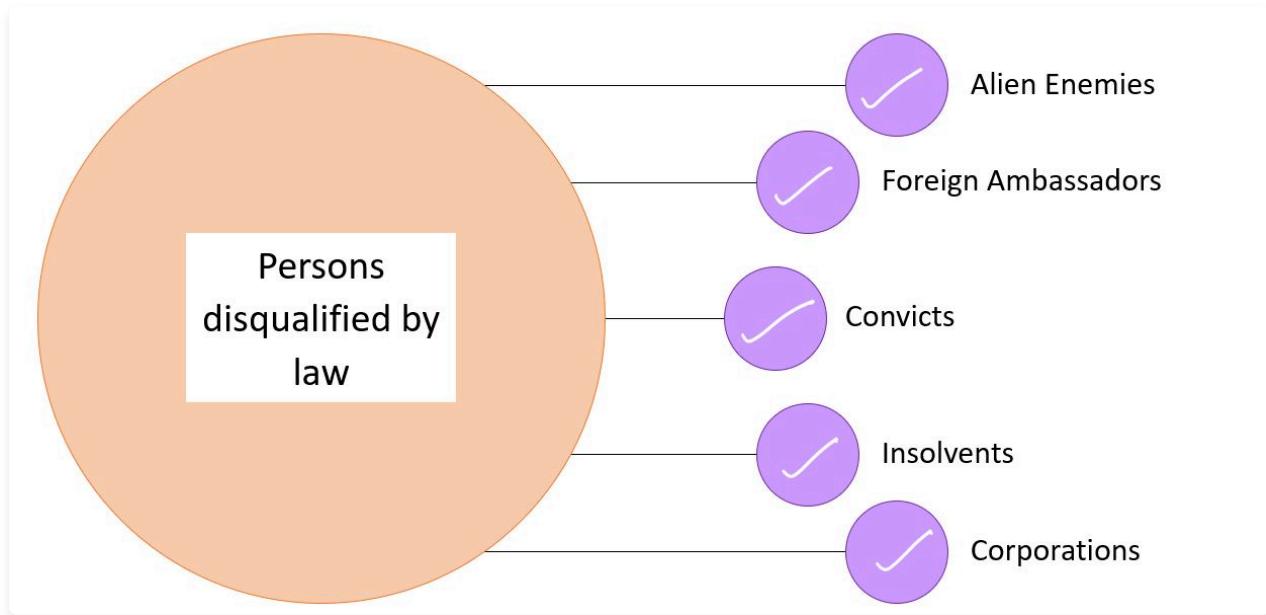
A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

A person who is permanently of unsound mind (in case of idiots) cannot enter into any contract. Any agreement entered into with such person is altogether void.

Further, a sane person who is delirious from fever or who is so drunk cannot contract during such state because he cannot understand the terms of a contract and is unable to form a rational judgement as to its effect on his interest.

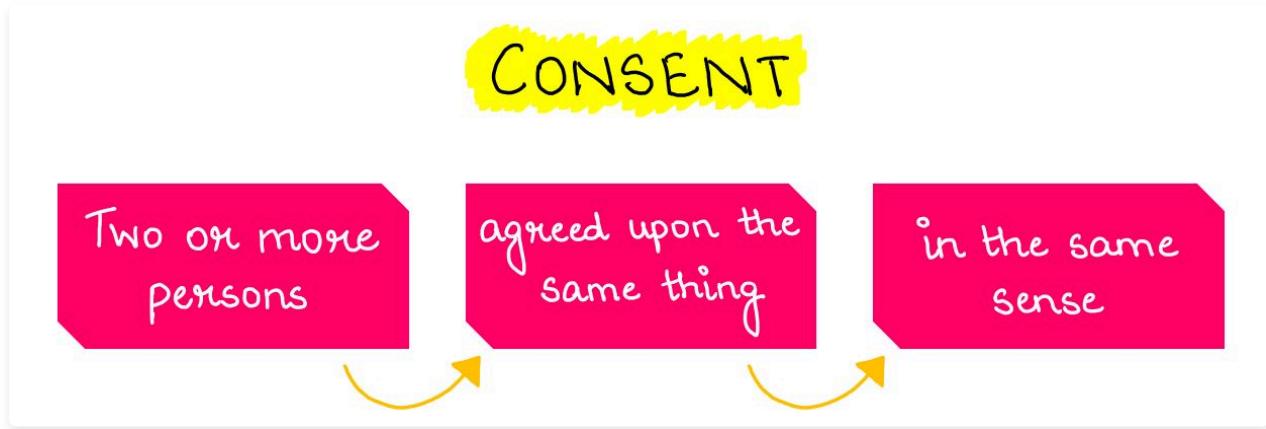
3. who is not disqualified otherwise

Besides minors and persons of unsound mind, there are also other persons who are disqualified from contracting, partially or wholly, so that the contracts by such persons are void. Incompetency to contract may arise from political status, corporate status, legal status, etc.

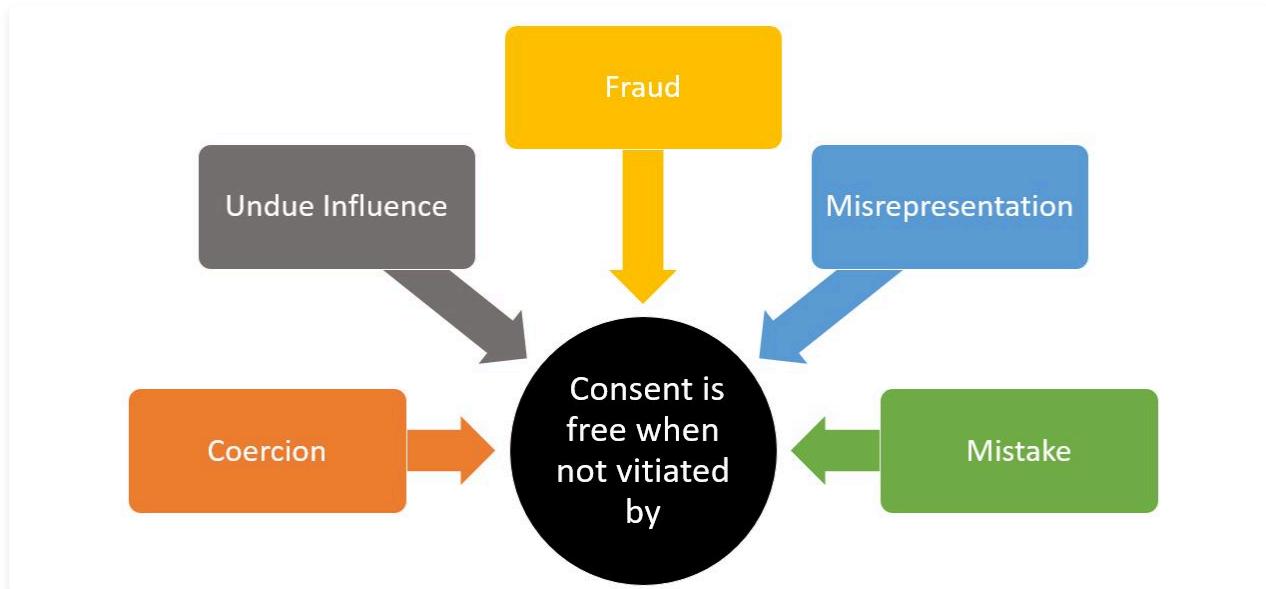


The following persons fall in this category: Foreign Sovereigns and Ambassadors, Alien enemy, Corporations, Convicts, Insolvent etc.

11. Free Consent



According to Section 13 of the Act, "two or more persons are said to consent when they agree upon the same thing in the same sense".



Further, according to Section 14 of the Act, consent is said to be free when it is not caused by:

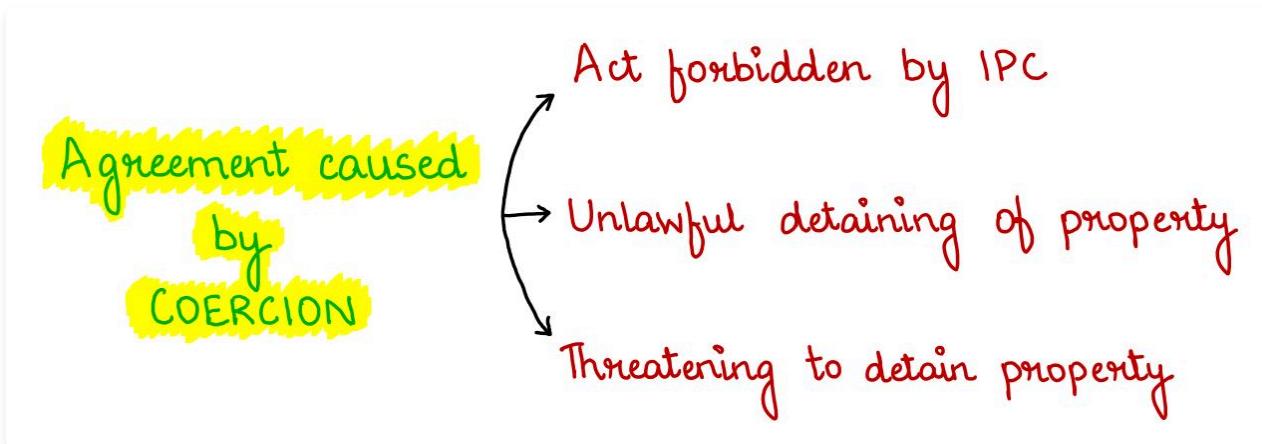
1. Coercion; or
2. Undue Influence; or
3. Fraud; or
4. Misrepresentation; or
5. Mistake.

It is important to note that, when consent to an agreement is caused by coercion, fraud, misrepresentation, or undue influence, the agreement is a contract **voidable** at the option of the party whose consent was so caused. When the consent is vitiated by mistake, the contract becomes **void**.

The above factors are discussed next briefly.

11. Free Consent

Coercion is the committing, or threatening to commit, any act forbidden by the Indian Penal Code or the unlawful detaining, or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.



For example, if Raj threatens to damage Priya's valuable collection of books unless she agrees to lend him a significant amount of money interest-free, it amounts to coercion, as Raj is using the threat of harm to compel Priya into an agreement.

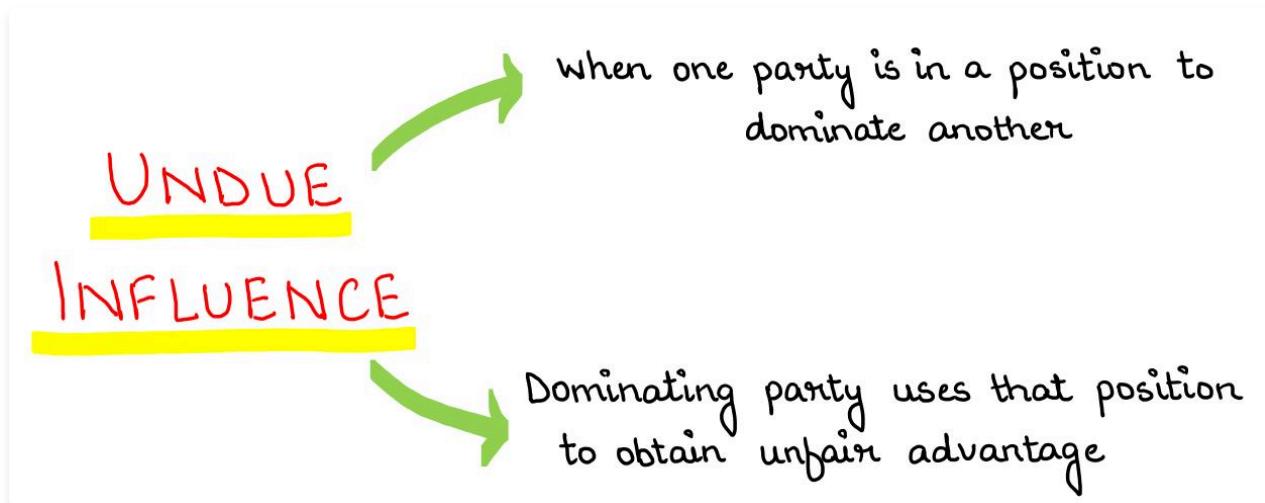
Note that it is immaterial whether the Indian Penal Code is or is not in force at the place where the coercion is employed.

Effect of coercion

According to Section 19 of the Indian Contract Act, if one person seeks consent of another by using coercion, such contract is voidable at the option of the aggrieved party whose consent had not been free. He can repudiate or avoid a contract, or he can enforce it against another party.

11. Free Consent

According to Section 16 of the Act, "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 he uses that position to obtain an unfair advantage over the other".



When a person is deemed to be in a dominating position

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

- (a) where he holds a real or apparent authority over the other; or
- (b) where he stands in a fiduciary relationship to the other; or
- (c) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress, for example, an old illiterate person.

Examples

An employer, Mr. Khanna, persuades his employee, Ravi, to sell his valuable antique collection to Mr. Khanna at a very low price. Due to Mr. Khanna's authority over Ravi as his employer, Ravi might feel compelled to agree, and this could be a case of undue influence.

A financial advisor, Priya, convinces her client, Rahul, to invest all his savings in a financial product that benefits her with higher commissions but may not be in Rahul's best interest. Priya, in her fiduciary role, has the potential to dominate Rahul's will, and this situation may involve undue influence.

A lawyer, Ms. Patel, takes advantage of an elderly, illiterate client, Mrs. Desai, by persuading her to sign over her property for far less than its value. Mrs. Desai's mental capacity is affected by age and lack of literacy, making her vulnerable to Ms. Patel's undue influence.

Relationships presumed to have undue influence

There is presumption of undue influence in the following relationships:

- (a) Parent and child
- (b) Guardian and ward
- (c) Doctor and patient
- (d) Solicitor and client
- (e) Trustee and beneficiary
- (f) Religious advisor and disciple
- (g) Fiancé and fiancée

However, there is no presumption of undue influence in case of relationship of:

- (a) landlord and tenant
- (b) debtor and creditor
- (c) husband and wife.

Consequences if the consent is caused by Undue influence

Following shall be the effect if the consent is caused by undue influence.

- (a) Agreement is voidable at the option of aggrieved party.
 - (b) Aggrieved party has the option to cancel (rescind) the contract.
 - (c) If the aggrieved party decides to rescind the contract, he must return (restore) all the benefits received by such person.
-

11. Free Consent

Fraud includes any of the following				
False claim made by someone who knows it is false	Deliberate hiding of a known fact	Making a promise with no intent to fulfill it	Any deceitful action	Any fraudulent act specified by law

According to Section 17 of the Act, 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with an intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

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

For example, Raj sells a car to Simran and suggests that it has never been in an accident, knowing that it was damaged and repaired. Raj is committing fraud by suggesting a false fact.

2. **the active concealment of a fact by one having knowledge or belief of the fact;**

For example, Neha sells a house to Aryan and actively conceals the fact that there is a termite infestation. This deliberate hiding of a known fact constitutes fraud.

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

For example, Karan promises to deliver a rare painting to Kavita, but he never had any intention of doing so. This false promise with no intention to fulfill it is an act of fraud.

4. **any other act fitted to deceive;**

For example, Preeti, while selling her laptop to Sameer, falsely claims that it is the latest model with advanced features. This act, fitted to deceive Sameer, falls under the category of fraud.

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

For example, Ankit sells a property to Riya without disclosing that it has been declared heritage by law, and any alterations are prohibited. Ankit's omission to disclose this information, especially when the law declares it fraudulent, constitutes fraud.

Effect of fraud upon validity of a contract

When the consent to an agreement is caused by the fraud, the contract is voidable at option of the party defrauded and he has the following remedies:

1. He can rescind the contract within a reasonable time.
2. He can sue for damages.
3. 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 had the representation made been true.

Exceptions

In the following cases, contract is not voidable:

- (i) If the party whose consent was caused by silence which amounting to fraud, had the means of discovering the truth with ordinary diligence.
- (ii) A fraud which did not cause the consent of the party to agreement.

Whether Silence is fraud or not

Does mere silence amount to fraud ?

Mere silence as to facts

Exceptions

No fraud

- Where there is the duty of a person to speak
- Silence is equivalent to speech

Silence amounts to fraud

Silence is fraud in following situations.

1. There is duty to speak

For example, A sell, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the unsoundness of the horse. This is not fraud by A.

In the above example, B is A's daughter. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

2. When silence is equal to speech

For example, B says to A - "if you do not deny it, I shall assume that the horse is sound." A says nothing. Here A's silence is equivalent to speech.

11. Free Consent

According to Section 18 of the Act, 'Misrepresentation' means a misstatement of a material fact made believing it to be true, without an intent to deceive the other party. Contract will be voidable in this case.

Misrepresentation

An act of providing false information about a significant fact, genuinely believing it to be true, without the intention to deceive the other party.

For example, suppose Ritu is selling her car to Arjun and, in good faith, tells him that the car has never been in an accident. However, unknown to Ritu, the car had a minor accident in the past that was repaired. Ritu genuinely believed her statement to be true. In this case, Ritu's misrepresentation about the car's accident history, even though made in good faith, qualifies as misrepresentation. If Arjun later discovers the truth and decides to void the contract, he has the right to do so because of the innocent misrepresentation.

Effect of misrepresentation

In a contract, when consent of the party is caused by misrepresentation made by another party, such contract is voidable at the option of an aggrieved party whose consent was caused by misrepresentation.

He has the following rights:

- (i) He can avoid or rescind the contract.
 - (ii) He can insist on the performance of a contract with a condition that he shall be placed in the same position, as he would have been if there had been no misrepresentation.
-

11. Free Consent

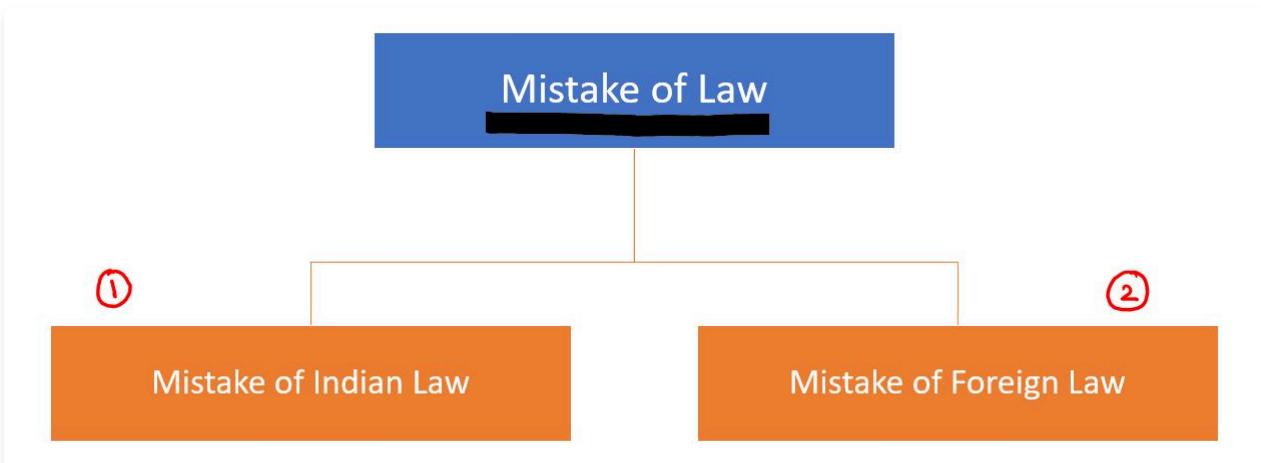
Mistake may be defined as an innocent or erroneous belief which leads the party to misunderstand others. It is essential for the creation of a contract that both the parties should agree to the same thing in the same sense. Thus, if two persons enter into a contract, each of them thinking about a different subject matter, no contract will arise. As a result, a mistake may lead a contract towards voidness.



The effect of Mistake of Law can be broadly studied under following 2 heads.

1. Mistake of Law

A mistake of law does not render a contract void as one cannot take excuse of ignorance of the law of his own country. But, if the mistake of law is caused through the inducement of another, the contract may be avoided. Mistake of foreign law is excusable and is treated like a mistake of fact. Contract may be avoided on such mistake.



Mistake of law of the country

Everyone is supposed to know the law of land. In the latin maxim it is said that 'Ignorantia juris non excusat.' Ignorance of law is no excuse. Therefore, if there is mistake of Indian Law, the contract is not void or voidable.

For example, suppose Rohan sells his car to Neha, and they agree on the price and terms. Later, Rohan discovers that he was unaware of a tax regulation in his own country that affects the transaction. In this case, Rohan's mistake of law regarding the tax regulation does not make the contract void. Even though he was ignorant of the law in his own country, the contract remains valid, and Rohan cannot use his lack of knowledge of the law as an excuse to void the agreement.

Following are the effects of mistake of law of the country.

1. When a party enters into a contract, without the knowledge of law in the country, the contract is valid and not void.
2. A contract is not voidable because it was caused by a mistake as to any law in force in India.
3. The reason here is that Ignorantia juris non excusat (ignorance of law is not an excuse at all).
4. However, if a party is induced (influenced) to enter into a contract by the mistake of law then such a contract may be avoided.
5. The principle in this case is ignorance of law is not an excuse.

Mistake of law of foreign country

A mistake of foreign law is treated, as if it were a mistake of facts, because person cannot be expected to know the law of the other country.

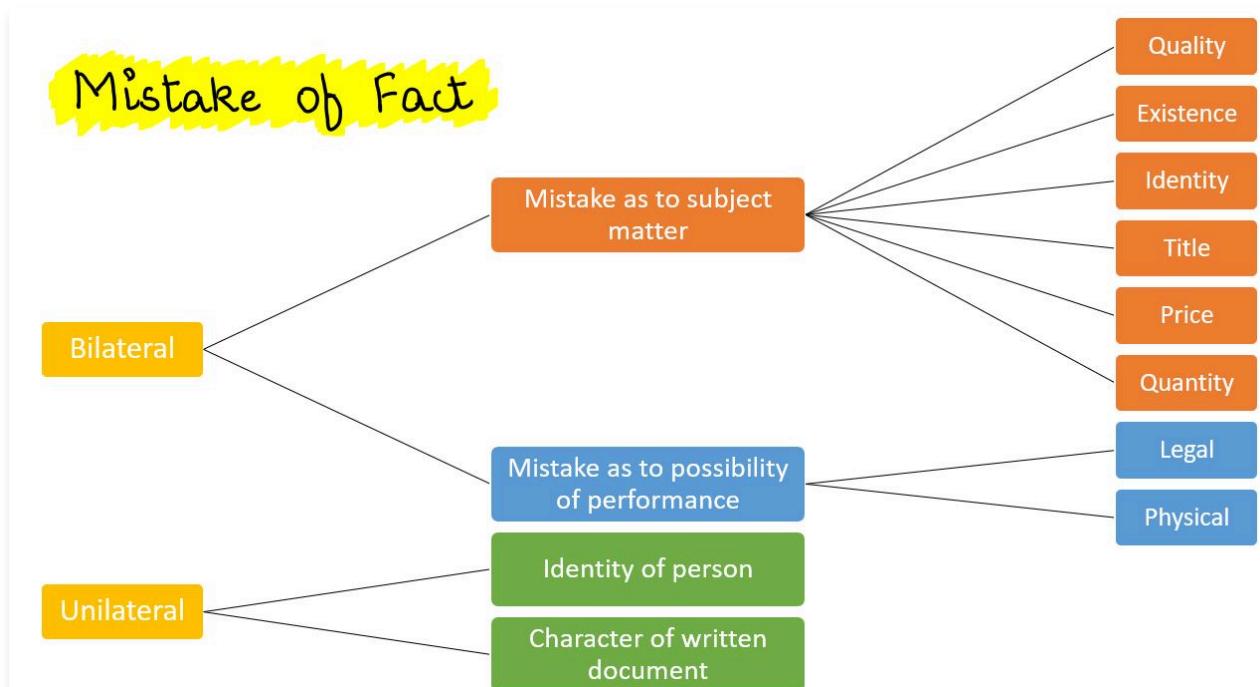
For example, suppose Ankit, an Indian businessman, enters into a contract with Maria, a foreign business partner, believing that a certain business practice is legal in their collaboration. Unknown to Ankit, the practice is actually against the laws of Maria's country. Ankit's mistake of foreign law is excusable, and if Maria induced this mistake or took advantage of it to secure the contract, Ankit may have the right to avoid the contract due to the mistake induced by Maria.

Following are the effects of mistake of law of foreign country.

1. Such a mistake is treated as mistake of fact and agreement is such case is void.
2. Ignorance of foreign law may be excused.

2. Mistake of Fact

Where the contracting parties misunderstood each other and are at cross purposes, there is a bilateral or mutual mistake. Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.



For example, A offers to sell his Maruti Alto Car to B. B believes that A has only Maruti 800 Car and agrees to buy the car. Here, the two parties are thinking about different subject matters, so there is no real consent and the agreement is void.

Mistake of Fact can be studied under following heads.

Bilateral mistake

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void. Here, mistake must be mutual i.e. both the parties should misunderstand each other.

Types of mistakes falling under bilateral mistake are as follows.

- (a) *Mistake as to existence of subject matter:* If both the parties are at mutual mistake as to existence of the subject matter the agreement is void.
- (b) *Mistake as to identity of subject matter:* It usually happens when both the parties have different subject matter of contract in their mind. The contract is void due to mistake of identify of subject matter.
- (c) *Mistake as to the quality of the subject matter:* If the subject matter is something essentially different from what the parties thought to be, the agreement is void.
- (d) *Mistake as to quantity of subject matter:* Bilateral mistake as to quantity of subject matter would render the contract void.
- (e) *Mistake as to title of subject matter:* The agreement is void due to bilateral mistake as to title of the subject matter.
- (f) *Mistake as to price of the subject matter:* Mutual mistake as to price of the subject matter would render the agreement void.
- (g) *Mistake as to possibility of performance of Contract:* Impossibility may be:
 - *Physical impossibility:* A contract is void if it is identified to be non-feasible (not possible) due to physical factors, like time, distance, height, etc.

- **Legal impossibility:** A contract is void if it provides that something shall be done which as a matter of law cannot be done.

Unilateral Mistake

Mistake regarding subject matter on the part of one party only, is known as unilateral mistake.

According to section 22 of the Indian Contract Act, "a contract is not voidable merely because it was caused by one of the party to it being under mistake as to a matter of fact." In other words, while entering into a contract one of the party carries erroneous opinion about essential facts of subject matter. But another party understood those facts correctly. The contract will not be void.

For example, a party bought oats from a vendor, a sample of which has already been shown to him. He erroneously thought that the oats were old. However, the oats were new ones. It was held that he had to suffer due to his own mistake and he could not avoid the contract.

The above rule is subject to **certain exceptions**, which are as under. In these exceptional cases, though the mistake is unilateral, but agreement would be void.

(a) *Mistake regarding nature of contract:* When the party of a contract gives his consent under a mistake as to nature and character of a written document, such mistake may render the contract void.

For example, A is an old man who is being looked after by his relative B who has also been managing A's property. B states to A that part of his property is being given on lease to C and asks him to sign a document, which is in fact a gift deed in favour of B. A signs on it by mistake. Such deed is void, because there is fraud about a character of document.

(b) *Mistake regarding identity of a party:* When one of the parties of a contract is under mistake regarding an identity of another part, which is essential for performing a contract, such contract is also void. Thus, mistake regarding identity of party renders contract void provided such identity is essential for the performance of a contract.

For example, A agrees to sell his motor bike to B on credits believing that he is C. Contract is void, because A is under mistake regarding B's identity and identity of B is essential for performing a contract i.e., recovery of price from him.

Effect of Mistake

When the consent of the party is caused by mistake for a contract, such contract is void and the following legal remedies are available to the parties.

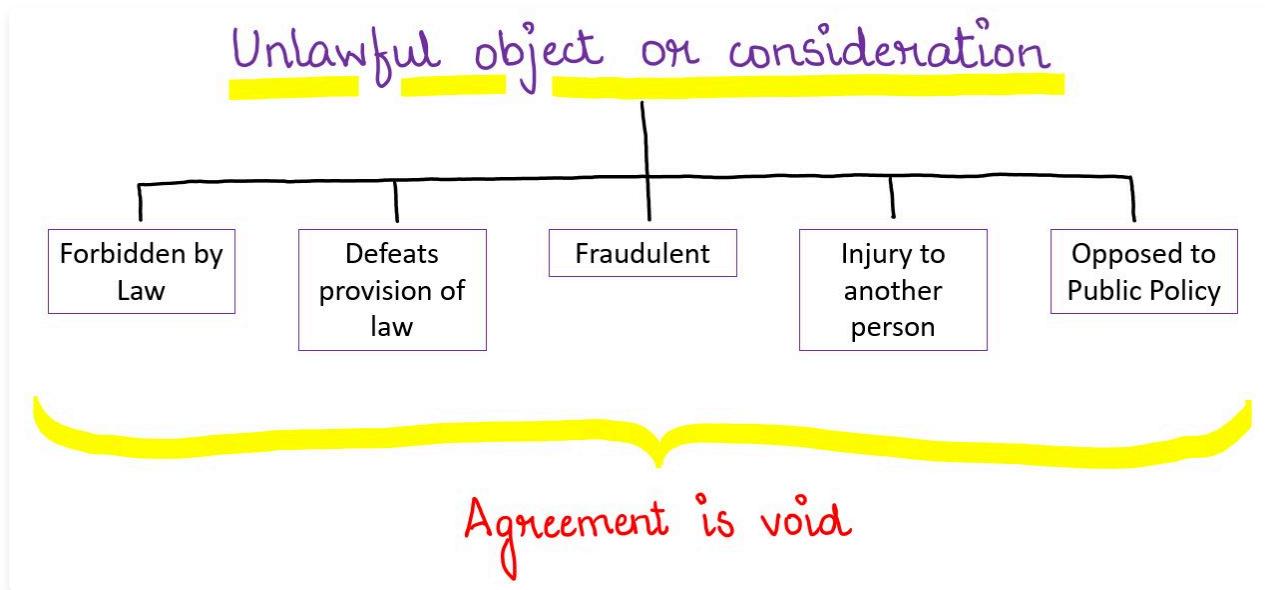
- (i) Any person, who gets any advantage in such contract, is bound to restore it or to make compensation for it to the person from whom he has received it.
 - (ii) A person to whom money has been paid or anything delivered by mistake must repay or return it to the party delivering it.
-

11. Free Consent

The points of difference between fraud and misrepresentation are as follows.

Basis	Fraud	Misrepresentation
Intention	To deceive other party by hiding truth.	No intention to deceive the other party.
Knowledge of Truth	The person making the statement believes the statement as untrue.	The person making the statement believes it to be true, although it is not true.
Rescission of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.

12. Legality of Object and Consideration



The consideration or object of an agreement is lawful, unless:

1. it is forbidden by law; or
2. is of such a nature that, if permitted, it would defeat the provisions of any law; or
3. is fraudulent; or
4. involves injury to the person or property of another; or
5. the court regards it as immoral; or
6. opposed to public policy.

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

Let's say Ravi agrees to pay Shreya a significant amount of money to smuggle illegal goods into the country. In this example, the consideration or object of their agreement involves an activity forbidden by law. Consequently, their agreement is unlawful and it is void.

13. Void Agreements

Expressly declared void agreements

By incompetent parties

In restraint of Legal Proceeding

With uncertain meaning

Under mutual mistake of fact

In restraint of Trade

When consideration or object is unlawful

In restraint of marriage

Without consideration

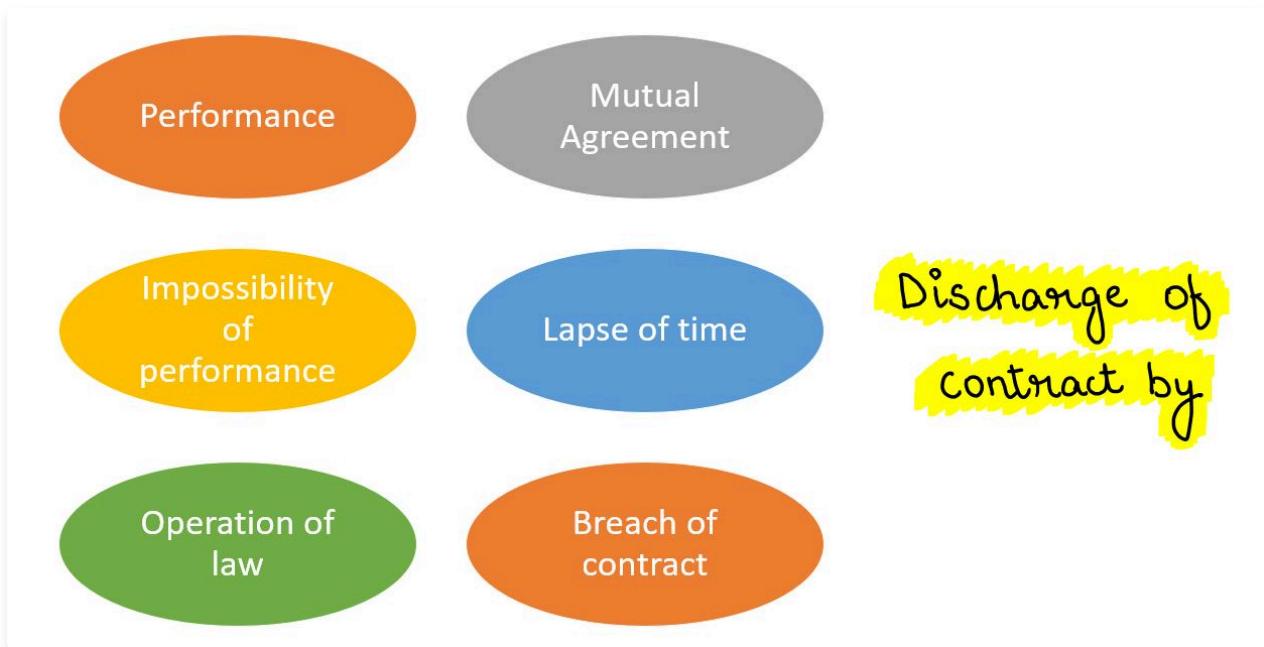
By way of wager

There are certain agreements which are **expressly declared void** under the Act, which are as follows:

1. Agreements made by incompetent parties, for example, agreements made with minors.
2. Agreements made under bilateral mistake of fact, for example, selling a painting under the mistaken belief it's a famous artist's work.
3. Agreements the consideration or object of which is unlawful; paying someone to commit a crime.
4. Agreements the consideration or object of which is unlawful in parts, for example, paying for a legitimate service along with an illegal one in the same contract.
5. Agreements made without consideration; for example, a promise without anything in return. However, there are certain exceptions to it.
6. Agreement in restraint of marriage, for example, agreeing not to marry anyone, which is void.
7. Agreements in restraint of trade; for example, a contract preventing someone from pursuing their chosen profession.
8. Agreement in restraint of legal proceedings, for example, a contract preventing someone from taking legal action.
9. Agreement the meaning of which is uncertain, for example, a contract where the terms are unclear.
10. Wagering Agreement (i.e., an agreement involving payment of a sum of money upon the determination of an uncertain event), for example, betting on the outcome of a cricket match.
11. Agreements to do impossible acts, agreeing to fly without any means of transportation.

14. Discharge of a Contract

A contract is discharged when the obligations created by it come to an end.



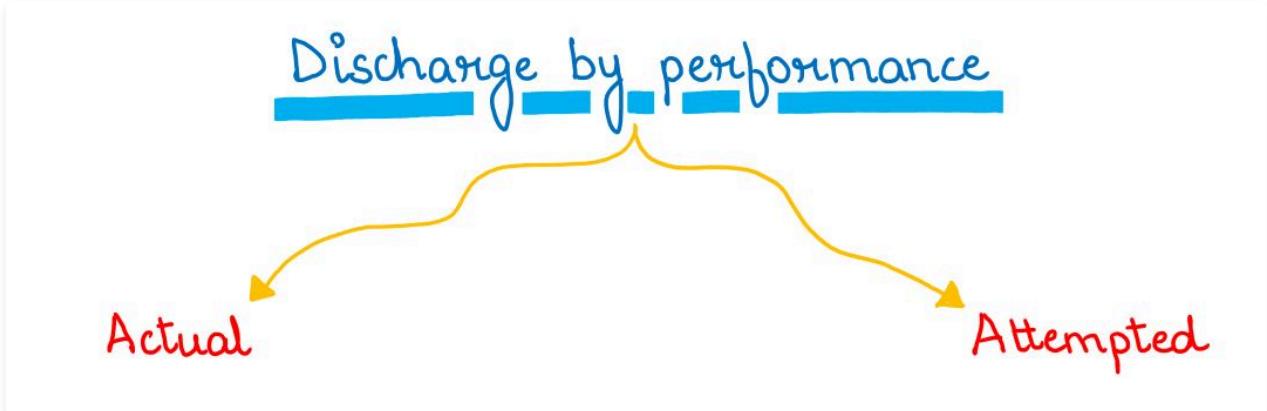
A contract may be discharged in any one of the following ways:

- (i) Discharge by performance
- (ii) Discharge by mutual agreement
- (iii) Discharge by impossibility of performance
- (iv) Discharge by lapse of time
- (v) Discharge by operation of law
- (vi) Discharge by breach of contract
- (vii) Discharge by merger of rights.

These are discussed next one by one.

14. Discharge of a Contract

It takes place when the parties to the contract fulfil their obligations arising under the contract within the time and in the manner prescribed.



Discharge by performance may be by actual performance or attempted performance.

Actual performance

Actual performance is said to have taken place, when each of the parties has done what they had agreed to do under the agreement.

Attempted performance

When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance.

14. Discharge of a Contract

If the parties to a contract agree to substitute a new contract for it, or to rescind or remit or alter it, the original contract need not be performed.

Discharge by Mutual Agreement

Novation

New
Contract

Remission

Lesser
Consideration

Merger

Inferior to
Superior

Rescission

Contract
Cancellation

Waiver

Renunciation

The methods stipulated under the Indian Contract Act for discharging a contract by mutual consent are as follows.

Novation

The novation means a new contract is entered into in consideration of the old contract. The new contract is entered into between the same parties or the new parties. The novation is valid when all the parties must consent to it. The new contract must be valid and enforceable, otherwise the old contract will continue to be valid.

For example, A owed Rs 100 to B, under contract. B owed Rs. 100 to C. It was agreed among A, B and C that A would pay Rs. 100 to C.

Alteration

An alteration of a contract means change in one or more terms of the contract with the mutual consent of the parties. The alteration discharges the original contract and creates a new contract. However, the parties to the new contract remain the same. In case of alteration of the contract, the old terms and conditions need not to be performed while the new terms and conditions must be performed.

For example, A agreed with B to supply 100 TV sets at a certain price by the end of October. A and B mutually agree that the supply be made by the end of November. This is an alteration in the terms of the contract by consent of both parties.

Rescission

The rescission of a contract means the cancellation of the contract by one or all the parties to contract.

A contract can be rescinded in any of the following ways:

- (a) *By mutual consent*: Parties may enter into a simple agreement to rescind the contract before its breach.
- (b) *By the aggrieved party*: When any of the parties has committed a breach of contract, the aggrieved party can rescind the contract without, in any way, affecting the right to compensation from the breach of contract.
- (c) *By the party whose consent is not free*: In case of a voidable contract, the party whose consent is not free, may rescind the contract, if it so desires.
- (d) *Non-performance till a long time*: Where none of the parties has performed its part for a long time and no other party has objected against it, the contract may be taken as rescinded.

Remission

The remission means the acceptance of a lesser consideration than what is agreed under the contract. It takes place when the promisor:

1. dispenses with a part or whole of the performance of a promise.
2. extends the time for a performance by the promisor.
3. accepts a lesser sum.
4. accepts any other consideration, than agreed in the contract.

A owes B Rs. 5,000. A pays Rs. 2,000 to B and B accepts the amount in satisfaction of the whole debt. The whole debt is discharged.

Note that when a party accepts a lesser sum in satisfaction of a larger sum due under the contract, it is called 'accord and satisfaction' in the English Law. This is a valid contract.

Waiver

It is the deliberate abandonment or giving up of a right which a party is entitled to under a contract, where upon the other party to the contract is released from his obligation.

For example, Anu deliberately gives up her right to charge interest on a late payment, releasing Raj from the obligation to pay it.

Merger

The conversion of the inferior right into superior right is called a merger. It is also called as vesting of rights and liabilities in the same person.

For example, a person holds property under lease, purchases the property. On purchase, his lease agreement is discharged.

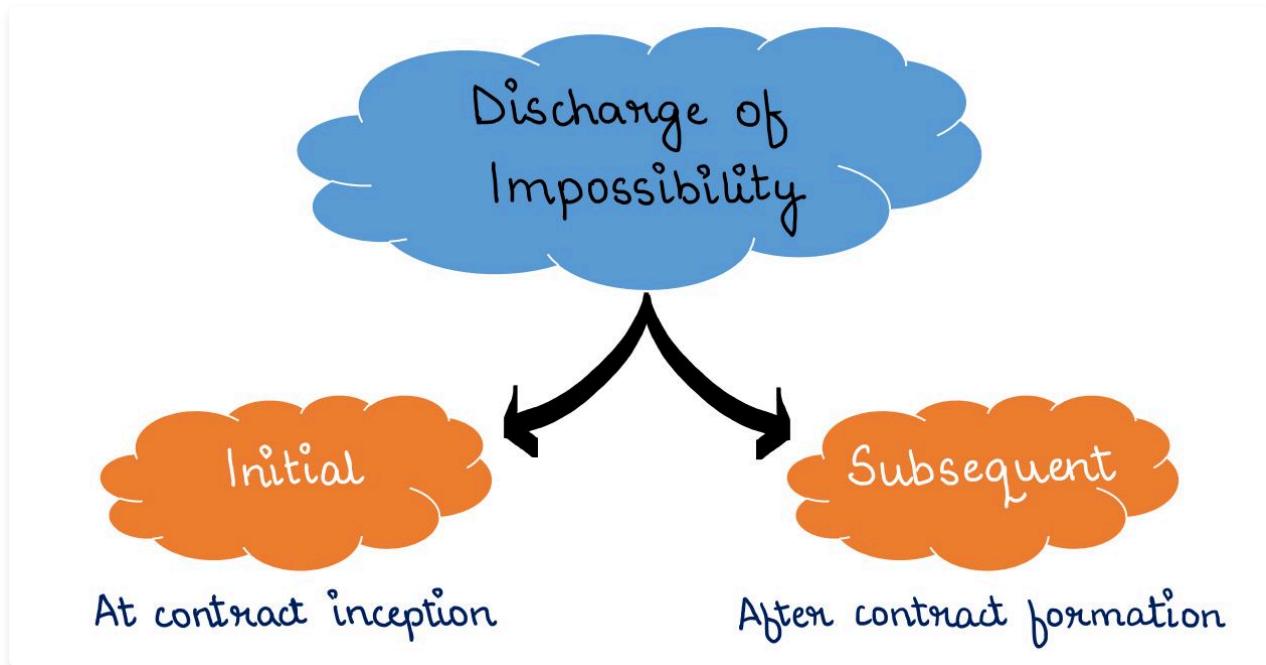
Accord and Satisfaction

The parties agree to accept different performance from what was originally agreed upon.

For example, Hemant owes Rs. 10,000 to ABC Limited. They agree that Hemant will pay Rs. 6,000 instead. Once Hemant pays the Rs. 6,000, it satisfies the new agreement, discharging the original Rs. 10,000 debt.

While both accord and satisfaction and remission involve the discharge of obligations, they differ in their nature and how they are executed. Accord and satisfaction involve an agreement to accept something different with subsequent performance, while remission is typically a unilateral forgiveness of debt without any new agreement or performance required from the debtor.

14. Discharge of a Contract



Sometimes, the performance of a contract is impossible. In such a case, the contract is discharged. The impossibility of performance may be of 2 types, namely (1) the initial impossibility and (2) the subsequent impossibility.

Initial Impossibility or Pre-contractual Impossibility

It means impossibility exists at the time of making a contract. The initial impossibility may be (i) known or (ii) unknown to the parties at the time of making the agreement.

Known Impossibility

It means one or both the parties have a knowledge that a promise is impossible to perform even though they enter into an agreement.

For example, A agrees with B to bring a dead man to life. It is known to the parties at the time of making the agreement that the performance is impossible. The agreement is void ab initio.

Unknown Impossibility

It means both the parties genuinely believe that the performance of a promise is possible but it is impossible to perform. It can also be said here that there is a bilateral mistake of parties.

For example, A agrees to sell certain goods to B, supposed to be on their way from Mumbai to Kolkata in a certain ship. Unknown to both the parties, the ship had already sunk in the deep sea, and the goods ceased to exist at the time of contract. The contract becomes void when the impossibility of performance is discovered.

Supervening Impossibility or Post-contractual Impossibility

The contract becomes void on account of the subsequent impossibility only if the following conditions are satisfied.

1. The act should have become impossible after the formation of the contract.
2. The impossibility should have been caused by a reason of some event which was beyond the control of the promisor.
3. The impossibility must not be the result of some act or negligence of the promisor himself.

For example, A and B contract to marry each other. Before the time fixed for the marriage, A becomes mad. The contract becomes void.

Specific grounds of subsequent impossibilities

It is also known as doctrine of frustration under the English law.

Grounds of subsequent impossibilities

Destruction of Subject-matter

Incapacity or Death

Change in Law

Declaration of War

In the following cases, the contract is discharged on the ground of the supervening impossibility.

1. *Destruction of Subject-matter* - The destruction of the subject matter after a contract is made without the fault of any party discharge the contract. But if the destruction of the subject matter is due to the fault of any party, he is liable for the damage to the other party. For example, A music hall and a garden was let out by A to B for a series of concerts on four different days. The hall was burnt-down before the date of the first concert. Held, the contract became void by the supervening impossibility.

2. *Incapacity or Death* - It is the case of incapacity or death of the promisor and the contract is for personal service or skill. The contracts involving the use of personal skill or ability of the promisor are discharged on the illness, death, or incapacity of the promisor. For example, A piano player agreed to perform a concert on a particular day. She was not able to give her performance due to her illness. Held, the contract was discharged due to her illness.

3. *Change in Law or Circumstances* - Sometimes, certain circumstances arise subsequent to the formation of a contract, which makes the performance of the contract impossible, as contemplated by the parties. In such circumstances, the contract is discharged. For example, A agreed to sell his land to B. Subsequently, the land was acquired by the government. Held, the contract was discharged.

4. *Declaration of War* - The pending contract at the time of declaration of a war is either suspended or declared void. Generally, the contract at the time of the declaration of a war is void, when the government declares it against the public interest or national interest. For example, A contracts to take in a cargo for B at a foreign port. A's government, afterwards, declares a war against the country in which the port is situated. The contract becomes void when war is declared.

Cases where contract is not discharged on the ground of supervening impossibility

In the following cases, the contract is not discharged on the ground of supervening impossibility. Such excuses are not recognized by the law.

Not grounds of subsequent impossibility

Performance becomes difficult

Commercial Impossibility

Impossibility due to default of 3rd party

Strikes, Riots or Civil disturbances

Self-induced impossibility

Failure of Object

1. *Performance Becomes Difficult* - When the performance of the contract becomes difficult, the contract is not discharged. Difficulty is not impossibility. A party can perform it with more effort or hardship.

2. *Commercial Impossibility* - The party is not discharged from the performance on the ground that it will be non-profitable for him to perform the contract. For example, A agreed to sell to B, dhotis manufactured in a particular mill. The mill got into repairs and so, dhotis did not manufacture. Held, the contract was not frustrated as the stipulation as to delivery did not make the delivery by the mills, a condition precedent. It was a breach of the contract.

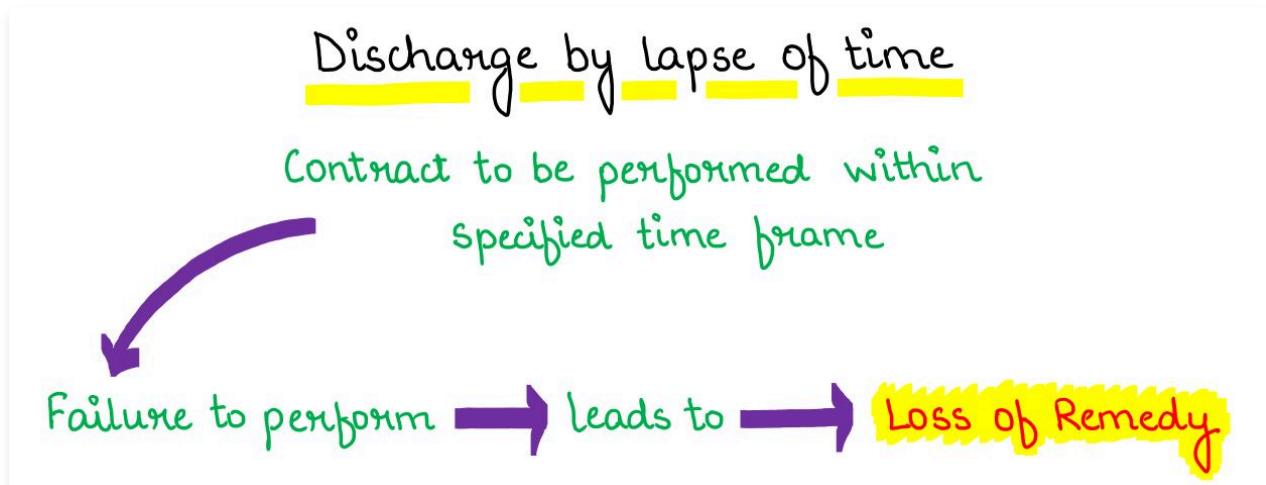
3. *Impossibility Due to the Conduct of Third Party* - If a promisor could not perform the promise because of default of the third party, he cannot make an excuse and claims that it is impossible to perform the promise. The third party's fault or conduct has nothing to do with the contract. The contract is not discharged because of third party's default. For example, A agreed with B to supply certain cloth manufactured by a specified mill. The terms of the agreement stipulated that A could supply goods as soon as they are supplied to him by the mill. The mill failed to supply the goods to A. Held, A was liable to supply as the terms only indicated the process of delivery.

4. *Strikes, Riots or Civil Disturbances* - Strikes, riots, or civil disturbances do not discharge the contract. When such an event takes place, the performance of a promise under the contract becomes impossible for the time being. Once a strike is called off or life becomes normal, it is possible to perform the promise. For example, A agreed to supply certain goods to B which were to be imported from Algeria. The goods could not be imported due to the riots and civil disturbances in that country. Held, A cannot be excused for the non-performance of the contract.

5. *Self-induced impossibility* - If the performance of the contract becomes impossible due to the act of the omission of a party, it is called self-induced impossibility. In such cases, the contract is not discharged.

6. *Failure of Object* - The failure of one of the object out of many objects, do not discharge the contract. But if all the objects of the contract fail, the contract becomes discharged.

14. Discharge of a Contract



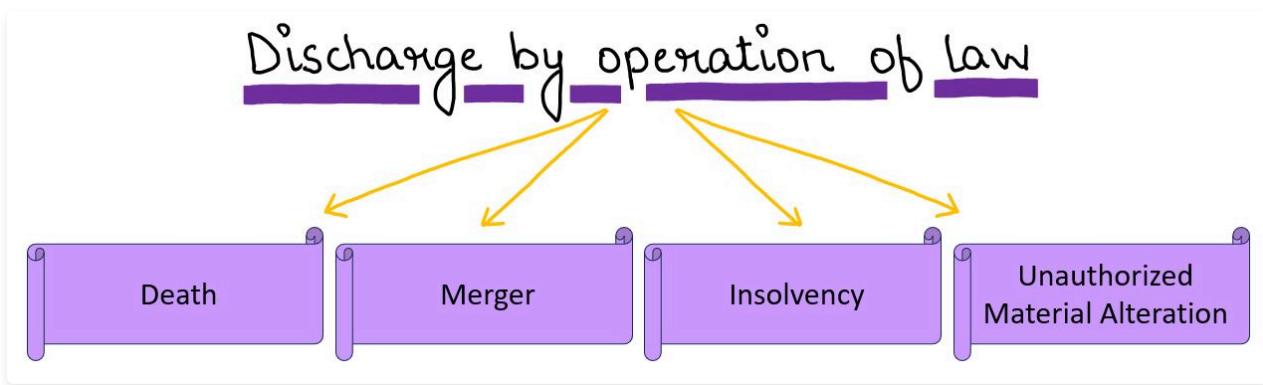
A contract should be performed within a specified period as prescribed by the Limitation Act, 1963. If it is not performed and if no action is taken by the promisee within the specified period of limitation, he is deprived of remedy at law.

Note that the Limitation Act, 1963 has prescribed different periods for different contracts, e.g. period of limitation for exercising a right to recover a debt is 3 years.

For example, Raj takes a loan from Arjun and agrees to make monthly payments for the next five years. However, he fails to make any payments. Despite Arjun reaching out to him multiple times, he becomes busy and takes no further action. Three years later, Arjun decides to seek legal help to recover his money. Unfortunately, the court rejects his case as he has surpassed the three-year time limit for debt recovery.

14. Discharge of a Contract

A contract may be discharged by operation of law such as by death of the promisor, by insolvency etc.



In the following circumstances, the contract is discharged by the operation of law.

Death

The contract that requires personal skill is discharged on the death of the promisors. However, any benefit received before the performance shall be returned by the legal representative of the deceased party.

Merger

The conversion of the inferior right into superior right is called as merger. It is also called as vesting of rights and liabilities in the same person.

Insolvency

The insolvent is discharged from all the liabilities on all the contracts, entered into, up to the date of insolvency.

Unauthorized Material Alteration

The alteration which changes the nature of the contract is material alteration. If one party makes any material alteration in the terms of the contract without the approval of the other party, the contract comes to an end.

14. Discharge of a Contract

Breach of contract means the failure of a party to fulfill his obligation or promise under the contract. When there is a breach of contract, certain remedy or consequences are available to the aggrieved party.

The aggrieved party means a party who is not at fault.

The aggrieved party is not required to perform his part of the promise in case of breach of contract by the other party.

The breach of contract is of the following 2 types.

1. Actual breach
2. Anticipatory breach

Actual Breach of Contract

An actual breach of contract means any party to contract refuses or fails to perform his promise on the due date of performance, or during the performance. The actual breach of contract may take place expressly or impliedly.

Examples

A agreed with B to sell 500 TV sets on 21 January. A refuses to deliver the TV sets on the due date. This is a breach of contract on the due date.

A agreed with B to supply 3000 computers at a certain price to be delivered in three installments of 1000 each. After 2000 computers had been supplied, B informs A to deliver no more. This is the actual breach of contract during the performance by express refusing, and A can claim damages for the breach.

Following are the consequences of the actual breach of contract.

(i) If time is the essence of the contract

- (a) The contract is voidable at the option of the aggrieved party.
- (b) The aggrieved party can claim the compensation for the loss for non-performance.
- (c) The aggrieved party cannot claim compensation when he accepts delayed performance.

(ii) If time is not the essence of the contract

If time is not the essence, the contract is not voidable but the aggrieved party can claim compensation for any loss caused for non-performance.

Anticipatory Breach of Contract

When any party declares his intention of not performing the contract before the performance is due. it is called as anticipatory breach of contract.

Example

A agrees with B to sell his car on 21 January. Before this date, he informs B that he will not sell it. This is an anticipatory breach of contract.

Modes of anticipatory breach

There are 2 modes of anticipatory breach:

- (a) express repudiation and
- (b) implied repudiation.

The express repudiation means when the party refuses expressly to perform his obligation before the performance due. The implied repudiation means the party acts in such manner that it becomes impossible for him to fulfill his obligation under the contract. In the case of implied repudiation, the party does some thing which indicates his unwillingness to perform the contract.

Consequences of anticipatory breach

Following are the consequence of anticipatory breach.

1. The aggrieved party may treat the contract as alive.
2. The aggrieved party can rescind the contract and claim damages.

Here, the damage will be equal to the difference between the contract price and the price as on the date of communication.

Note that when a contract becomes void, any benefit received under such contract is bound to restore such benefit or to make compensation for such benefit to the person from whom he received it.

15. Breach of contract

Breach of contract occurs, if any party -

Refuses, or

①

Fails to perform his part of the contract

②

By his act

③

Makes it impossible to perform his obligation

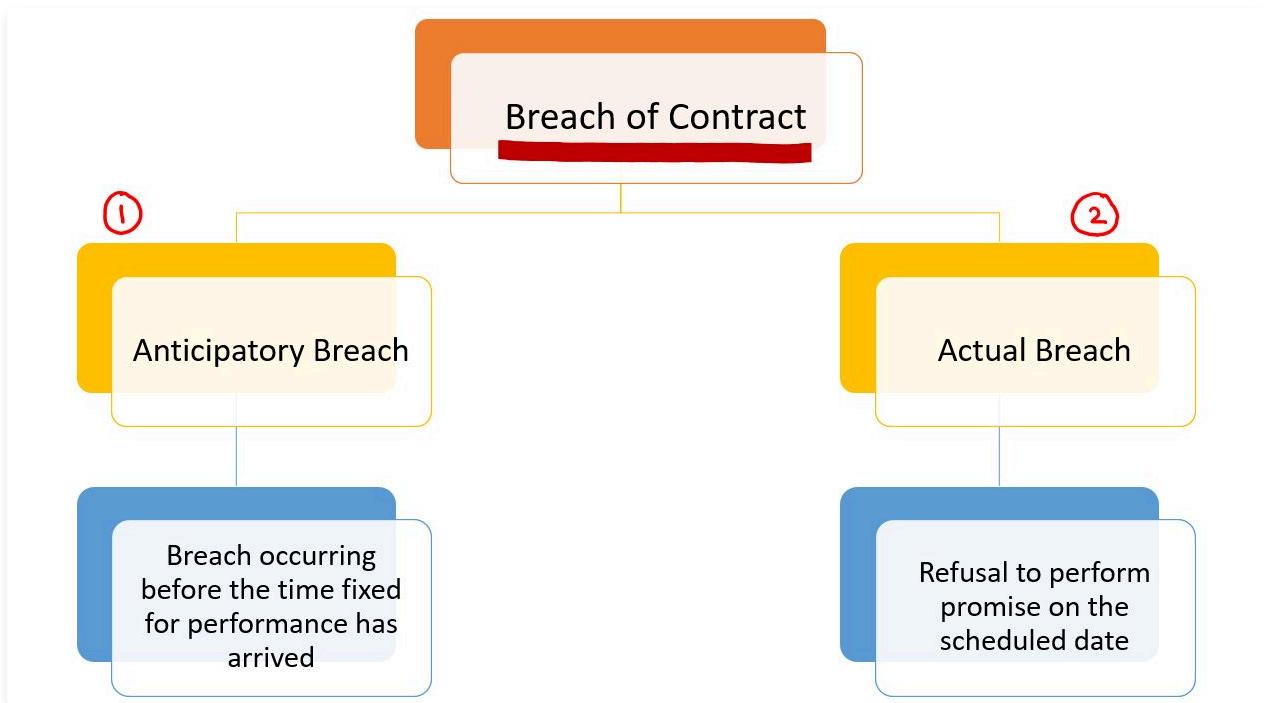
④

Contract can also be discharged by not performing it. Breach of contract means refusal of performance on the part of parties. When a party to a contract refuses to perform it, or does not perform it or makes himself unable to perform it, other party may put such contract to an end.

In other words, when a party does not fulfill his promise or refuse to perform it, breach of contract takes place. In that contract, the suffering party is technically known as aggrieved party. Such aggrieved party is relieved from performing his obligation, and gets a right to proceed against the party at fault.

15. Breach of contract

Breach of contract may arise in two ways, i.e., actual or anticipatory.



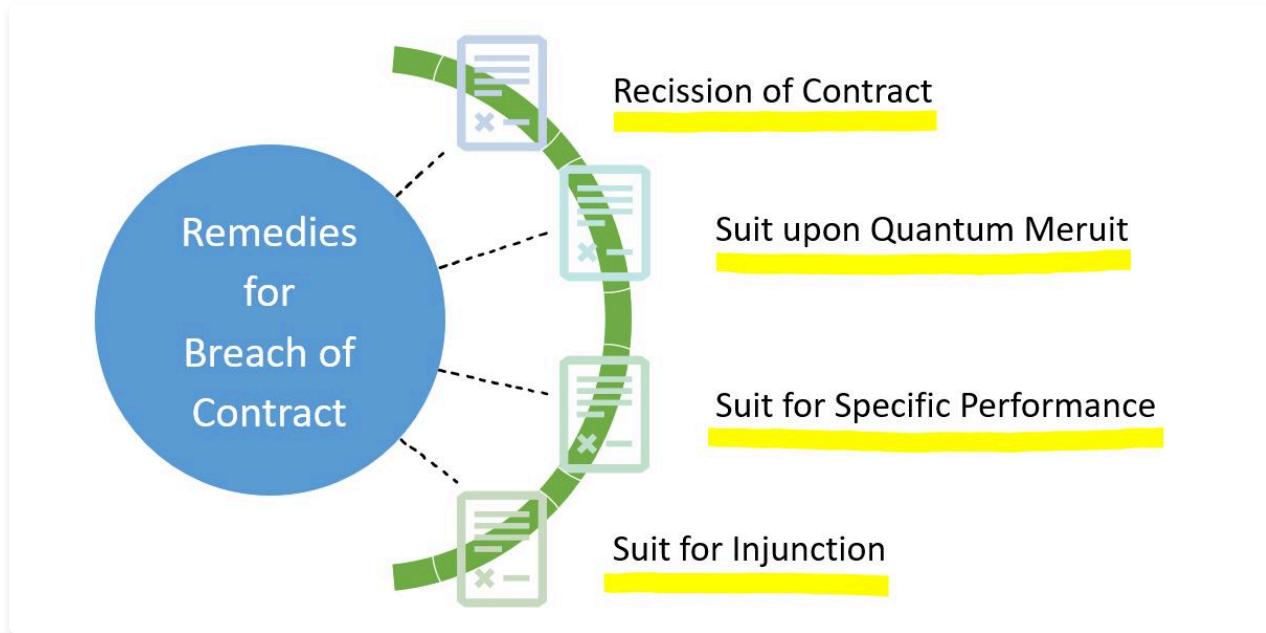
(i) Actual breach of contract

When one of the parties breaks the contract by refusing to perform his promise on the scheduled date, he is said to have committed actual breach of contract. Actual breach of contract may be committed (a) at the time when the performance of the contract is due or (b) during the performance of the contract.

(ii) Anticipatory breach of contract

An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called anticipatory breach. Anticipatory breach of a contract may be expressed or implied. In anticipatory breach, the promisee is excused from performance or from further performance. Further, he gets an option to either treat the contract as "rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance; or, he may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance".

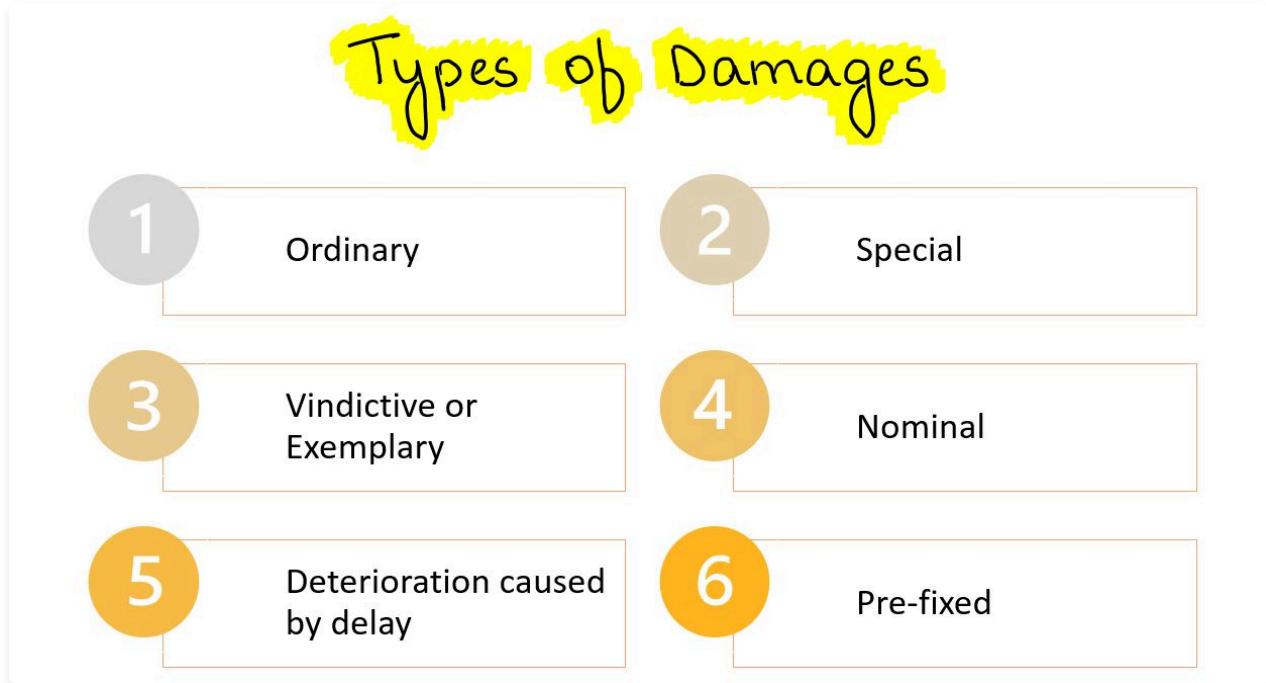
15. Breach of contract



Following remedies are available to the suffering party in case of breach of Contract.

1. Suit for Damages

The injured party is entitled to recover compensation for the loss suffered by it due to the breach of contract, from the party who causes the breach.



The following types of damages can be awarded to the suffering party.

Ordinary Damages

When there is a breach, the suffering party is entitled to receive, from the other party, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Special Damages

Where a party to a contract receives a notice of special circumstances affecting the contract, he will be liable not only for damages arising naturally and directly from the breach but also for special damages.

Vindictive or Exemplary Damages

These damages may be awarded only in 2 cases:

- (a) for breach of promise to marry, because it causes injury to a person's feelings; and
- (b) for wrongful dishonour by a banker of his customer's cheque, because in this case, the injury due to wrongful dishonour to the drawer of cheque is so heavy that it causes loss of credit and reputation to him.

Nominal Damages

Nominal damages are awarded where the plaintiff has proved that there has been a breach of contract but he has not suffered any real damage. It is awarded just to establish the right to decree for the breach of contract. The amount may be a rupee or even 10 paise.

Damages for deterioration caused by delay

In the case of deterioration caused to goods by delay, damages can be recovered from carrier even without notice. The word 'deterioration' not only implies physical damages to the goods, but it may also mean loss of special opportunity for sale.

Pre-fixed damages

When parties to contract stipulate at the time of its formation that on a breach of contract by any of them, a certain amount will be payable as damage. It may amount to either liquidated damages (i.e., a reasonable estimate of the likely loss in case of breach) or a penalty (i.e., an amount arbitrarily fixed as the damages payable).

2. Rescission of Contract

When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case, he is absolved of all his obligations under the contract and is entitled to compensation for any damages that he might have suffered.

3. Suit for Specific Performance

Where damages are not an adequate remedy in the case of breach of contract, the court may in its discretion on a suit for specific performance direct party in breach, to carry out his promise according to the terms of the contract.

4. Suit for Injunction

Where a party to a contract is negating the terms of a contract, the court may by issuing an 'injunction order', restrain him from doing what he promised not to do. For example, where, a film star, agreed to act exclusively for a particular producer, for one year, however, during the year, the film star contracted to act for some other producer. Therefore, the film star could be restrained by an injunction.

5. Suit upon Quantum Meruit

'Quantum Meruit' means as much as the party doing the service has deserved. It covers a case where the party injured by the breach had done part but not all of the work which he is bound to do under the contract and seeks to be compensated for the value of the work done. The object of allowing a claim on quantum meruit is to recompensate the party or person for value of work which he has done.

16. Quasi Contracts

Quasi-Contract

An obligation imposed by law to prevent unjust enrichment.

A valid contract must contain certain essential elements, such as offer and acceptance, capacity to contract, consideration and free consent. But sometimes, the law implies a promise imposing obligations on one party and conferring right in favour of the other, even when essential elements of a valid contract are not present and in fact, there is neither agreement nor promise. Such cases are not contracts in the strict sense, but the Court recognises them as relations resembling those of contracts and enforces them as if they were contracts. Such contracts are known as 'Quasi Contracts' (i.e. resembling a contract).

Features of a Quasi-Contract

Imposed by law

Obligation is a duty
and not the promise
of a duty

The right is always a
right to money

Right is available
against specific
person

Suit for breach may
be filed same as of a
complete contract

Quasi contracts create same obligations as in the case of regular contracts. Quasi contracts are based on principles of equity, justice and good conscience.

A quasi or constructive contract rests upon the maxims, "No man must grow rich out of another person's loss" or "one party must not be unduly enriched at the loss of other party".

Examples of Quasi Contracts

Quasi Contracts are exemplified below.

1. A tradesman, leaves goods at X's house by mistake. X treats the goods as his own. X is bound to pay for the goods.
2. A pays some money to B by mistake. It is really due to C. B must refund the money to A.
3. A chocolate parcel is delivered under a mistake to R who consumes the chocolates thinking them as a birthday present. R must return the parcel or pay for the chocolates. Although, there is no agreement between R and the true owner, yet he is bound to pay, as the law regards it as a Quasi-contract.
4. A supplies B, a lunatic, or a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property, as although, minor or lunatic is incapable of entering into a contract, yet A is entitled for reimbursement, because this is the case of deemed quasi-contract.
5. A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. For example, where house property tax is paid by tenant on behalf of owner of the house property; the owner is bound to reimburse the expenses borne by tenant on account of property tax.

6. A person who finds goods belonging to another (finder of lost goods) and takes them into his custody is subject to same responsibility as if he were a 'bailee'. Thus, a finder of lost goods has (i) to take proper care of the property as man of ordinary prudence would take; (ii) no right to appropriate the goods and (iii) to restore the goods if the owner is found.

7. A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it.

1. Introduction

The Indian Contract Act, 1872 lays down the general principles relating to the formation and enforceability of contracts; rules governing the provisions of an agreement and offer; the various types of contracts including special contracts such as contract of indemnity and guarantee, bailment and pledge and contract of agency.



Following special contracts are dealt with next one by one.

1. Contract of Indemnity
2. Contract of Gurantee
3. Contract of Bailment
4. Contract of Pledge
5. Contract of Agency.

2. Contract of Indemnity

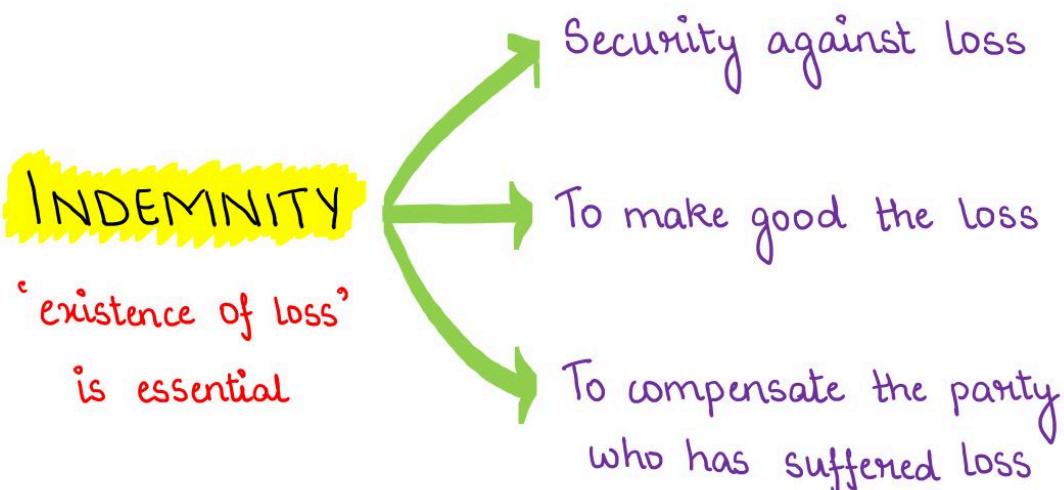
Contract of Indemnity and Guarantee are the specific types of contracts provided under Sections 124 to 147 of the Indian Contract Act, 1872. The general principles of contracts are also applicable to such contracts.

Contract of Indemnity

One party promises to compensate the other for any loss that may occur.

The term "Indemnity" literally means "security against loss" or "to make good the loss" or "to compensate the party who has suffered some loss".

According to Section 124 of the Indian Contract Act, 1872, 'Contract of Indemnity' is a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person. A contract of indemnity is like any other contract and must fulfil all the essentials of a valid contract.



Parties in the Contract of Indemnity

Parties to Contract of Indemnity

Indemnifier

Who promises to save
the other party
from loss

Indemnified

Who is promised
to be saved
against loss

There are 2 parties in this form of contract.

- The party who promises to indemnify/ save the other party from loss is called 'indemnifier';
- The party who is promised to be saved against the loss is called 'indemnified' or 'indemnity holder'.

For example, A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of Rs. 2,000. This is a contract of indemnity. A is an indemnifier or a promisor while B is an indemnity holder or a promisee.

2. Contract of Indemnity

A contract of indemnity like any other contract may be express or implied.

Modes of Contract of Indemnity

EXPRESS

When a person expressly promises to compensate

IMPLIED

When it is to be inferred from the conduct of the parties or from the circumstances of the case

(a) A contract of indemnity is **said to be express** when a person expressly promises to compensate the other from loss.

(b) A contract of indemnity is **said to be implied** when it is to be inferred from the conduct of the parties or from the circumstances of the case.

2. Contract of Indemnity

Rights of Indemnity holder
when sued

①

All Damages

②

All Costs

③

All sums

In a contract of indemnity, the promisee i.e., indemnity-holder acting within the scope of his authority is entitled to recover from the promisor (i.e., indemnifier the following rights):

- (a) all damages which he may be compelled to pay in any suit,
- (b) all costs which he may have been compelled to pay in bringing/ defending the suit and
- (c) all sums which he may have paid under the terms of any compromise of suit.

The indemnity holder/ indemnified has also other rights besides those mentioned above. If he has incurred an absolute liability, he is entitled to call upon his indemnifier to save him from the liability and to pay it off. It is also important to note that the Indian Contract Act is silent about the rights which the indemnifier has on carrying out his promise to indemnify. But, they are similar to the rights of a 'surety' under Contract of Guarantee.

Further, the liability of an indemnifier commences as soon as the liability of the indemnity-holder becomes absolute and certain.

3. Contract of Guarantee

A contract of guarantee is a contract to perform the promise made or discharge the liability of a third person in case of his default.

Contract of Guarantee

An agreement where one party agrees to be responsible for the debt or obligation of another party if that party fails to fulfill its obligation.

Parties in a Contract of Guarantee

There are 3 parties involved in a contract of guarantee.

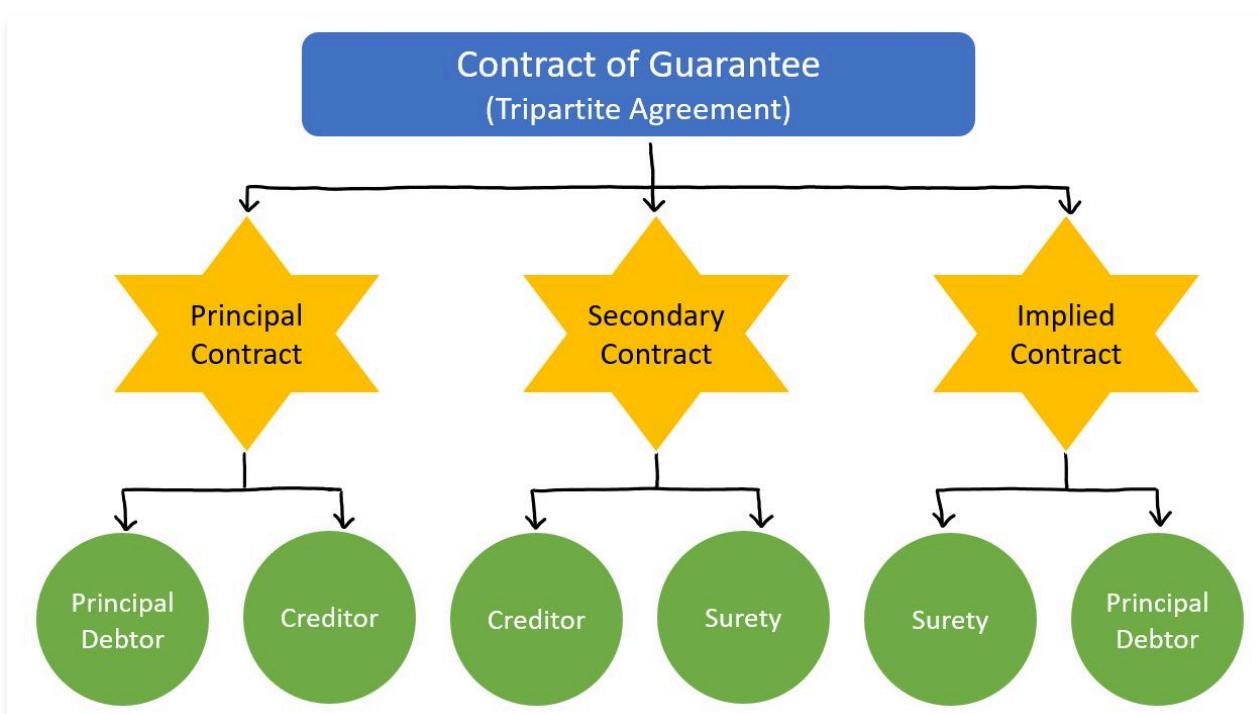
- (a) *Surety*: the person who gives the guarantee;
- (b) *Principal Debtor*: the person in respect of whose default the guarantee is given;
- (c) *Creditor*: the person to whom the guarantee is given.

For example, when A requests B to lend Rs. 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C failing to do so, he (i.e., A) will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C, the principal debtor and A, the surety.

Modes of Guarantee

Any guarantee given may be oral or written. The contract of guarantee may be express or implied, and may even be inferred from the course of conduct of the parties concerned.

A contract of guarantee is a tripartite agreement between principal debtor, creditor and surety.



Thus, there are, in effect 3 contracts:

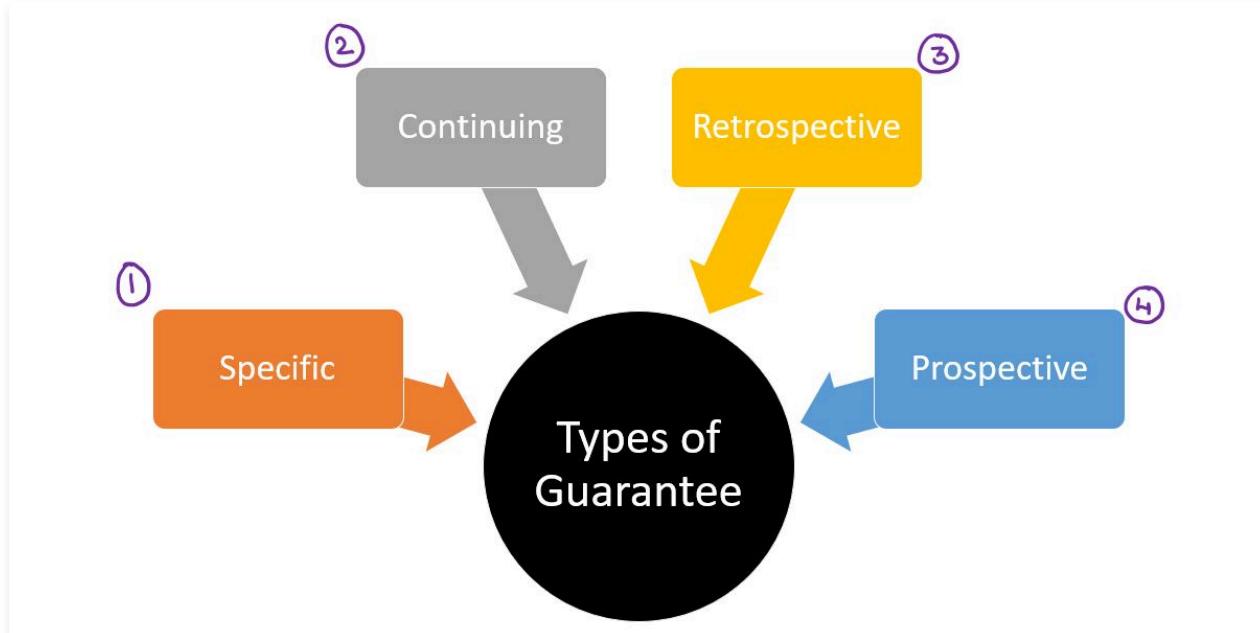
- (i) a *principal contract* between the principal debtor and the creditor.
- (ii) a *secondary contract* between the creditor and the surety.

(iii) an *implied contract* between the surety and the principal debtor, whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

3. Contract of Guarantee

Guarantee can be classified as follows.



1. Specific Guarantee

A guarantee which extends to a single debt/ specific transaction is called a specific guarantee. The surety's liability comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

2. Continuing Guarantee

A guarantee which extends to a series of transaction is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee. However, a surety is liable for previous transactions. The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

3. Retrospective Guarantee

A guarantee given for an existing debt or obligation is called the retrospective guarantee.

4. Prospective Guarantee

A guarantee for a future debt or obligation is called the prospective guarantee.

3. Contract of Guarantee

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

The term "co-extensive with that of principal debtor" means that the surety is liable for what the principal debtor is liable. However, the liability of the surety may be made less than that of the principal debtor by an express contract to that effect.

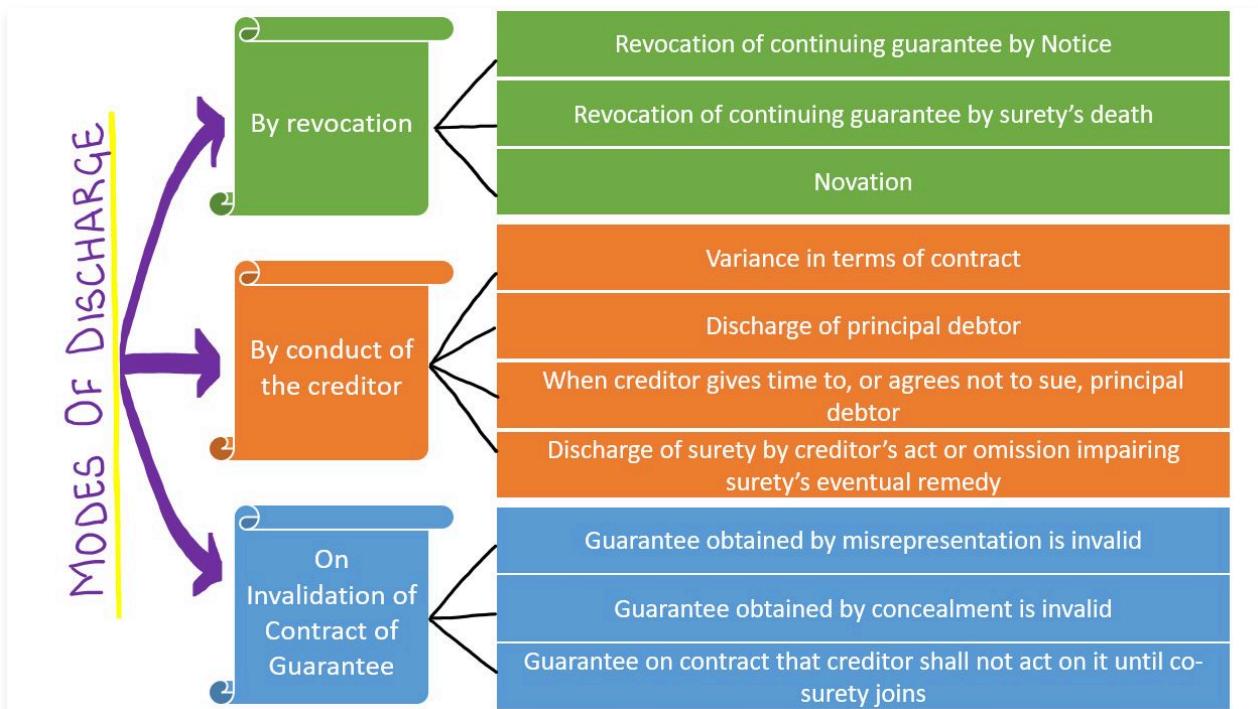
Note that liability of principal debtor is primary.

Following points are noteworthy, in this respect:

- (a) Liability of surety is **secondary** in nature, as he is liable only on default of principal debtor.
 - (b) His liability is **conditional**, that is, it arises immediately on the default by the principal debtor.
 - (c) The liability of the surety is **co-extensive** with that of the principal debtor, which means the surety is liable for all the debts, payable by the principal debtor to the creditor. Accordingly, the interest, damages and costs which may be recovered from the principal debtor may also be recovered from the surety. However, the contract of guarantee may provide otherwise, i.e., the surety has a right to limit his liability.
 - (c) The **creditor has a right to sue the surety directly** without first proceeding against principal debtor. However, note that, until the default, the creditor cannot call upon the surety to pay.
-

3. Contract of Guarantee

A surety is said to be discharged, when his liability as surety comes to an end.



The various modes of discharge of surety are discussed below.

1. By revocation of the contract of guarantee

The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. A specific guarantee can be revoked only if liability to principal debtor has not accrued.

In addition, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.

2. By the conduct of the creditor

Where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance. The surety is also discharged, if the creditor enters into a fresh contract with principal debtor, or creditor does any act or omission, the legal consequence of which is the discharge of the principal debtor.

For example, A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantee's A performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

Note that the surety is also discharged, when creditor makes composition with, gives time to, or agrees not to sue, principal debtor.

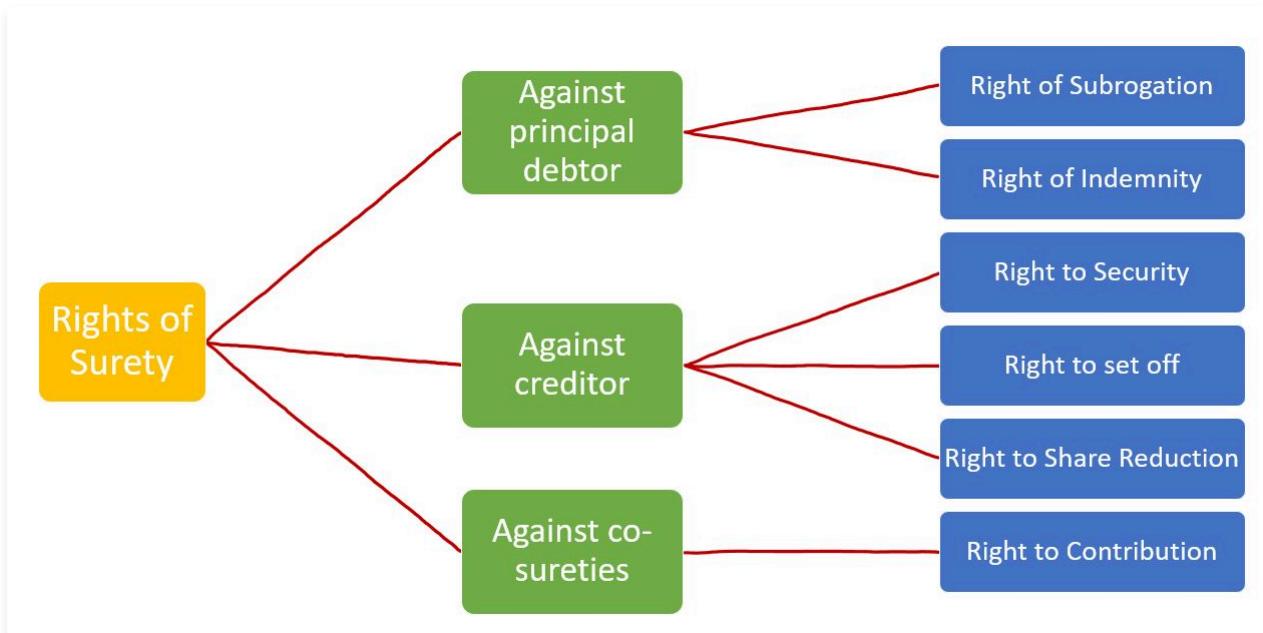
3. By the invalidation of the contract of guarantee

In following cases, the contract of guarantee gets invalidated:

- Guarantee obtained by misrepresentation made by the creditor; or
- Guarantee obtained by concealment of material circumstances by the creditor; or
- Guarantee on contract that creditor shall not act on it until co-surety joins, such a guarantee is not valid if that co-surety does not join.

3. Contract of Guarantee

The surety enjoys the following rights.



1. Rights against the Principal Debtor

Right of subrogation, which means, on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.

Right of indemnity, which means in every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety. The surety is entitled to recover from the principal debtor.

2. Rights against the Creditor

Right to benefit of security, which means, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Right to set-off, which means, if the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of set off, if any, that the principal debtor had against the creditor.

Right to reduction, which means, that the surety has right to claim proportionate reduction in his liability, if the principal debtor becomes insolvent.

3. Rights against co-sureties

Co-sureties are liable to **contribute equally**. The principle of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

3. Contract of Guarantee

The difference between Contract of Indemnity and Contract of Guarantee is given below.

Basis	Contract of Indemnity	Contract of Guarantee
Number of Parties	There are only two parties, namely, the indemnifier (promisor) and the indemnified (promisee).	There are three parties: creditor, principal debtor and surety.
Nature of Liability	The liability of the indemnifier is primary and unconditional.	The liability of the surety is secondary and conditional, as the primary liability is that of the principal debtor.
Time of Liability	The liability of the indemnifier arises only on the happening of a contingency.	The liability of surety arises only on the non-performance of an existing promise or non-payment of an existing debt.
Time to Act	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Right to sue third party	Indemnifier cannot sue a third party for loss in his own name, as there is no privity of contract*. Such a right would arise only, if there is an assignment in his favour.	Surety can proceed against principal debtor in his own right because he gets all the rights of a creditor after discharging the debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to Contract	All parties must be competent to contract.	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

*The term 'privity of contract' means a contract cannot confer rights or impose obligations upon any person who is not a party to the contract.

4. Contract of Bailment

As per Section 148 of the Act, bailment is the delivery of goods by one person to another for some purpose, upon a contract, that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

Bailment

Delivery of goods by one person to another for some specific purpose.

For example, X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is a contract for bailment.

Parties to the Contract of Bailment

Parties of Bailment

Bailor

- The person delivering the goods

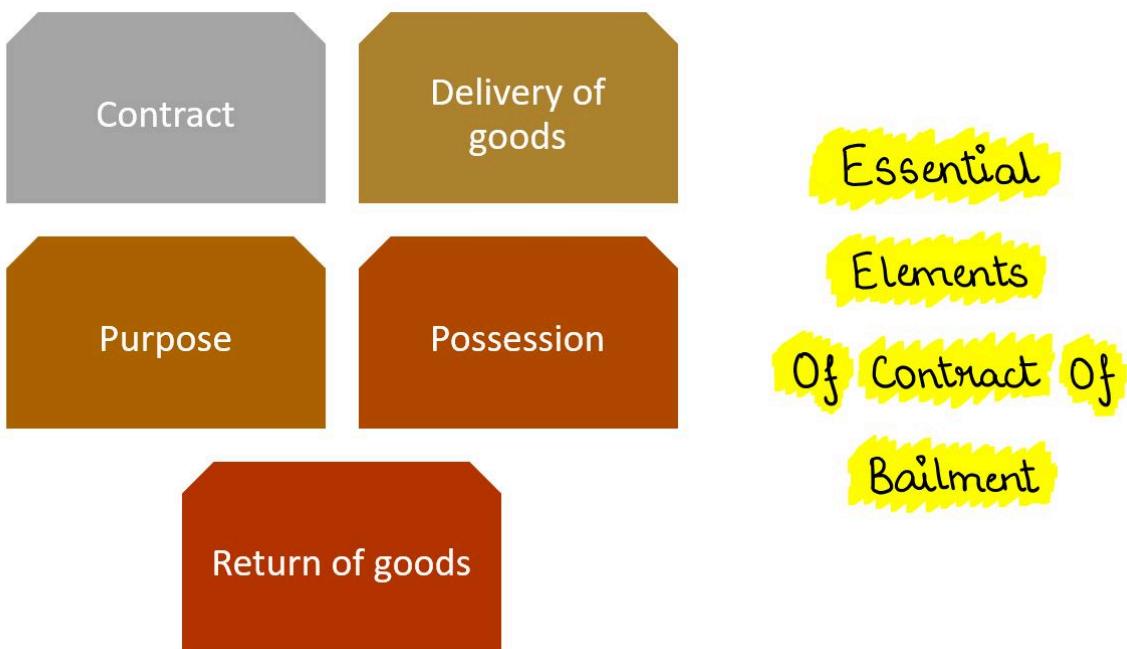
Bailee

- The person to whom the goods are delivered

There are 2 parties involved in a Contract of Bailment.

- (a) *Bailor*: The person delivering the goods.
- (b) *Bailee*: The person to whom the goods are delivered.

4. Contract of Bailment



Following are the essential elements of Contract of Bailment.

1. Bailment is based upon a contract. The contract may be express or implied. No consideration is necessary to create a valid contract of bailment.
2. Bailment is only for moveable goods and never for immovable goods or money.
3. Delivery of goods may be actual or constructive. Actual delivery means handing over physical possession of goods, whereas constructive delivery implies doing of any act which has the effect of putting goods in the possession of the bailee or his authorized representative.
4. The goods are delivered for some purpose. The purpose may be express or implied.
5. In bailment, possession of goods changes. The change of possession does not lead to change in ownership.
6. Bailee is obliged to return the goods physically to the bailor. The goods should be returned in the same form as given or may be altered as per bailor's direction.

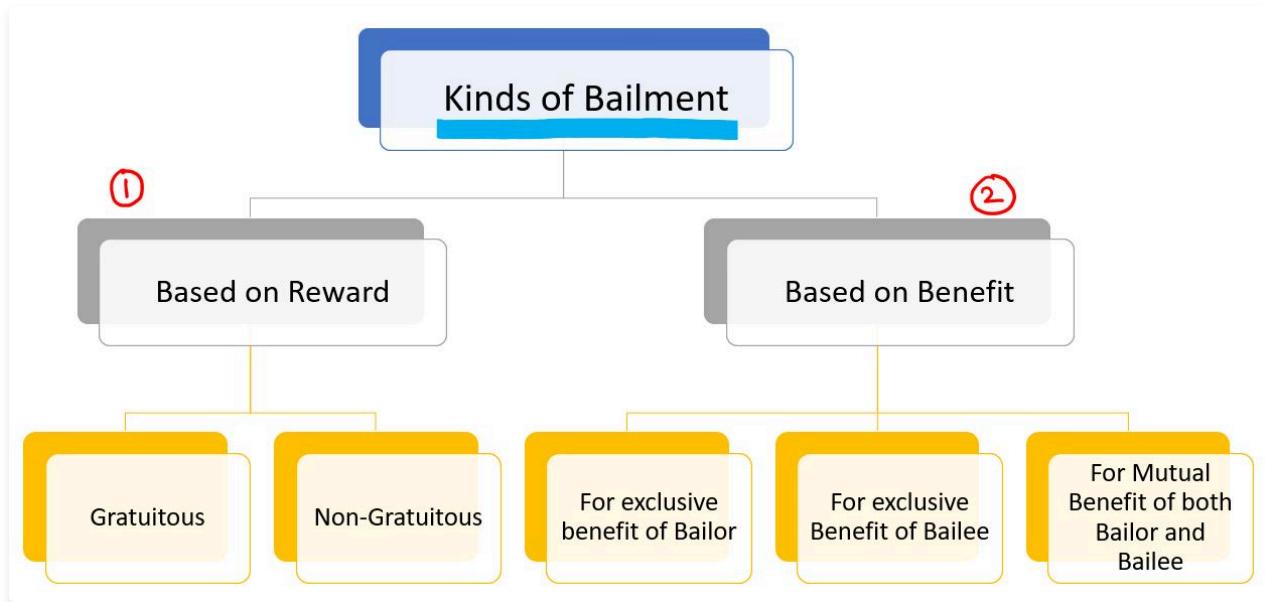
Key takeaways

Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank.

4. Contract of Bailment

Bailment can be classified on the basis of reward and on the basis of benefit.



On the basis of Reward

The bailment on the basis of Reward may be classified as follows.

1. Gratuitous Bailment

It is the bailment of goods without any charges or reward. The bailee is not required to pay any charges for the bailment.

2. Non-gratuitous Bailment

It is the bailment for some charges or reward. The bailee is required to pay some charges to the bailor.

On the basis of Benefit

The bailment on the basis of benefit may be classified as follows.

1. For the Exclusive Benefit of a Bailor

It is the bailment in which the goods are delivered by the bailor to the bailee only for the exclusive benefit of the bailor himself.

2. For the Exclusive Benefit of a Bailee

It is the bailment in which the goods are delivered by the bailor to the bailee only for the exclusive benefit of the bailee.

3. For Mutual Benefit of Both Bailor and Bailee

It is the bailment in which the goods are delivered by the bailor to the bailee for the benefit of both the parties.

4. Contract of Bailment

Rights and Duties of Bailor and Bailee are given below.

Duties of Bailor

Following are the duties of Bailor under the contract of bailment.

1. To disclose faults in goods bailed to the bailee.
2. It is the duty of the bailor to pay any extraordinary expenses incurred by the bailee. For example, if a horse is lent for a journey, the expense of feeding the horse would, of course, be borne by the bailee. If, however, the horse becomes ill and expenses have been incurred on its treatment, the bailor shall have to pay these expenses.
3. To compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received, where bailor had lent the goods gratuitously and decides to terminate the bailment before the expiry of the period of bailment.
4. To indemnify for any loss which the bailee may sustain by reason of bailor's defective title to goods.
5. To receive back the goods when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished.

Duties of Bailee

Following are the duties of Bailee under the contract of bailment.

1. To take reasonable care of the goods bailed.
2. Not to make any unauthorized use of goods.
3. Not to mix bailor's goods with his own goods.
4. To return the goods according to the bailor's directions, as soon as the time for which they were bailed, has expired, or the purpose for which they were bailed has been accomplished.
5. To return any extra profit accruing from goods bailed.

Rights of Bailor

Following are the rights of Bailor.

1. To terminate the bailment, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.
2. To demand back the goods anytime (in case of gratuitous bailment); however, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.
3. To file a suit for enforcement of duties imposed upon a bailee.
4. To claim compensation, in case of damage caused to the goods due to unauthorized use or mixing of bailed goods by the bailee.

Rights of Bailee

Following are the rights of Bailee.

1. To deliver the goods to any one of the joint bailors, in case of joint ownership of goods bailed.
2. To be indemnified by the bailor for any loss arising to bailee by reasons of bailor's defective title to goods.
3. To claim compensation in case of faulty goods.
4. To get reimbursement (from the bailor) of necessary expenses incurred by the bailee for the purpose of bailment, in case of gratuitous bailment.
5. Right of particular lien for payment of services, i.e., right to retain such goods until bailee receives due remuneration for the services he has rendered in respect of them. Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc., are entitled to particular lien.
6. Right of general lien, which implies that bankers, factors, wharfingers, policy brokers and attorneys of a High Court (and no other person) may retain any goods bailed to them, as a security for a general balance of account. For example, a banker enjoys the right of a general lien on cash, cheques, bill of exchange and securities deposited with him for any amounts due to him. However, the goods cannot be sold but can only be retained for dues, under right of general lien.

In addition to above rights, where a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case, if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

4. Contract of Bailment

Termination
Of
Bailment

1.

Expiry of fixed period

2.

Fulfillment of the purpose

3.

Death of Bailor or Bailee

4.

Inconsistent use of goods

5.

Destruction of the subject matter

A contract of bailment shall terminate in the following circumstances:

- on expiry of stipulated period
- on fulfillment of purpose of bailment
- on unauthorized use of goods by the bailee
- on death of bailor or bailee
- on destruction or modification of subject matter of the bailment (which makes it impossible to be used for the purpose of bailment)
- on termination of gratuitous bailment by bailor.

4. Contract of Bailment



A person who finds some goods which do not belong to him, is called the finder of goods. Finder of the lost goods is in a position of a bailee, and therefore, all the duties of the bailee are equally applicable to the finder of goods.

It is the duty of the finder of goods (as a bailee) to find the true owner and surrender the goods to him. However, the finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him in finding the owner and preserving the goods found.

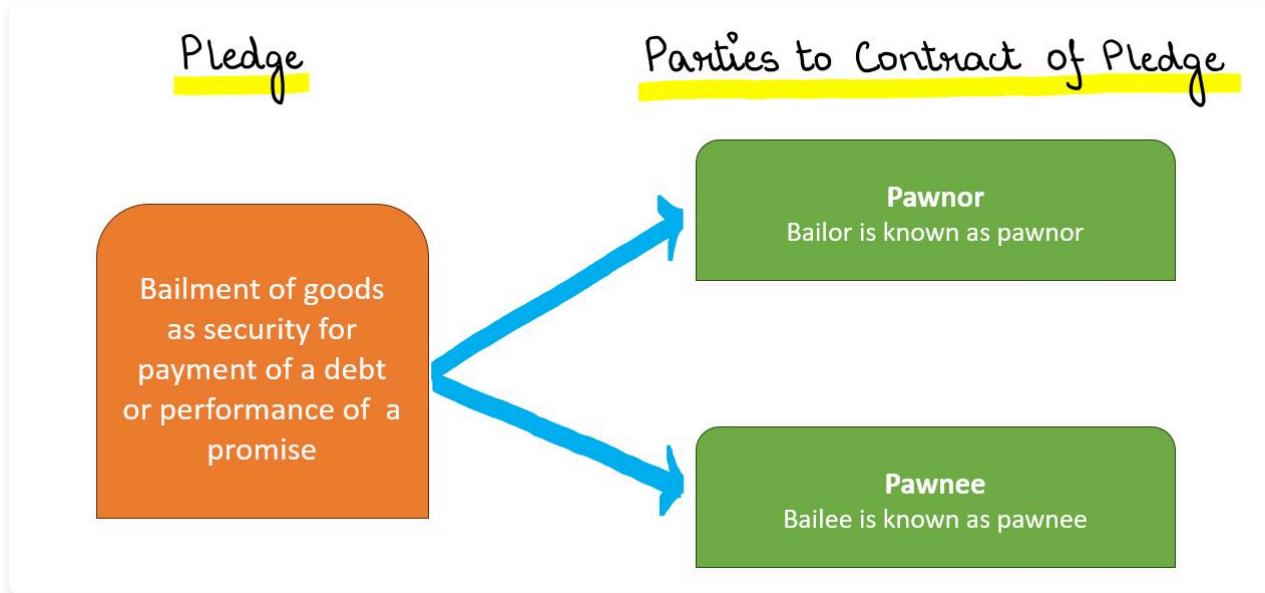
But, he has a right to retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward on the lost goods, the finder may sue the owner for such reward, and may retain the goods until then.

Does finder of lost goods has right to sell goods found

The finder, though has no right to sell the goods found in the normal course, however, he may sell the goods, if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

- (a) when the article is in danger of perishing and losing the greater part of the value or
 - (b) when the lawful charges of the finder amounts to 2/3rd or more of the value of the article found.
-

5. Contract of Pledge



Sections 172 to 179 of the Indian Contract Act, 1872 deals with the contract of pledge. Pledge is a variety or species of bailment. It is bailment of goods as a security for payment of debt or performance of a promise.

Parties to the Contract of Pledge

- (a) *Pledger or Pawnor* - The person who pledges (or bails) is known as pledger or pawnor.
- (b) *Pledgee or pawnee* - The person to whom the goods are delivered is known as pledgee or pawnee.

In pledge, there is no change in ownership of the property. For example, A lends money to B against the security of jewellery deposited by B with him. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor/ pledger and A is a pawnee/ pledgee.

Under exceptional circumstances, the pledgee has a right to sell the property pledged.

5. Contract of Pledge

Since pledge is a special kind of bailment, therefore all the essentials of bailment are also the essentials of pledge.

Apart from that, the other essentials of pledge are as follows.

1. There shall be bailment for security against payment or performance of promise.
2. The subject matter of pledge is 'goods'.
3. The goods pledged for shall be in existence.
4. There shall be the delivery of goods from pledger to pledgee.

5. Contract of Pledge

The Rights and Duties of Pawnor and Pawnee are given below.

Rights of Pawnee/ Pledgee

The Pawnee or Pledgee has the following rights.

1. To retain the pledged goods (towards the payment of debt as well as any interest thereon, or for any necessary expenses incurred by him in respect of pledged goods or for their preservation).
2. To retain goods for subsequent debts, which can be exercised only, when it has been provided for in a contract to this effect.
3. To receive from the pawnor, extraordinary expenses incurred by him for the preservation of the goods pledged. For such extraordinary expenses, however, he does not have the right to retain the goods, but he can sue the pawnor for such expenses.
4. If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee has the following rights:
 - the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or
 - he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

Rights of Pawnor

As the bailor of goods, pawnor has all the rights of the bailor. Along with that, he also has the right of redemption to the pledged goods. Accordingly, if the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

Duties of the Pawnee

Pawnee has the following duties.

1. To take reasonable care of the pledged goods.
2. Not to make unauthorized use of pledged goods.
3. To return the goods when the debt has been repaid or the promise has been performed.
4. Not to mix his own goods with goods pledged.
5. Not to do any act which is inconsistent with the terms of the pledge.
6. To return accretion to the goods, if any.

Duties of a Pawnor

Pawnor has the following duties.

1. To pay the debt or perform the promise, as the case may be.
 2. To compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.
 3. To disclose all the faults which may put the pawnee under extraordinary risks.
 4. To indemnify the pawnee, if loss occurs to the pawnee due to defect in pawnor's title to the goods.
 5. To pay the deficit, if the pawnee sells the goods due to default by the pawnor.
-

6. Contract of Agency

Agency

An agreement in which one party (the principal) authorizes another party (the agent) to act on their behalf in business transactions.

Agent

A person employed to do any act for another or to represent another in dealing with the third persons.

Principal

A person for whom such act is done or who is so represented.

The law of agency is contained in Sections 182 to 238 of the Indian Contract Act, 1872. The Act does not define the word 'Agency'. However, Section 182 of the Act, defines Agent and Principal as:

Agent: means a person employed to do any act for another or to represent another in dealing with the third persons, and

Principal: means a person for whom such act is done or who is so represented.

Thus, 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim **Qui facit per alium, facit per se** i.e., he who acts through an agent, is himself acting. Further, no consideration is necessary to create an agency.

Who may employ agent

Who may employ an agent?

Person who is major

Person who has sound mind

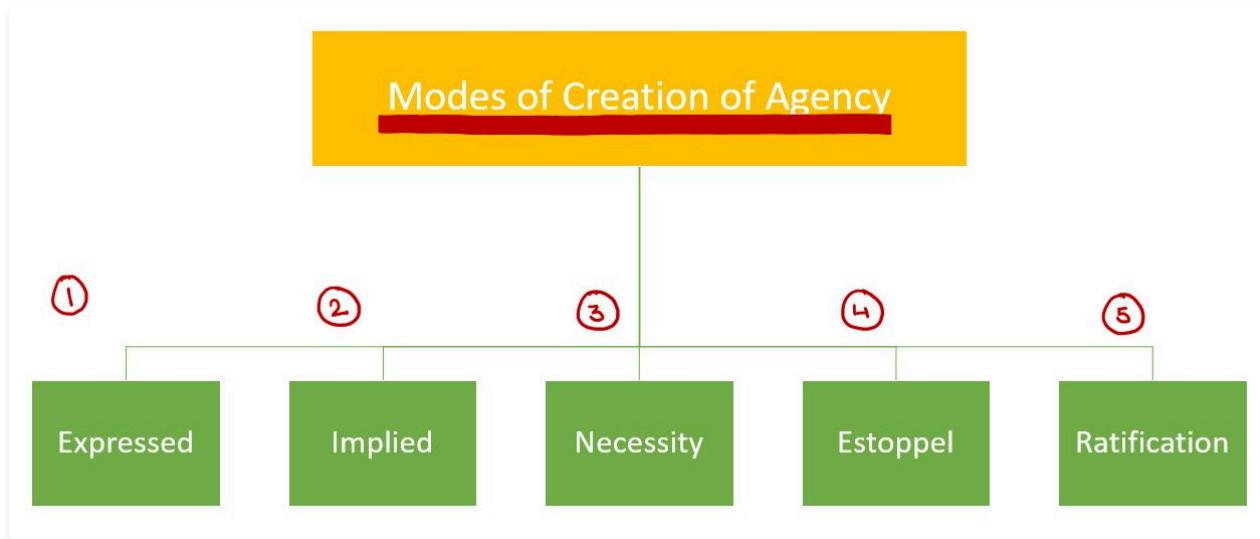
According to Section 183 of the Act, "any person who has attained majority according to the law to which he is subject, and who is of sound mind, may employ an agent". Thus, a minor or a person of unsound mind cannot appoint an agent.

Who may be an agent

According to Section 184 of the Act, any person may become an agent, i.e., even a minor or a person of unsound mind may become an agent and the principal shall be bound by his acts. But as a rule of caution, a minor or a person of unsound mind should not be appointed as an agent, because such persons are incompetent to contract and in case of his misconduct or negligence, the principal shall not be able to proceed against him.

For example, Ajay appoints Bijay who is a minor, to sell his bike for not less than Rs. 60,000. However, Bijay sells it for Rs. 40,000. Ajay will be held bound by the transaction and further shall have no right against Bijay for claiming the compensation for having not obeyed the instructions, since Bijay is a minor and a contract with a minor is 'void-ab-initio'.

6. Contract of Agency



The various modes of Creation of Agency are discussed below.

1. Expressed Authority

An authority is said to be express when it is given by words, spoken or written.

For example, A is residing in Delhi and he has a house in Mumbai. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.

2. Implied Authority

An authority is said to be implied, when it is to be inferred from the circumstances of the case, conduct of the parties and things spoken or written, or in the ordinary course of dealing, may be accounted from the circumstances of the case.

For example, Mr. A owns a shop in Delhi, living himself in Gurugram and so visiting the shop occasionally. The shop is managed by F, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. F has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

3. Agency by Estoppel

Agency by Estoppel

When an agent has without authority-

- Done acts
- Or incurred obligations

To third persons on behalf of his principal

The principal is bound by such

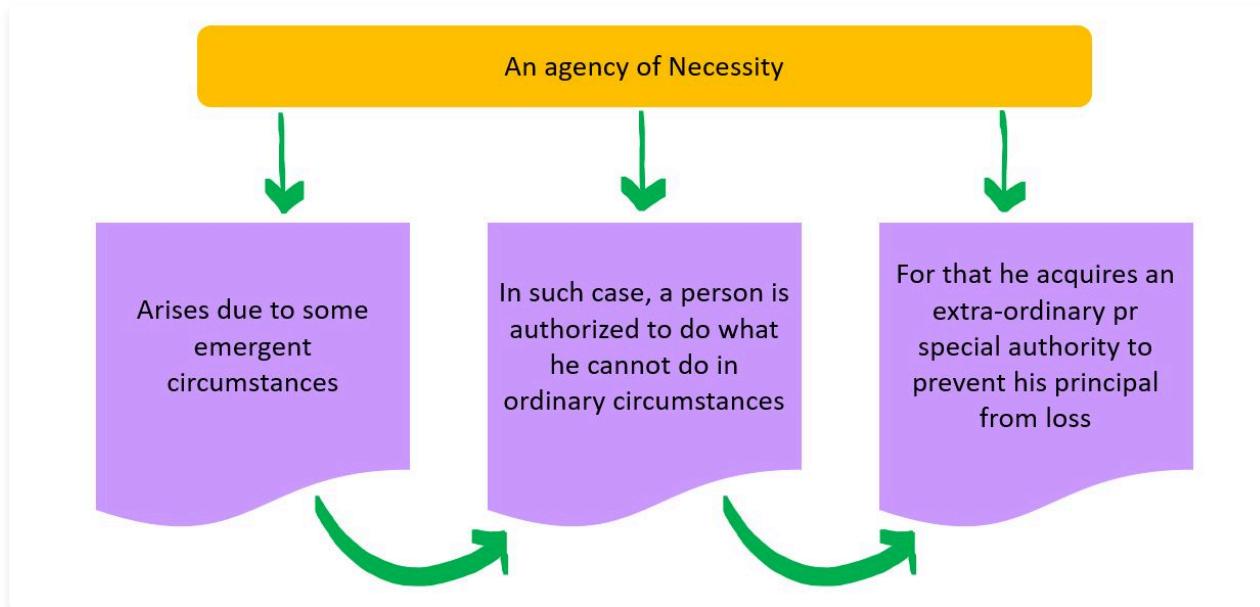
- Acts or
- Obligations

If he has by his words/conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority

The principle of estoppel lays down that when one person by declaration (representation), act or omission has intentionally caused or permitted another person to believe a thing to be true and to act upon such belief, he shall not be allowed to deny his previous statement or he shall be stopped to deny his previous statement or conduct.

For example, Mr. P (the principal) for several months made Tenali, to buy goods on credit from a nearest provision store on his behalf and has paid for the goods bought by Tenali. Here P cannot later refuse to pay for the goods purchased from the provisions store, who had supplied goods on credit to Tenali in the belief that he was P's agent and was buying the goods on behalf of P. Thus, here P is estopped from now asserting that Tenali is not his agent because on earlier occasions he permitted provision dealer to believe that Tenali was his agent and so he had acted in that belief.

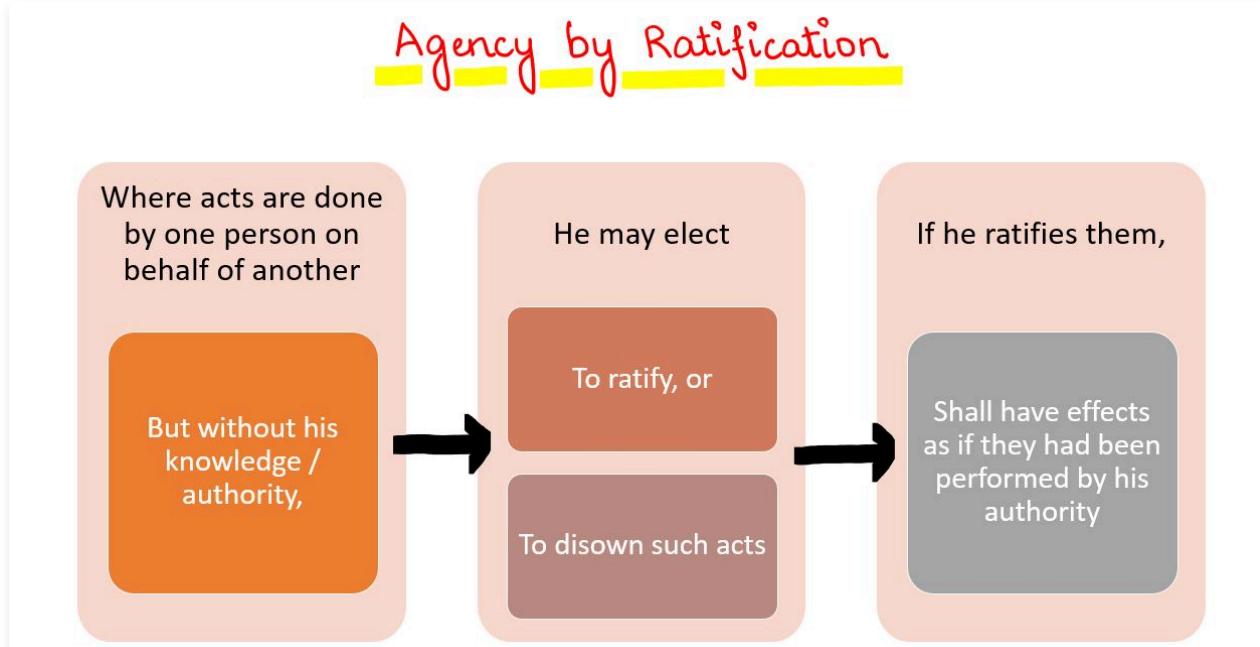
4. Agency by Necessity



An agency by necessity arises due to some emergent circumstances. In emergency, a person is authorised to do what he cannot do in ordinary circumstances. Thus, where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he acquires an extra-ordinary or special authority to prevent his principal from loss.

For example, Rajkamal has a farm in which Bhuwan is the security guard. During visit of Rajkamal to USA, huge fire was caught in the farm. Bhuwan becomes an agent of necessity for Rajkamal so as to save the property from being destroyed by fire. Rajkamal (the principal) will bear up all the expenses, which Bhuwan (his agent of necessity) incurred to put out the fire and save the farm from destruction during Rajkamal's absence from the country.

5. Agency by Ratification



Where a person having no authority purports to act as agent, or a duly appointed agent exceeds his authority, the principal is not bound by the contract supposedly based on his behalf. But, the principal may ratify the agent's transaction and so accept liability. In this way, an agency by ratification arises. This is also known as *ex post facto agency*, i.e., agency arising after the event.

For example, X is Y's agent. He (X) on 10.01.2021 purchased goods from Z on credit without seeking Y's permission. After that, on 20.01.2021, Y tells X that he (Y) will accept responsibility to pay for the purchases although at the time of purchase X had no authority to buy on credit. Y's subsequent statement on 20.01.2021 amounts to a ratification of the agent's (X's) purchase of goods on 10.01.2021.

6. Contract of Agency

According to Section 188 of the Act, an agent having an authority to do an act, has authority to do everything lawful which is necessary for the purpose or usually done in the course of conducting business.

Authority of the agent which binds Principal

Actual

- Delegated
- Expressed or Implied

Ostensible

- Presumed
- Perceived

Emergent

- Beyond normal scope

An agent's authority means the capacity of the agent to bind his principal. The acts of the agent, done within the scope of his authority, bind the principal.

Such an authority of the agent to bind the principal may be:

1. Actual or real authority.
2. Ostensible or apparent authority.
3. Authority in an emergency.

Actual Authority

An actual authority means that authority which has been really delegated to the agent. The authority of the agent may be express or implied. An authority is said to be *express* when it is given by words spoken or written. An authority is said to be *implied* when it is to be inferred from the circumstances of the case or the ordinary course of dealing between the parties. The principal is bound by the act of the agent done within his express or implied authority.

Ostensible or Apparent Authority

When the agent is employed for a particular business, persons dealing with him can presume that he has the authority to do all such acts as are necessary for such a business. Such an authority of the agent is called an ostensible or an apparent authority. The ostensible or an apparent authority is the authority of the agent as it appears to others. It often coincides with the actual authority.

Authority in an emergency

According to Section 189 of the Act, an agent has authority to do all such things which may be necessary to protect the principal from loss in an emergency and which he would do to protect his own property under similar circumstances. When the agent has acted beyond the authority in emergency, the principal is bound by the act of the agent.

6. Contract of Agency

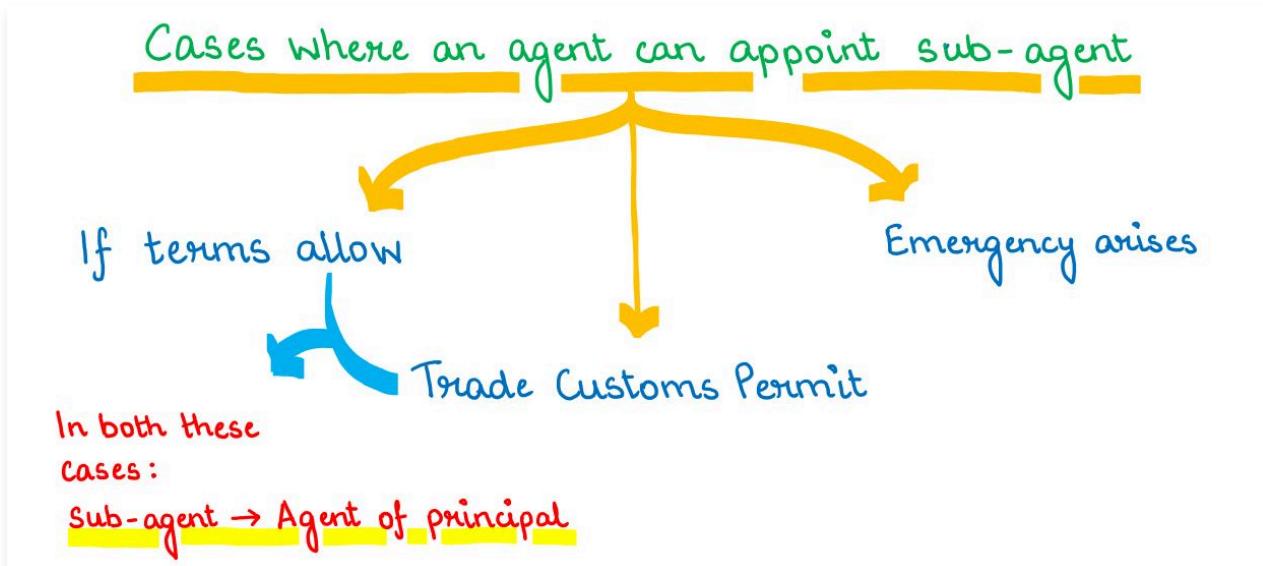
Sub-agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegatee and a delegatee cannot further delegate. This is based on the Latin principle **delegatus non potest delegare**.



A contract of agency is of a fiduciary character. It is based on the confidence reposed by the principal in the agent and that is why a delegatee cannot further delegate.

Cases in which agent can appoint sub-agent

In spite of the fact, a delegatee cannot further delegate, in following cases, an agent can appoint a sub-agent:



1. The appointment of a sub agent would be valid, if the terms of appointment originally contemplated it.

2. Sometimes, customs of the trade may provide for appointment of sub agents.

Note that in both these cases, the sub-agent would be treated as the agent of the principal.

3. Where in the course of an agent's employment, unforeseen emergency arises making it necessary for him to delegate the authority that was given to him by the principal.

Where sub-agent is properly appointed

Cases where sub-agent properly appointed

①

Principal bound
by sub-agent's act

②

Agent liable to
Principal for sub-
agent's actions

③

Sub-agent
accountable to
Agent not
Principal unless
fraud or
wrongdoing

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

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

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

Where sub-agent is not properly appointed

Cases where sub-agent is not properly appointed

Principal

Not bound

Agent

Liable as principal
to both Principal
and 3rd Parties

Sub-Agent

Not answerable to
Principal but to
Agent

In case, where the appointment of sub-agent takes place without authority, the principal is not bound by the acts of sub-agent and sub-agent is not answerable to the principal. It is the agent who is the principal of sub-agent and is responsible for his acts, both to the principal and to third persons. Where the sub-agent purportedly acts in the name of first principal, that first principal may ratify the act of sub-agent.

Sub - AGENT

If he acts in the
name of the
Principal

Ratification
Possible

If he acts in his
own name

Ratification
not possible

However, if the sub-agent acts in his own name or in the name of the agent who has without authority delegated to the sub-agent the business which is in fact of the principal, the principal cannot ratify such acts of sub-agent.

6. Contract of Agency

Duties of an Agent



Execute Mandate
order of principal



Take reasonable care
and skill



Communicate with
principal



Avoid conflict of
interest



Not to make secret
profit



Remit sums



Conduct business in
accordance with the
principal

Following are the duties of an agent.

- (a) An agent **must act within the scope of the authority** conferred upon him and carry out strictly the instructions of the principal.
 - (b) In the absence of express instructions, he **must follow the custom prevailing in the same kind of business** at the place where the agent conducts the business.
 - (c) He **must do the work with reasonable skill and diligence** and he must exercise the skill which is expected from the members of the profession.
 - (d) He **must disclose promptly any material information** coming to his knowledge which is likely to influence the principal in the making of the contract.
 - (e) He **must not disclose confidential information** entrusted to him by his principal.
 - (f) He **must not allow his interest to conflict with his duty**, for example, he must not compete with his principal.
 - (g) He **must keep true accounts**.
 - (h) He **must not make any secret profit**; he must disclose any extra profit that he may make.
- Where an agent is discovered taking secret bribe, etc., the principal is entitled to:
- (i) dismiss the agent without notice,
 - (ii) recover the amount of secret profit, and
 - (iii) refuse to pay the agent his remuneration. He may repudiate the contract, if the third-party is involved in secret profit and also recover damages.
- (i) He **must not delegate his authority** to sub-agent.

6. Contract of Agency

Rights of an Agent

- Right to retain out of sums
- Right to Remuneration
- Agent's lien on principal's property
- Right of indemnification for lawful acts
- Right of indemnification against acts done in good faith

Following are the rights of an Agent.

1. To retain, out of any sums received on account of the principal in the business of agency for the following payments:
 - (a) all moneys due to himself in respect of advances made;
 - (b) in respect of expenses properly incurred by him in conducting such business;
 - (c) such remuneration as may be payable to him for acting as agent.
2. To receive remuneration, as per the terms of contract of agency.
3. To retain the goods, papers and other property, whether movable or immovable, of the principal, received by him, until the amount due to himself for commission, disbursement and services in respect of the same has been paid or accounted for him.
4. To be indemnified by the Principal against all consequences of lawful acts done in exercise of his authority and also for acts done in good faith (except in case of criminal acts).
5. Every principal owes to his agent the duty of care, and not to expose him to unreasonable risks.

6. Contract of Agency

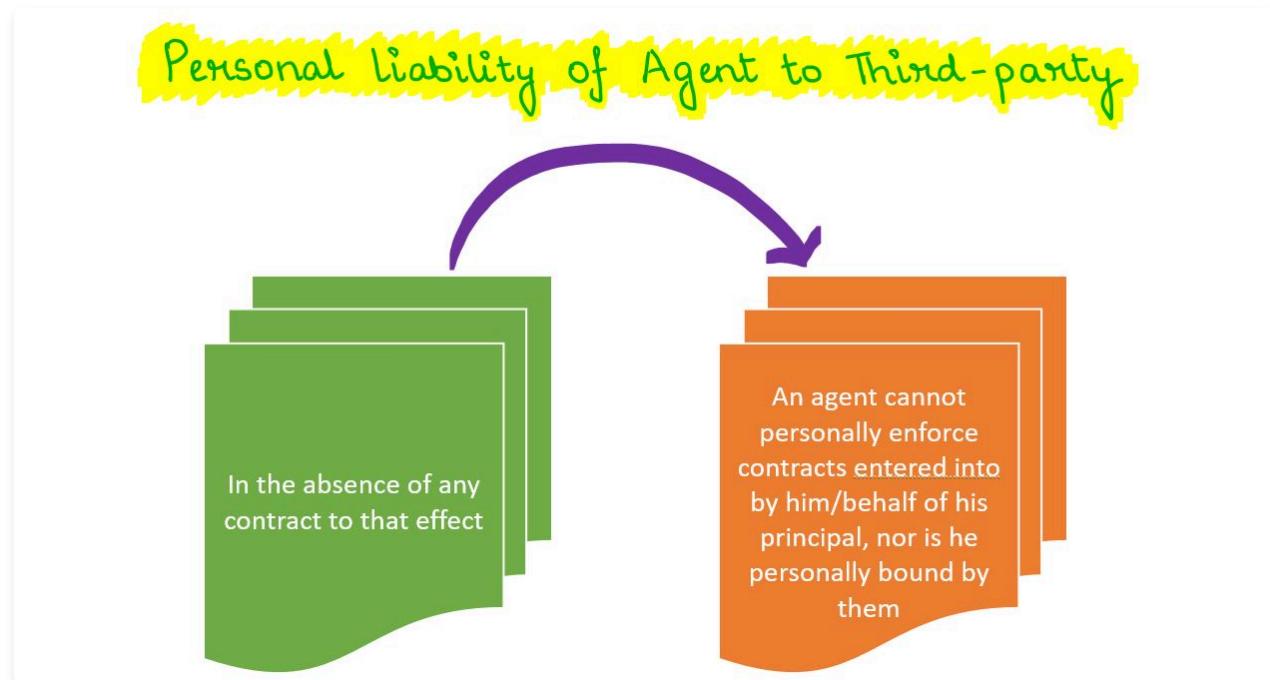
A tort is a civil wrongdoing that causes harm or loss to an individual or their property, leading to legal liability for the person who commits the tort. Common examples of torts include negligence, defamation, assault, and trespass. Tort law is designed to provide remedies and compensation for individuals who suffer harm due to the wrongful actions of others.

If an agent commits a tort or other wrong (e.g., misrepresentation or fraud) during his agency, whilst acting within the scope of his actual or apparent authority, the principal is liable.

But the agent is also personally liable, and he may be sued also. The principal is liable, even if the tort is committed exclusively for the benefit of the agent and against the interests of the principal.

6. Contract of Agency

Usually, the agent cannot personally be liable for the contract entered into by him on behalf of the principal.



However, the agent is personally responsible in the following cases.

1. When the agent acts for a foreign principal.
2. When the agent acts for an undisclosed principal.
3. When agent acts for an incompetent principal.
4. When the agent acts for a principal not in existence.
5. When the agent signs a contract in his own name.
6. When the agent acts beyond his authority.
7. Where there is a misrepresentation or fraud by agent.
8. Where the trade, usage or custom makes the agent personally liable.
9. Where authority is coupled with an interest, for example, an agent, is authorized by his principal to sell a property, and where such an agent has a personal interest in the sale proceeds.
10. A person who untruly represents himself to be the authorized agent (known as pretended agent) and induces a third person to enter onto the contract or otherwise deals with him is called a pretended agent.

6. Contract of Agency

Termination of Agency → Putting an end to the legal relationship between Principal & Agent

Termination of agency means putting an end to the legal relationship between principal and agent.

Modes of Termination



Following are the modes of termination of contract of agency.

- (a) By the performance of the contract of agency;
- (b) By an agreement between the principal and agent;
- (c) By expiration of the period fixed for contract of agency;
- (d) By the death of the principal or agent;
- (e) By the insanity of either the principal or agent;
- (f) By the insolvency of the principal, and in some cases that of the agent;
- (g) Where the principal or agent is an incorporated company, by its dissolution;
- (h) By the destruction of the subject-matter;
- (i) By the renunciation of his authority by the agent;
- (j) By the revocation of authority by the principal.

1. Introduction

Sale of goods is one of the specific forms of contracts recognized and regulated by law in India. Sale is a typical bargain between the buyer and seller.

PRIMER to Sale of Goods Act, 1930

- It came into force on 1st July 1930.
- The provisions of the act are applicable to the sale of **ONLY** movable properties and is not applicable to immovable properties.

The Sale of Goods Act, 1930 is an Act to define and amend the law relating to sale and of goods. It came into force on 1st July, 1930. Note that earlier, the Sale of Goods Act was part of the Indian Contract Act, 1872.

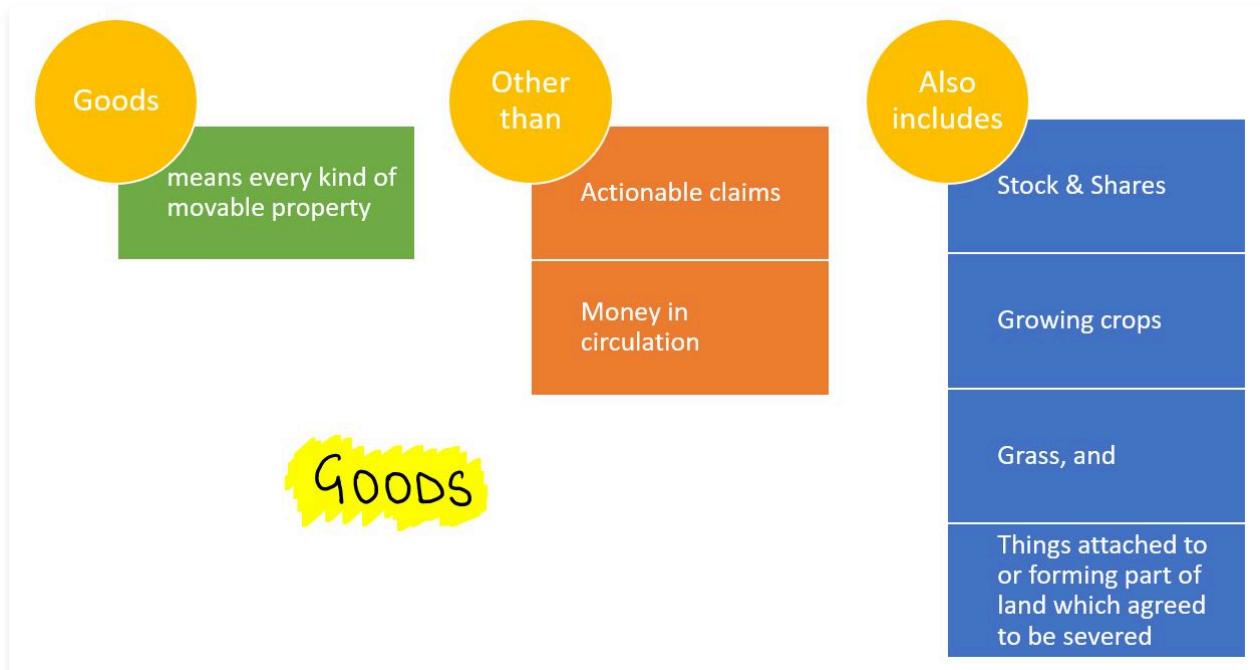
2. Definitions

The Act defines the following important terms.

Buyer

The Buyer means a person who buys or agrees to buy goods and Seller means a person who sells or agrees to sell goods.

Goods



Goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale.

Actionable claims

Actionable claims are claims, which can be enforced only by an action or suit, for example, debt. A debt is not a movable property or goods.

Document of title to goods

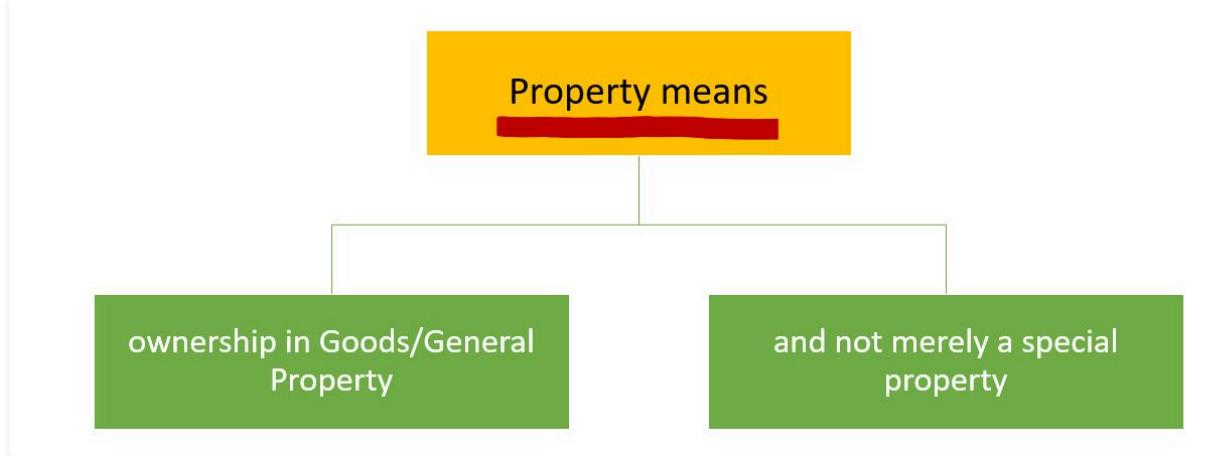
Document of title to goods includes bill of lading, dock-warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, multimodal transport document, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented. Any other document which has the above characteristics also will fall under the same category. A document amounts to a document of title only where it shows an unconditional undertaking to deliver the goods to the holder of the document.

Mercantile Agent

Mercantile Agent means an agent having in the customary course of business as such agent authority, either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods.

Property

Property means 'ownership' or general property. In every contract of sale, the ownership of goods must be transferred by the seller to the buyer, or there should be an agreement by the seller to transfer the ownership to the buyer. It means the general property (right of ownership-in-goods) and not merely a special property.



For example, if A owns certain goods and pledges them to B, A has general property in goods, whereas B has special property or interest in goods to the extent of amount of advance he has made.

Insolvent person

A person is said to be insolvent when he ceases to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.

Price

Price means the money consideration for a sale of goods.



Quality

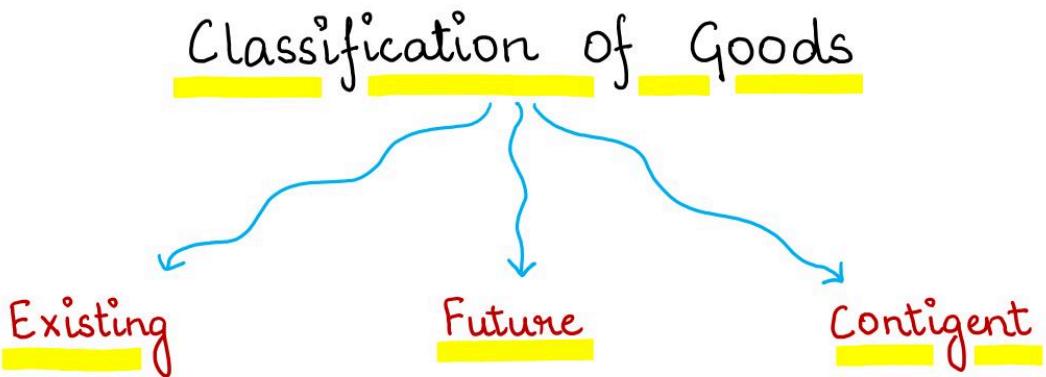
Quality of goods includes their state or condition.

Seller

Seller means a person who sells or agrees to sell goods.

3. Classification of Goods

Goods can be classified as follows.

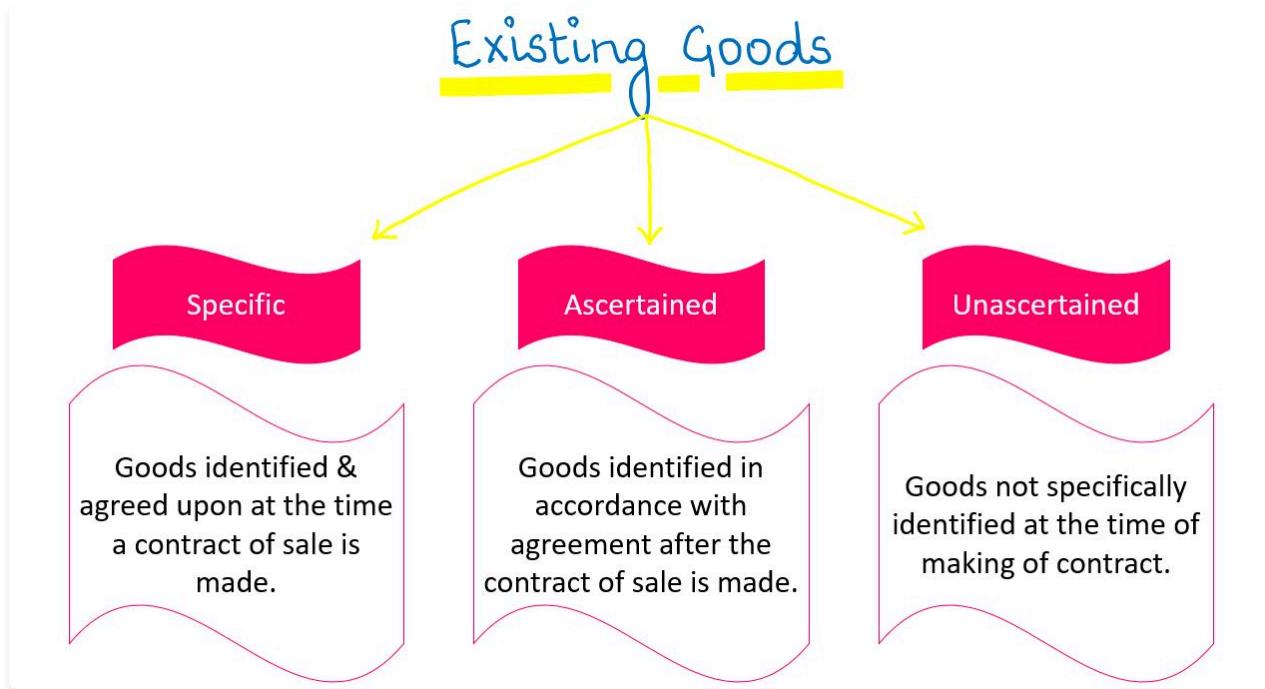


1. Existing Goods
2. Future Goods
3. Contingent Goods.

These are explained next one by one.

3. Classification of Goods

These are goods which are in existence at the time of the contract of sale, i.e., those owned or possessed by the seller at the time of contract of sale.



The existing goods may be of following kinds.

(a) Specific Goods

Specific goods means goods identified and agreed upon at the time a contract of sale is made.

For example, Mr. A had five cars of different models. He agreed to sell his 'fiat' car to Mr. B and Mr. B agreed to purchase the same car. In this case, the sale is for specific goods, as the car has been identified and agreed at the time of contract of sale.

(b) Ascertained Goods

Ascertained Goods are those goods which are identified in accordance with the agreement after the contract of sale is made. This term is not defined in the Act, but has been judicially interpreted. In actual practice, the term 'ascertained goods' is used in the same sense as 'specific goods.' When from a lot or out of large quantity of unascertained goods, the number or quantity contracted for is identified, such identified goods are called ascertained goods.

For example, a wholesaler of cotton has 100 bales in his godown. He agrees to sell 50 bales and these bales were selected and set aside. On selection, the goods become ascertained. In this case, the contract is for the sale of ascertained goods, as the cotton bales to be sold are identified and agreed after the formation of the contract. It may be noted that before the ascertainment of goods, the contract was for the sale of unascertained goods.

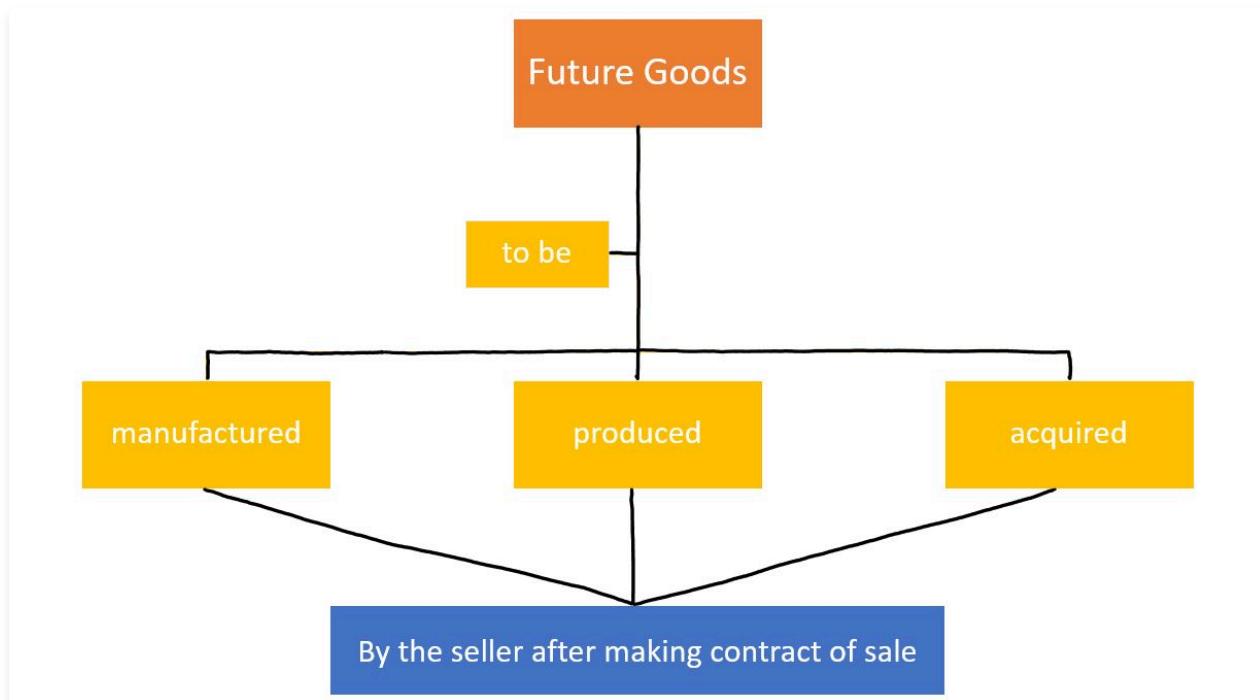
(c) Unascertained Goods

Unascertained goods are goods which are not specifically identified or ascertained at the time of making of the contract. They are indicated or defined only by description or sample.

For example, if A agrees to sell to B one packet of salt out of the lot of 100 packets lying in his shop, it is a sale of unascertained goods, because it is not known, which packet is to be delivered. As soon as a particular packet is separated from the lot, it becomes ascertained or specific goods.

3. Classification of Goods

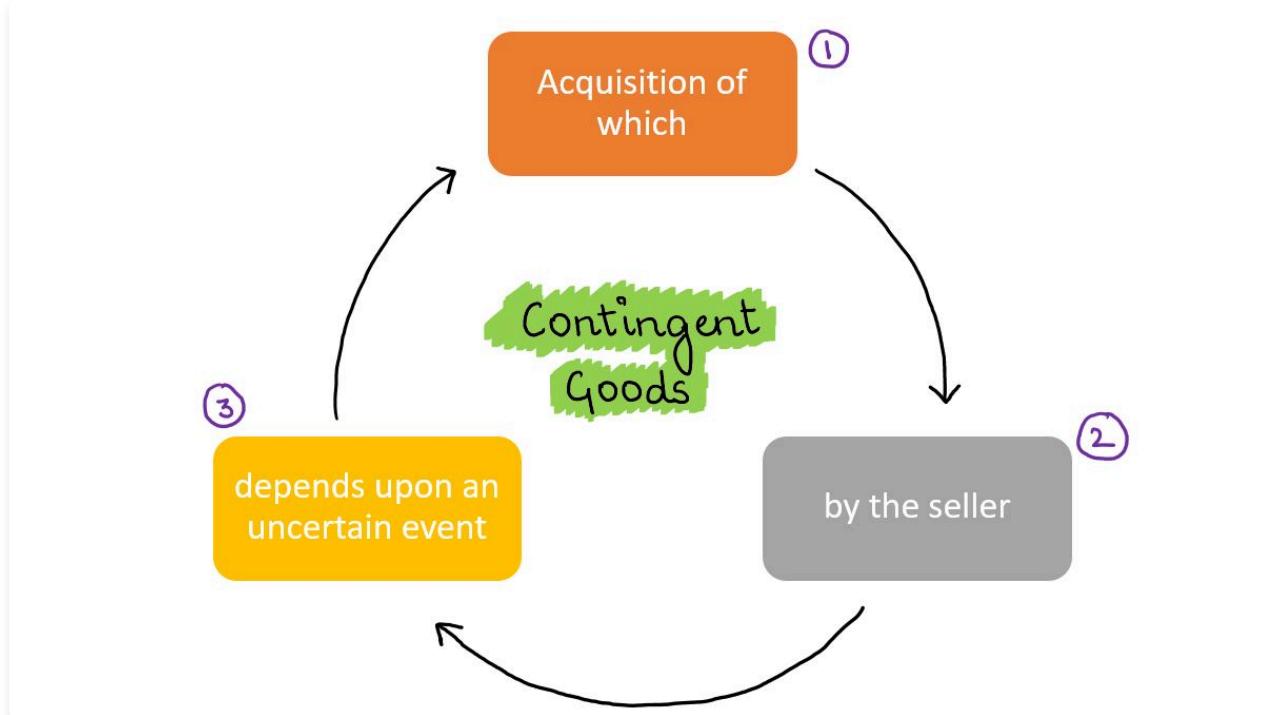
Future Goods means goods to be manufactured or produced or acquired by the seller after making a contract of sale. A contract for the sale of future goods is always an agreement to sell. It is never actual sale because a man cannot transfer what is not in existence.



For example, Mr. X agrees to sell to Mr. Y all the apples which will be produced in his orchard this year. It is contract of sale of future goods, amounting to 'an agreement to sell'.

3. Classification of Goods

The goods, the acquisition of which by the seller depends upon an uncertain contingency (uncertain event), are called 'contingent goods'. Contingent goods also operate as 'an agreement to sell' and not a 'sale', so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also, the property does not pass to the buyer at the time of making the contract.

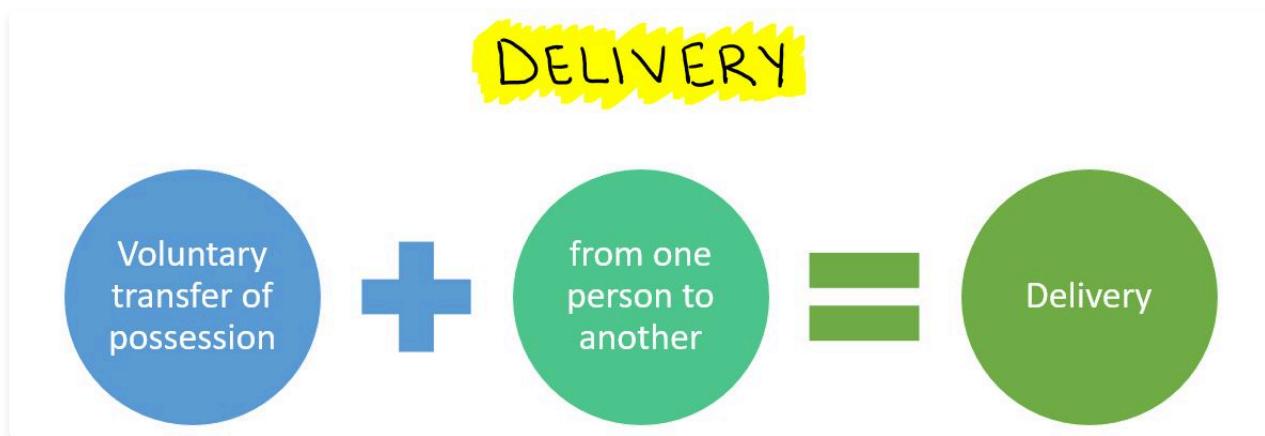


For example, A agrees to sell to B, a painting, provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

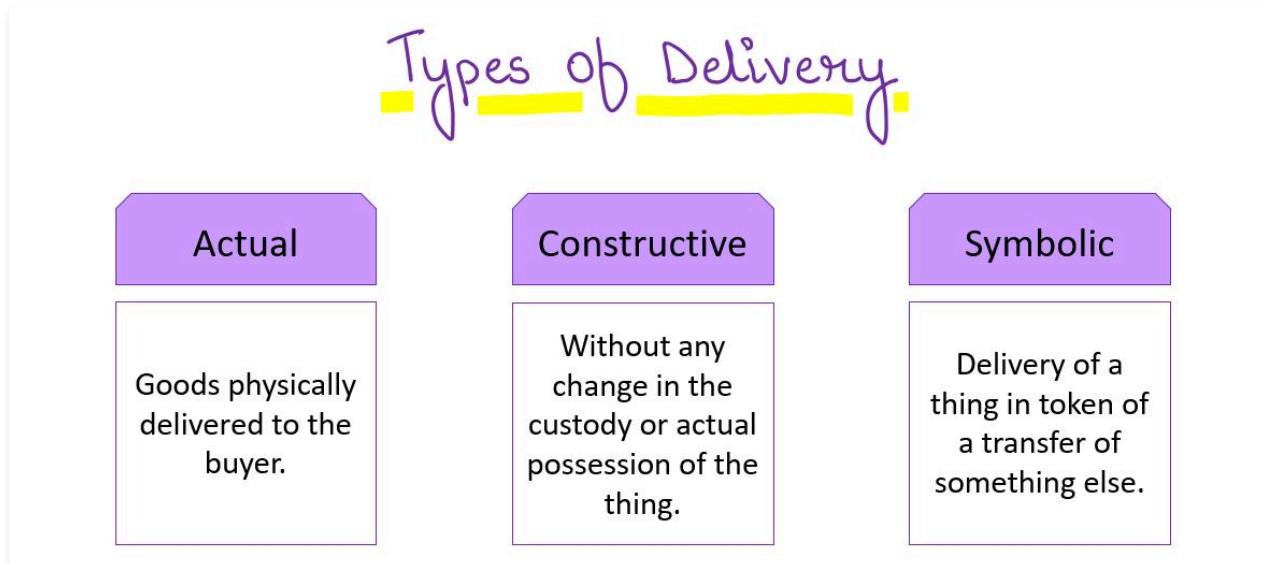
Consider another example, where P contracts to sell 500 pieces of particular item provided the ship which is bringing them reaches the port safely.

4. Delivery

Delivery means voluntary transfer of possession from one person to another. As a general rule, delivery of goods may be made by doing anything, which has the effect of putting the goods in the possession of the buyer, or any person authorized to hold them on his behalf.



Forms of delivery



Following are the kinds of delivery for transfer of possession.

1. **Actual delivery:** When the goods are physically delivered to the buyer.
2. **Constructive delivery:** When it is effected without any change in the custody or actual possession of the thing, as in the case of delivery by attorney (acknowledgement). For example, where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request.
3. **Symbolic delivery:** When there is a delivery of a thing in token of a transfer of something else, i.e., delivery of goods in the course of transit may be made by handing over documents of title to goods, like bill of lading or railway receipt or delivery orders or the key of a warehouse containing the goods is handed over to buyer.

When are goods said to be in a deliverable state

Goods are said to be in a deliverable state when they are in such a condition that the buyer would, under the contract, be bound to take delivery of them. For example, when A contracts to sell timber and make bundles thereof, the goods will be in a deliverable state, after A has put the goods in such a condition.

5. What is Contract of Sale



Contract of Sale of Goods is a contract whereby (i) the seller transfers, or (ii) agrees to transfer - the property in goods to the buyer for a price.

It involves 2 parties:

Buyer: A person who buys or agrees to buy goods.

Seller: A person who sells or agrees to sell goods.

The essential elements of contract of sale are discussed next.

5. What is Contract of Sale

The following essential elements must co-exist to constitute a Contract of Sale of Goods under the Act.

Two Parties

- Buyer & Seller

Consideration

- Price in money

Nature of Contract of Sale

- May be absolute or conditional

Subject matter

- Movable Goods

Delivery of goods

- Transfer of property i.e., ownership to take place

Fulfill other essential elements of a Valid Contract

Contract of Sale

**Elements must
co-exist**

(i) There must be at least 2 parties, the seller and the buyer.

(ii) The subject matter of the contract must necessarily be goods covering only movable property. It may be either existing goods, owned or possessed by the seller or future goods.

(iii) A price in money (not in kind) should be paid or promised. But, there is nothing to prevent the consideration from being partly in money and partly in kind.

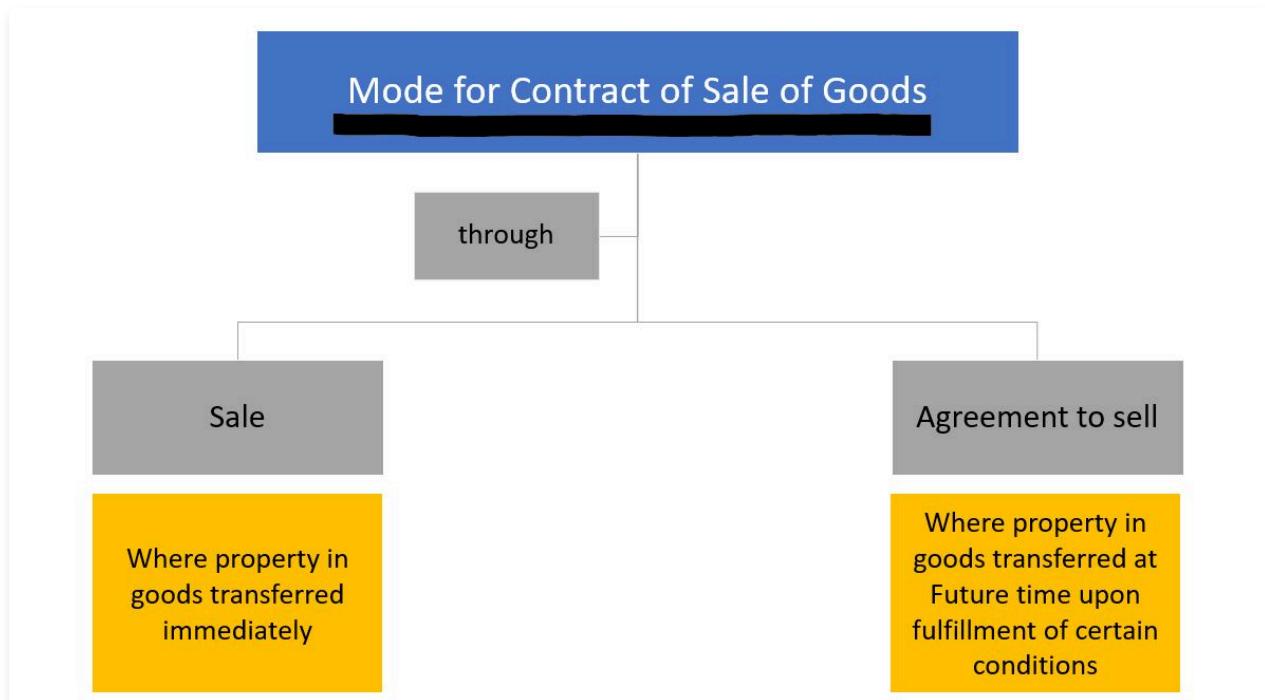
(iv) A transfer of property in goods from seller to the buyer must take place. The contract of sale is made by an offer to buy or sell goods for a price by one party and the acceptance of such offer by other.

(v) A contract of sale may be absolute or conditional.

(vi) All other essential elements of a valid contract must be present in the contract of sale, e.g. competency of parties, legality of object, consideration etc.

6. Sale and Agreement to Sell

A contract for the sale of goods may be either 'sale' or 'agreement to sell'.



Sale

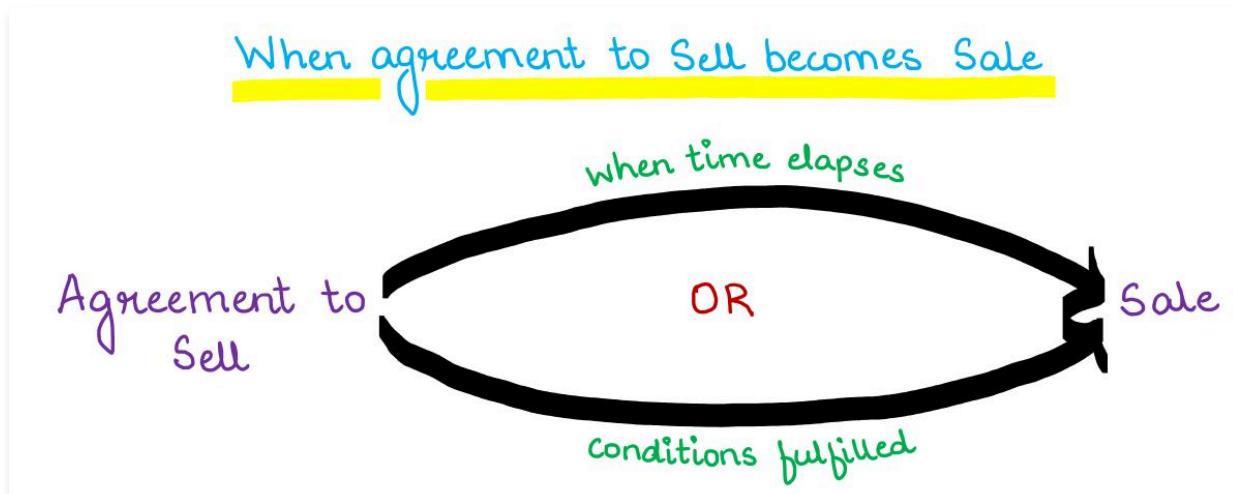
In Sale, the property in goods is transferred from seller to the buyer immediately. The term sale is defined in Section 4(3) of the Sale of Goods Act, 1930 as "where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called a sale".

Agreement to Sell

In an agreement to sell, the ownership of goods is not transferred immediately. It is intending to transfer at a future date upon the completion of certain conditions thereon. The term is defined in Section 4(3) of the Sale of Goods Act, 1930, as "where the transfer of property in goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell".

Thus, whether a contract of sale of goods is an absolute sale or an agreement to sell, depends on the fact whether it contemplates immediate transfer from the seller to the buyer or the transfer is to take place at a future date.

When Agreement to Sell becomes Sale



An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in goods is to be transferred.

6. Sale and Agreement to Sell

Difference between Sale and Agreement to Sell is given below.

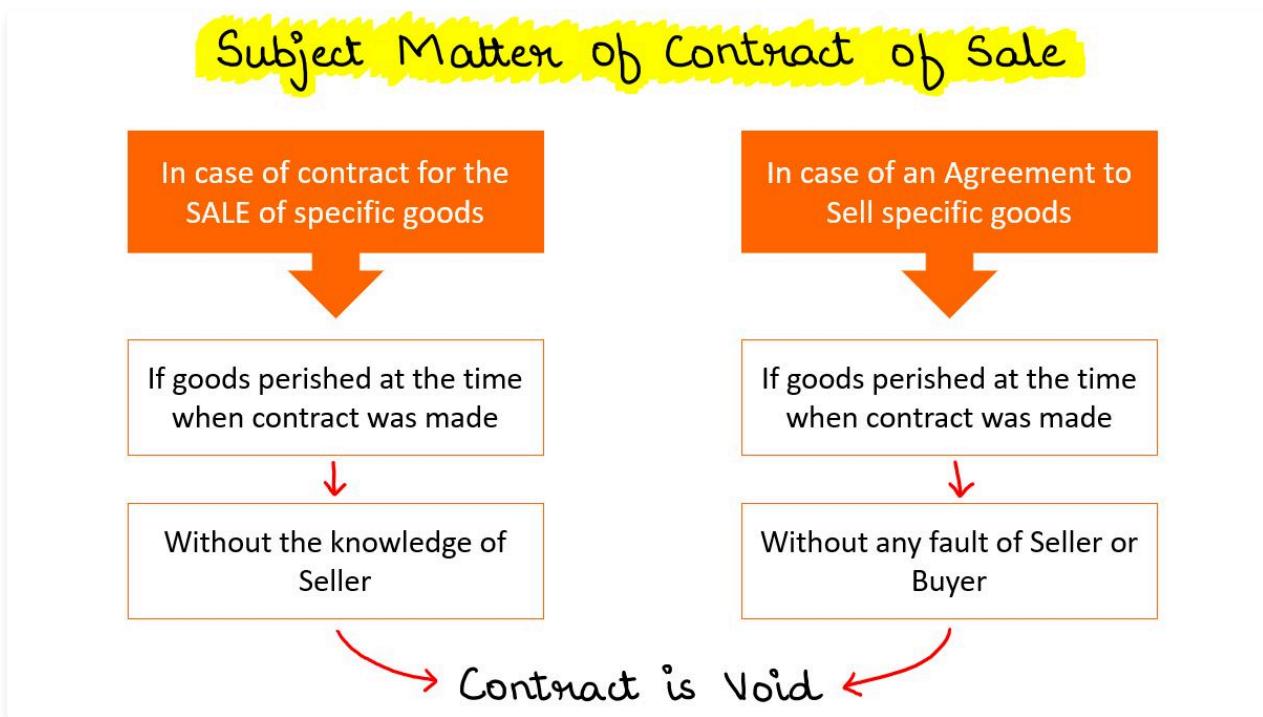
Basis	Sale	Agreement to Sell
Transfer of Property	The property in goods passes to the buyer immediately.	Property in goods passes to the buyer on future date or on fulfilment of some condition.
Nature of Contract	It is an executed contract, i.e., contract for which consideration has been paid.	It is an executory contract, i.e., contract for which consideration is to be paid at a future date.
Remedies for Breach	The seller can sue the buyer for the price of the goods because of the passing of the property therein, to the buyer.	The aggrieved party can sue for damages only and not for the price, unless the price was payable at a stated date.
Liability of Parties	A subsequent loss or destruction of the goods is the liability of the buyer.	Such loss or destruction is the liability of the seller.
Burden of Risk	Risk of loss is that of buyer since risk follows ownership.	Risk of loss is that of seller.
Nature of Rights	Creates 'Jus in rem' meaning 'right to a thing'.	Creates 'Jus in personam', meaning the right to enforce a particular person's obligation by instituting an action against such person.
Right of Resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.

7. Subject Matter of Contract of Sale

Section 6 to 8 of the Act deals with provisions related to subject matter of contract of sale of Goods.

Subject matter of Sale of existing or future goods

Section 6 talks about subject matter of sale in case of sale of existing or future goods.



The goods which form the subject of a contract of sale, may be either existing goods, owned or possessed by the seller, or future goods. There may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

For example, a contract for sale of certain cloth to be manufactured by a certain mill is a valid contract. Such contacts are called contingent contracts.

Where by a contract of sale, the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

Nature of Contract of Sale with respect to perishing goods

The nature of contract of sale with respect to perishing goods is dealt under Section 7 and 8 of the Act.

Goods perishing before making of contract (Section 7)

According to Section 7 of the Act, where there is a contract for the sale of specific goods, the contract is void, if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract.

For example, A agrees to sell B, 50 bags of wheat stored in A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither parties were aware of the fact. The agreement is void.

Goods perishing before sale but after agreement to sell (Section 8)

According to Section 8 of the Act, where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller or buyer perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided.

For example, where there is an agreement to sell a machinery (on goods sent to buyer on approval basis), between seller and buyer, and the machinery gets destroyed due to fire at buyer's premises, without any fault of seller or buyer, the agreement is thereby avoided.

8. Modes of Contract of Sale

By an offer to buy/sell goods & acceptance of such offer

By immediate delivery

By immediate payment but with future delivery

By immediate delivery & immediate payment

By delivery or payment both in installments

By delivery or payment both at some future date

Modes of
Contract of Sale

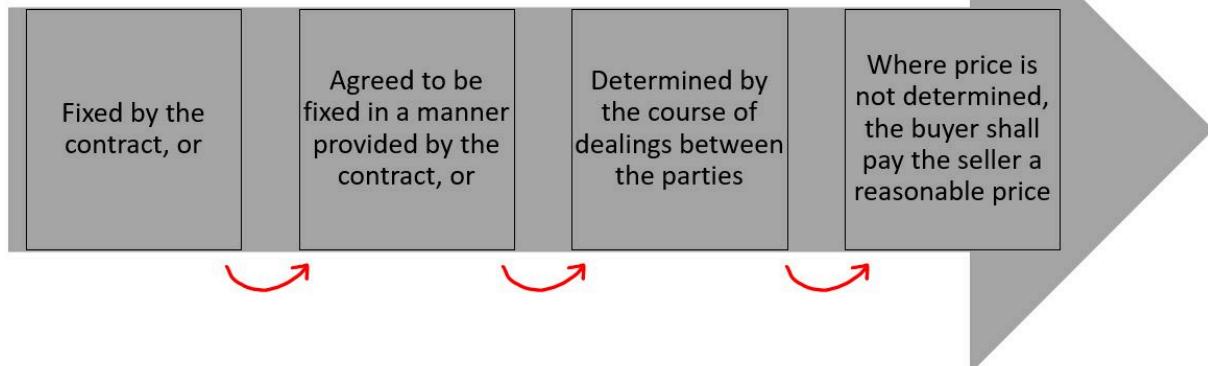
A contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties.

According to Section 5 of the Sale of Goods Act, 1930, a contract of sale may be made in any of the following modes.

- (i) Contract of sale is made by an offer to buy or sell goods for a price and acceptance of such offer; or
- (ii) There may be immediate delivery of the goods; or
- (iii) There may be immediate payment of price, but it may be agreed that the delivery is to be made at some future date; or
- (iv) There may be immediate delivery of goods and an immediate payment of price; or
- (v) It may be agreed that the delivery or payment or both are to be made in instalments; or
- (vi) It may be agreed that the delivery or payment or both are to be made at some future date.

9. Ascertainment of Price

Ascertainment of Price



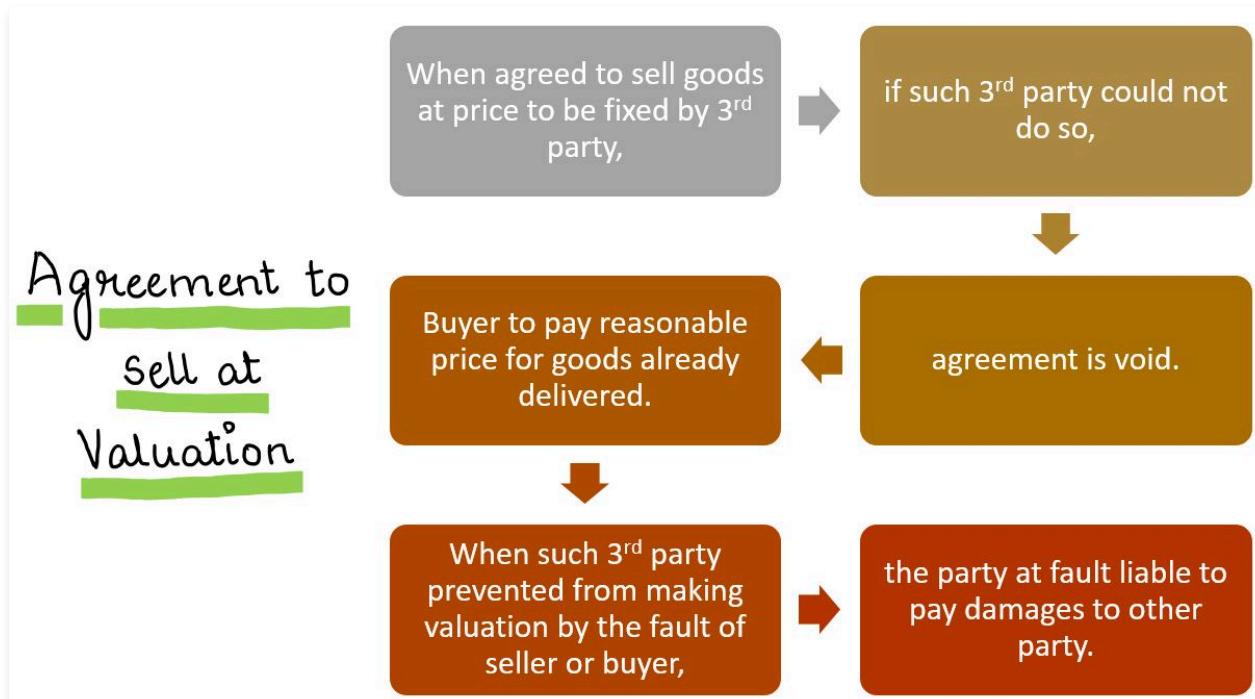
Section 9 provides that the price in the contract of sale may be:

1. fixed by the contract, or
2. agreed to be fixed in a manner provided by the contract, e.g., by a valuer, or
3. determined by the course of dealings between the parties.

Where the price is not determined as above, the buyer shall pay the seller a reasonable price.

Agreement to sell at valuation

Section 10 provides for the determination of price by a third party. Where there is an agreement to sell goods on the terms that price has to be fixed by the third party and such third party cannot make such valuation, the agreement will be void.



In case the third party is prevented by the default of either party from fixing the price, the party at fault will be liable to damages to the other party who is not at fault. However, a buyer who has received and appropriated the goods must pay a reasonable price for them in any eventuality.

For example, let's assume P is having 2 bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P asks S to return the bike already delivered, while S claims

for the delivery of the second bike too. In the given example, buyer S shall pay reasonable price to P for the bike already taken. As regards the second bike, the contract can be avoided.

10. Conditions and Warranties

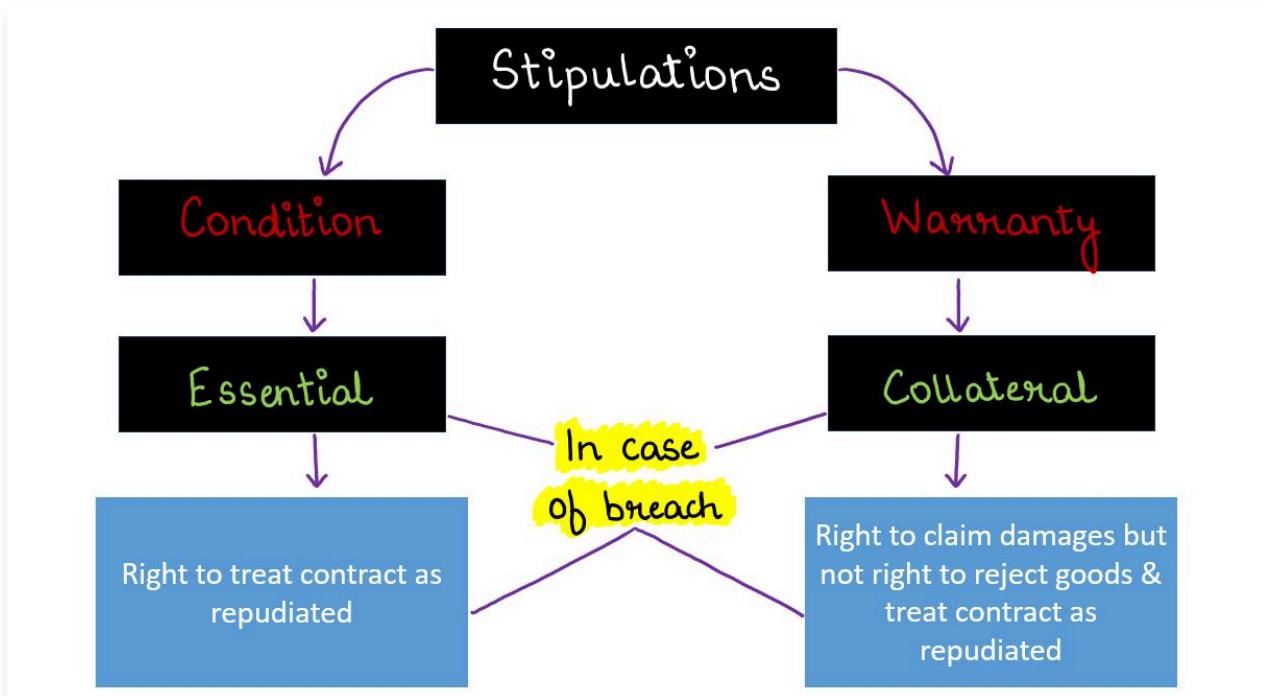
At the time of selling the goods, a seller usually makes certain statements or representations with a view to induce the intending buyer to purchase goods. Such representations are generally about the nature and quality of goods, and about their fitness for buyer's purpose.

A representation which forms a part of the contract of sale and affects the contract, is called a stipulation. However, every stipulation is not of equal importance.

Condition and warranty

Section 12 of the Act deals with provisions related to Condition and Warranty.

A stipulation in a contract of sale with reference to goods which are the subject thereof, may be a condition or a warranty.



"A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated".

"A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated".

Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract.

For example, Ram consults Shyam, a motor-car dealer for a car suitable for touring purposes to promote the sale of his product. Shyam suggests 'Maruti' and Ram, accordingly buys it from Shyam. The car turns out to be unfit for touring purposes. Here, the term that the 'car should be suitable for touring purposes' is a condition of the contract. It is so vital that its non-fulfilment defeats the very purpose for which Ram purchases the car. Ram is, therefore, entitled to reject the car and have refund of the price.

Let us assume Ram buys a new Maruti car from the show room and the car is guaranteed against any manufacturing defect under normal usage for a period of one year from the date of original purchase and in the event of any manufacturing defect there is a warranty for replacement of defective part, if it cannot be properly repaired. After six months, Ram finds that the horn of the car is not working, here, in this case, he cannot terminate the contract. The manufacturer can either get it repaired or replaced it with a new horn. Ram gets a right to claim for damages, if any, suffered by him, but not the right of repudiation.

Condition Vs. Warranty

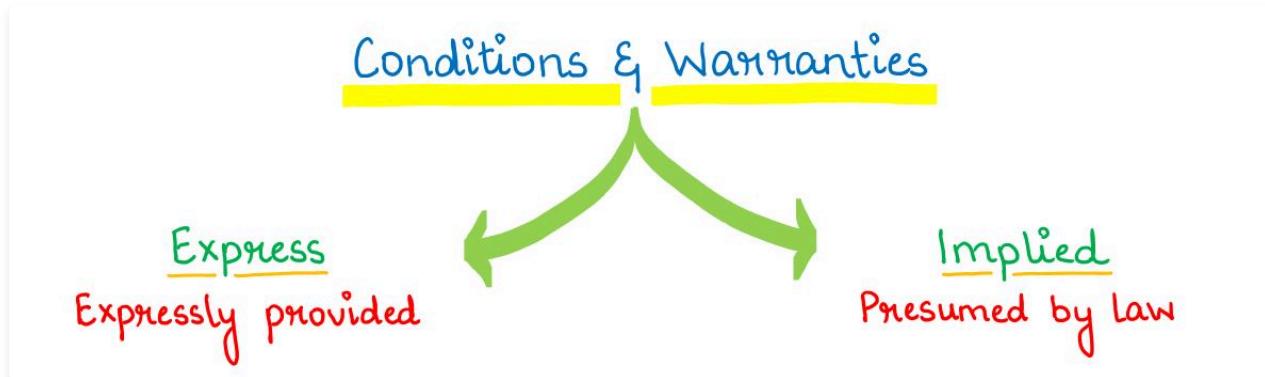
The difference between condition and warranty is given in the table below.

Basis	Condition	Warranty
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Meaning	A condition is essential to the main purpose of the contract.	It is only collateral to the main purpose of the contract.
Right in case of breach	The aggrieved party can repudiate the contract or claim damages or both, in the case of breach of condition.	The aggrieved party can claim only damages in case of breach of warranty.
Conversion of stipulations	A breach of condition may be treated as a breach of warranty.	A breach of warranty cannot be treated as a breach of condition.

10. Conditions and Warranties

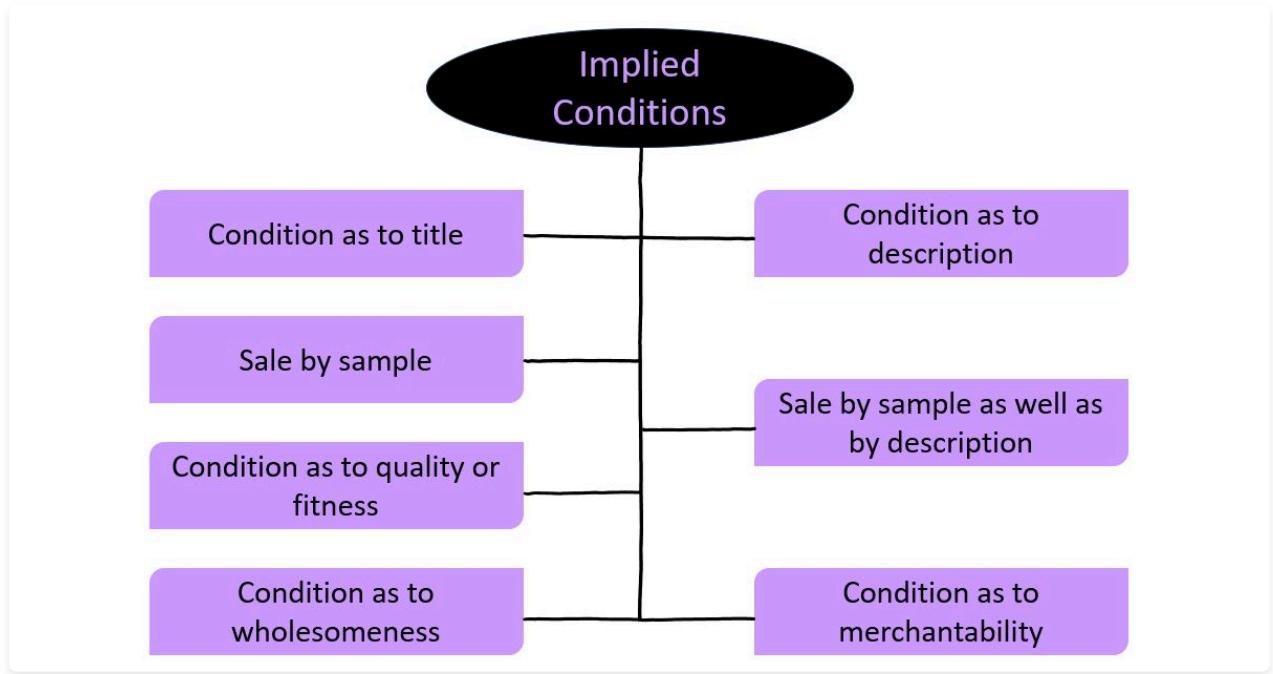
'Conditions' and 'Warranties' may be either express or implied.



Express conditions or warranties are those, which are agreed upon between the parties at the time of contract and are expressly provided in the contract.

Implied conditions or warranties on the other hand, are those, which are presumed by law to be present in the contract. It should be noted that an implied condition may be negated or waived by an express agreement.

11. Implied Conditions



Following are the implied conditions in a Contract of Sale.

1. Conditions as to title
2. Sale by sample
3. Condition as to description
4. Sale by sample as well as by description
5. Condition as to quality or fitness
6. Condition as to merchantability
7. Condition as to wholesomeness.

These are discussed next one by one.

11. Implied Conditions

There is an implied condition on the part of the seller that:

1. in the case of a sale, the seller has a right to sell the goods.
2. in the agreement to sell, the seller will have a right to sell the goods at the time of passing of the ownership in goods.

If the seller's title turns out to be defective, the buyer must return the goods to the true owner and recover the price from the seller.

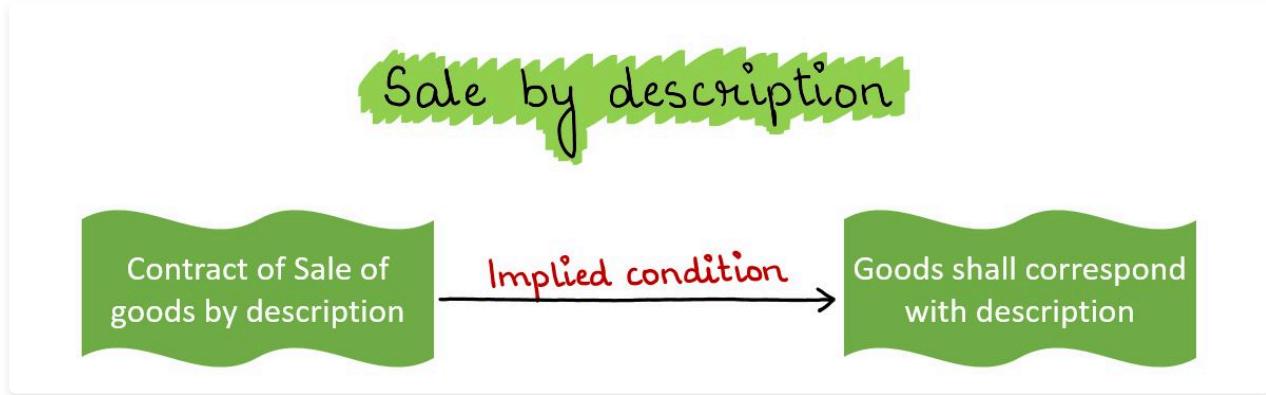


For example, upon purchasing a painting, the buyer relied on the seller's assertion of rightful ownership. If the seller's title is later found to be flawed, the buyer is entitled to return the painting to the true owner and seek a refund from the seller.

Take another example, where A purchased a tractor from B, who had no title to it. After few months, the true owner spotted the tractor and demanded it from A. It was held that A was bound to handover the tractor to its true owner and that A could sue B, the seller without title, for the recovery of purchase price.

11. Implied Conditions

Where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with the description. The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods. It is a condition which goes to the root of the contract and the breach of it entitles the buyer to reject the goods whether the buyer is able to inspect them or not.



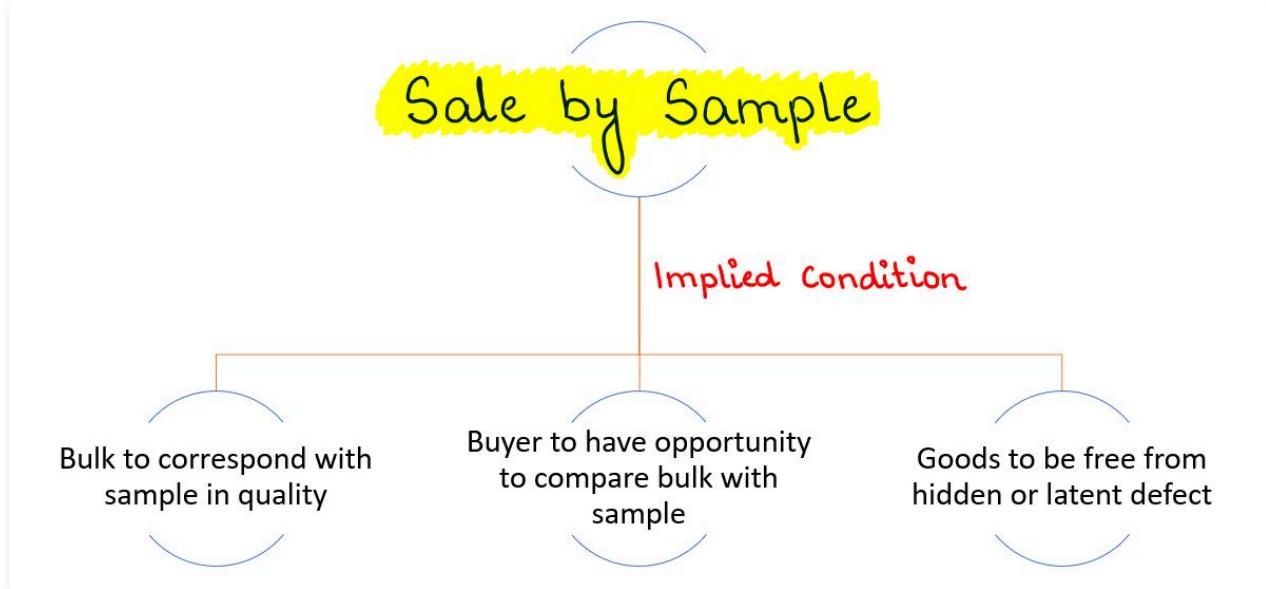
For example, Sara ordered a smartphone online, relying on the website's description of it being the latest model. Upon delivery, she found an outdated version, allowing her to reject the goods as they did not match the provided description.

Take another example, where a ship was contracted to be sold as "copper-fastened vessel", but actually it was only partly copper-fastened. It was held that goods could not correspond to description and hence could be returned or if buyer took the goods, he could claim damages for breach.

11. Implied Conditions

In a contract of sale by sample, there is an implied condition that:

- (a) the bulk shall correspond with the sample in quality;
- (b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample and
- (c) the goods shall be free from any defect rendering them un-merchantable, which would not be apparent on reasonable examination of the sample.

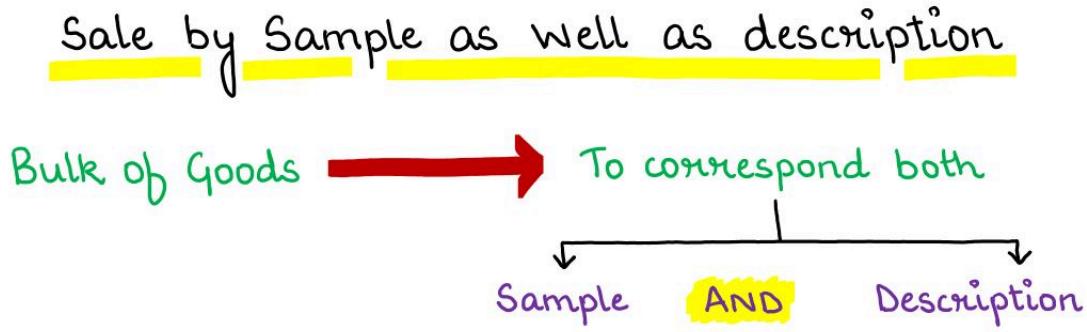


For example, A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. In this case, the court held that the buyer was entitled to the refund of the price plus damages.

Note that this implied condition applies in the case of latent defects, i.e., those defects which cannot be discovered by an ordinary inspection. In fact, such defects are discovered when the goods are put to use or by examination in the laboratories. The seller is not liable for any apparent or visible defects, which can be discovered by examination.

11. Implied Conditions

Where the goods are sold by sample as well as by description, the implied condition is that the bulk of goods supplied shall correspond both with the sample and the description. In case, the goods correspond with the sample but do not tally with description or vice versa or both, the buyer can repudiate the contract.



For example, Hema ordered a custom-designed chair from a furniture store, relying on the description and an image of a sample provided by the seller. When the delivered chair arrived, it had the correct design but was made from a different material than described. As the goods corresponded with the sample but did not align with the description, Hema had the right to repudiate the contract.

Take another example, A agreed with B to sell certain oil described as refined sunflower oil, warranted only equal to sample. The goods tendered were equal to sample but contained a mixture of hemp oil. B can reject the goods.

11. Implied Conditions

Ordinarily, there is no implied condition as to the quality or fitness of the goods sold for any particular purpose. However, the condition as to the reasonable fitness of goods for a particular purpose may be implied, if the buyer had made known to the seller the purpose of his purchase and relied upon the skill and judgment of the seller to select the best goods and the seller has ordinarily been dealing in those goods.

However, this implied condition will not apply, if the goods have been sold under a trademark or a patent name.

Conditions as to quality or fitness

- ↪ Communication of purpose
- ↪ Reliance on seller's expertise
- ↪ Seller regularly deals in goods

For example, Jigya, buying a laptop for gaming, informed the seller about her specific purpose. If the laptop fails to meet the reasonable fitness expectation for gaming, Jigya can claim a breach of implied condition.

Take another example, A bought a set of false teeth from B, a dentist. But the set was not fit for A's mouth. A rejected the set of teeth and claimed the refund of price. It was held that A was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

11. Implied Conditions

Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. However, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed.

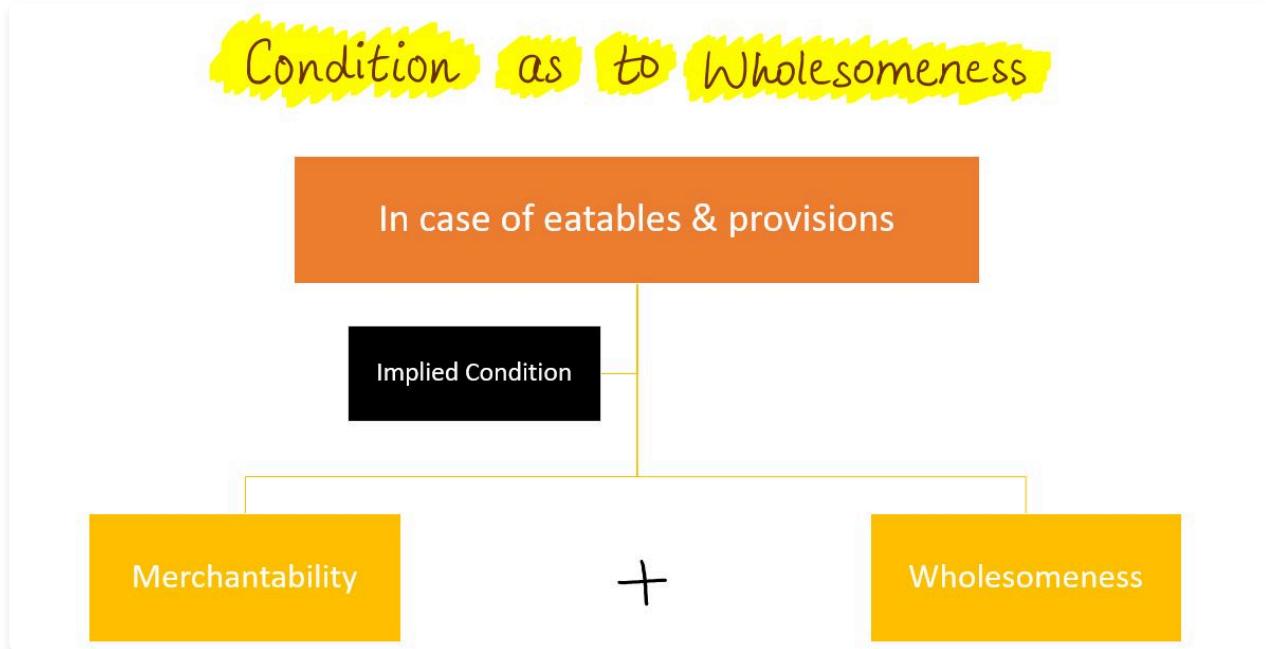
Conditions as to Merchantability

- ↪ Goods bought by description
- ↪ Seller must be dealer in goods of that description

For example, A bought a black velvet cloth from C and found it to be damaged by white ants. Held, the condition as to merchantability was broken.

11. Implied Conditions

In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.



For example, upon buying a pack of biscuits, Era expects them to be safe for consumption. If she later discovers they are contaminated, she can argue a breach of the implied condition of wholesomeness.

Take another example, A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. It was held that there was a breach of condition as to fitness and A was liable to pay damages.

12. Implied Warranties

It is a warranty which the law implies into the contract of sale. In other words, it is the stipulation which has not been included in the contract of sale in express words. But the law presumes that the parties have incorporated it into their contract.



The Act discloses the following implied warranties.

1. Warranty as to undisturbed possession
2. Warranty as to non-existence of encumbrances
3. Warranty as to quality or fitness by usage of trade
4. Disclosure of dangerous nature of goods.

These are discussed next one by one.

12. Implied Warranties

Warranty as to undisturbed possession

Buyer to enjoy quiet possession of goods

If buyer later disturbed in his possession

Entitled to sue seller for breach of warranty

It is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. That is to say, if the buyer got possession of the goods, is later on disturbed in his possession, he is entitled to sue the seller for the breach of warranty.

For example, A purchased a second-hand typewriter which happened to be stolen. Subsequently, the original owner of the typewriter discovered its whereabouts and demanded its return from A. As a result, A's possession of the typewriter was disturbed. In this scenario, A can sue the seller for breach of the implied warranty of undisturbed possession, as the seller did not provide A with the quiet possession of the goods that was warranted.

12. Implied Warranties

It is an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party, not declared or known to the buyer before or at the time the contract is entered into.

Warranty as to non-existence of encumbrances

Goods to be free from any charge

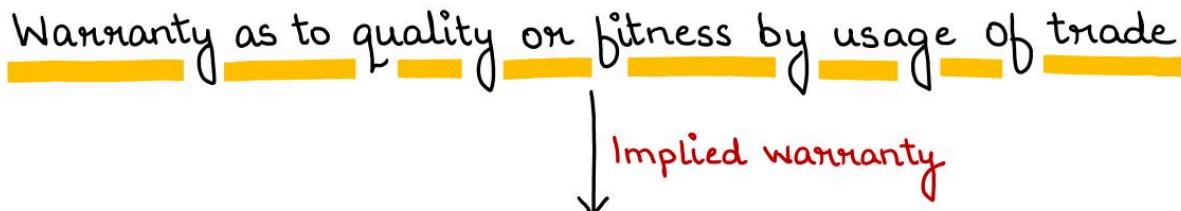
In favour of 3rd party

Before or at the time the contract is entered into

For example, A pledges his car with C for a loan of Rs. 15,000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact. B, may either ask A to clear the loan or himself may pay the money and then, file a suit against A for recovery of the money with interest.

12. Implied Warranties

An implied warranty as to quality or fitness for a particular purpose may be annexed or attached by the usage of trade. In other words, the goods must have quality, which is required as per custom or usage of trade.



Goods to have quality requirement as per custom or usage of trade

For example, when buying coffee beans from a reputable supplier, the implied warranty as to quality is based on the customary standards of the coffee trade, ensuring the beans meet the expected quality as per industry practices.

Regarding implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied, the rule is 'let the buyer beware' i.e., the seller is under no duty to reveal unflattering truths about the goods sold, but this rule has certain exceptions.

12. Implied Warranties

Where the goods are dangerous in nature and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of warranty, the seller may be liable to pay damages.

Disclosure of dangerous nature of goods

The goods are dangerous in nature and

the buyer is ignorant of the danger,

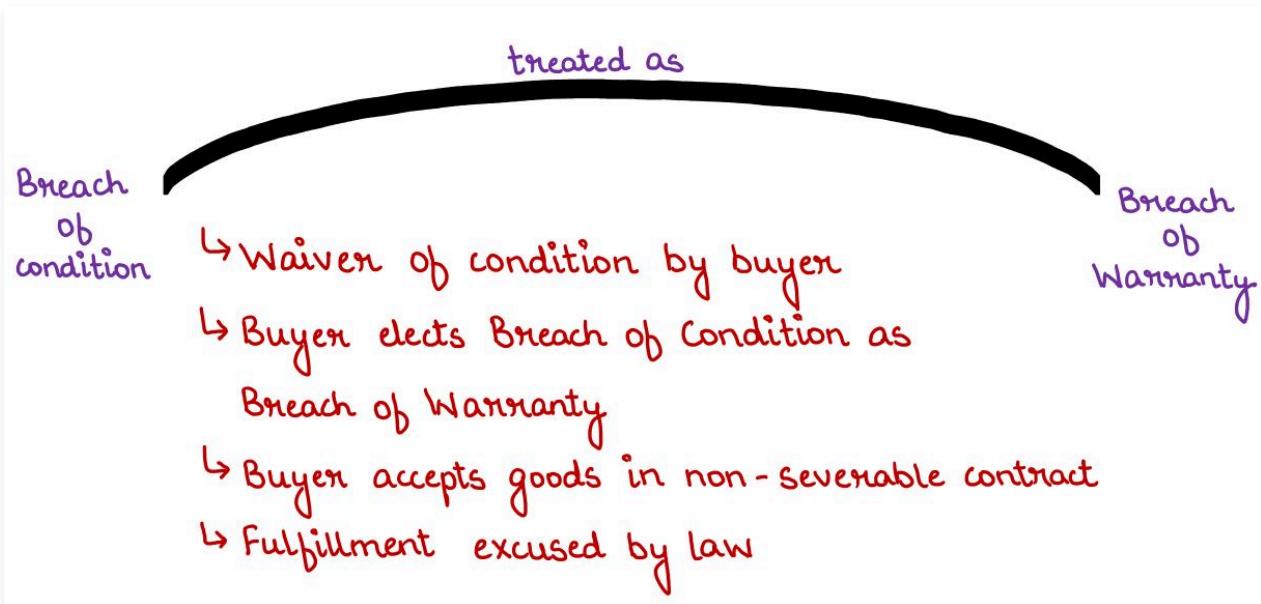
the seller must warn the buyer of the probable danger.

If there is a breach of warranty, the seller may be liable in damages.

For example, if a seller, aware of the hazardous nature of chemicals being sold, fails to inform the buyer who is unaware of the danger, and harm occurs due to the undisclosed danger, the seller may be held liable for breaching the warranty, leading to potential damages.

13. When breach of Condition treated as breach of Warranty

According to Section 13 of the Act, a breach of condition may be treated as breach of warranty in following circumstances.



(i) where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition.

For example, if a seller promises to deliver goods by a certain date, but the buyer agrees to accept the goods even if they arrive late, the buyer is waiving the condition of timely delivery.

(ii) where the buyer elects to treat the breach of condition as breach of a warranty.

For example, if a buyer purchases a laptop with a condition that it will come with a specific software pre-installed, but the software is missing, the buyer might choose to treat it as a breach of warranty rather than a fundamental breach of condition.

(iii) where the contract of sale is non-severable and the buyer has accepted the whole goods or any part thereof.

For example, when a buyer agrees to purchase all the furniture in a showroom, and the seller delivers a portion of it, the buyer's acceptance of the delivered portion may lead to treating any defects as breaches of warranty rather than breaches of condition.

(iv) where the fulfilment of any condition or warranty is excused by law by reason of impossibility or otherwise.

For example, if a seller promises to deliver a unique, handmade item, but the item is destroyed in an unforeseen fire, the law may excuse the fulfillment of the condition due to impossibility, and the breach may be treated as a breach of warranty.

14. Doctrine of Caveat Emptor

CAVEAT EMPTOR → Let the buyer beware

General Rule:

It is the duty of the buyer to examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for his purpose for which he is buying them.

The rule of Caveat Emptor is laid down under Section 16 of the Act, which states that, "subject to the provisions of this Act or of any other law in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".

In case of sale of goods, the doctrine 'Caveat Emptor' means 'let the buyer beware'. When sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. If the goods turn out to be defective, he cannot hold the seller liable. The seller is in no way responsible for the bad selection of the buyer. The seller is not bound to disclose the defects in the goods which he is selling.

It is the duty of the buyer to satisfy himself before buying the goods that the goods will serve the purpose for which they are being bought. If the goods turn out to be defective or do not serve his purpose or if he depends on his own skill or judgment, the buyer cannot hold the seller responsible.

For example, A purchases a horse from B. A required the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor rule applies here and therefore, A can neither reject the horse nor can claim compensation from B.

Exceptions to the rule of Caveat Emptor

There are, however, certain exceptions to the rule which are stated as under (exceptions here means, the cases, where seller is responsible):

1. Where the buyer expressly or by implication, makes known to the seller the particular purpose for which he needs the goods and depends on the skill and judgement of the seller whose business is to supply goods of that description, there is an implied condition that the goods shall be reasonably fit for that purpose. However, in case, where the goods are purchased under its patent name or brand name, there is no implied condition that the goods shall be fit for any particular purpose;
2. If the goods can be used for a number of purposes, the buyer must tell the seller, the particular purpose for which he requires the goods, to hold the seller responsible;
3. Where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be of merchantable quality. This means, the rule of Caveat Emptor does not apply. However, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed;
4. Where the seller sells the goods by making some misrepresentation or fraud and the buyer relies on it or when the seller actively conceals some defect in the goods so that the same could not be discovered by the buyer on a reasonable examination, then the rule of Caveat Emptor will not apply. In such case, the buyer has a right to avoid the contract and claim damages.

15. Unpaid Seller

According to Section 45 of the Sale of Goods Act, 1930, the seller of goods is deemed to be an 'Unpaid Seller' when:

- (a) the whole of the price has not been paid or tendered, or
- (b) a bill of exchange or other negotiable instrument has been received as conditional payment, and it has been dishonoured.

16. Rights of an Unpaid Seller

Rights of an Unpaid Seller against Goods

- Property in goods passed to buyer
 - Lien
 - Stoppage in transit
 - Resale

Property in Goods not passed to buyer

- Withholding delivery
- Lien
- Stoppage in transit
- Resale

Rights of an Unpaid Seller against the Buyer

Suit for Price

Suit for Damages

Suit for Interest

An unpaid seller has been expressly given the rights against the goods as well as the buyer personally, which are discussed as under the following heads.

1. Rights of Unpaid Seller against Goods
2. Rights of Unpaid Seller against Buyer.

These Rights are discussed next.

16. Rights of an Unpaid Seller

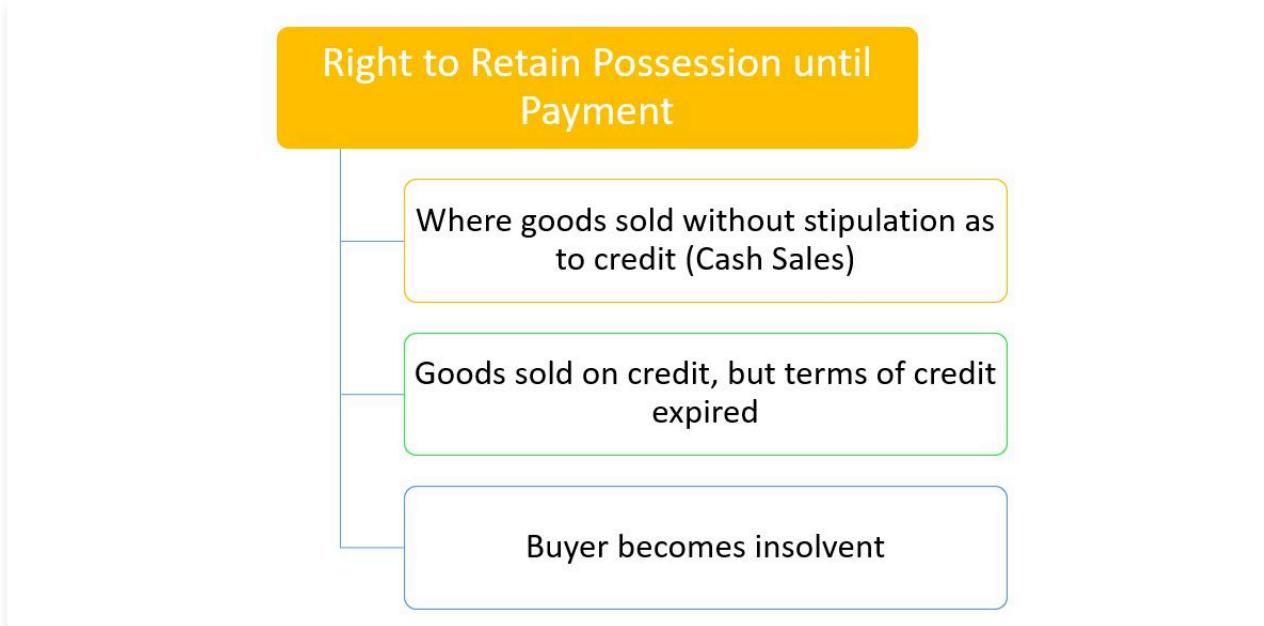
The rights of an unpaid seller against goods can be categorized under 2 headings.

1. Where the property in goods has passed to the buyer

Following rights are available to the unpaid seller.

(a) Right of lien

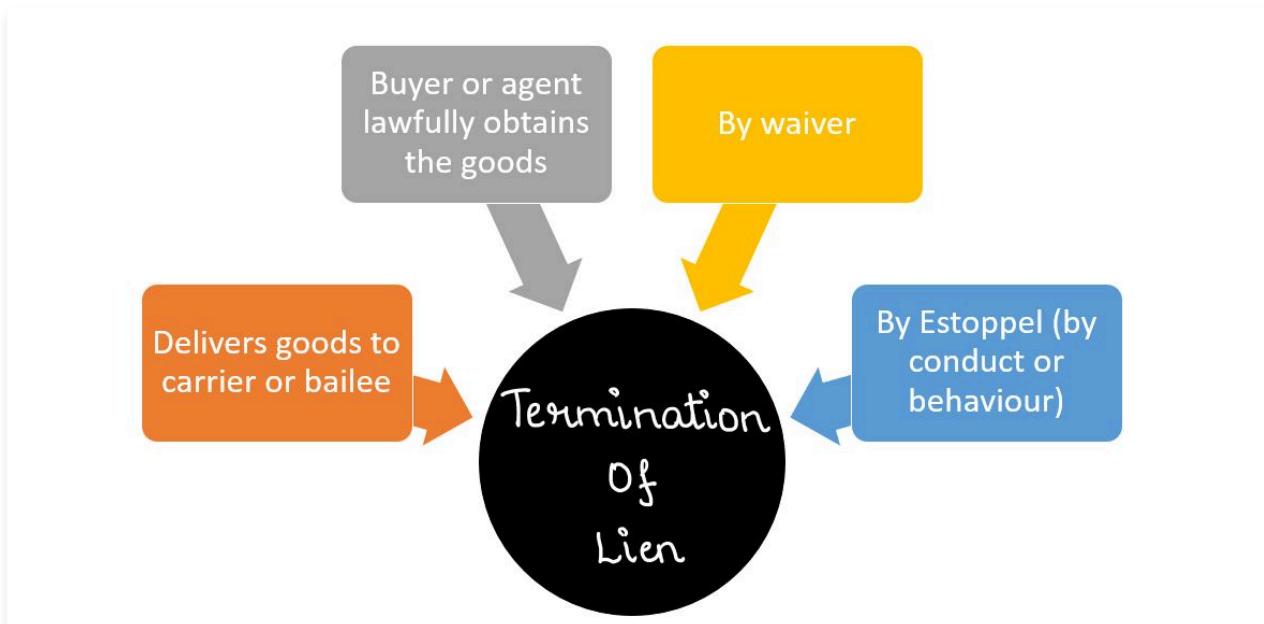
The unpaid seller's lien is a possessory lien i.e., the lien can be exercised as long as the seller remains in possession of the goods.



The unpaid seller who is in possession of goods is entitled to retain possession of goods until payment, in following cases, namely:

- where the goods have been sold without any stipulation as to credit;
- where the goods have been sold on credit, but the term of credit has expired;
- where the buyer becomes insolvent.

When right of lien is lost



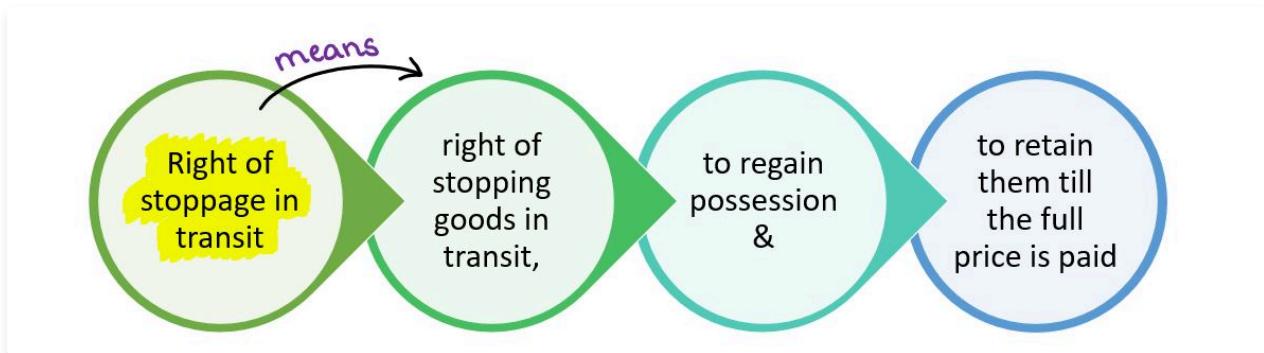
The unpaid seller loses his right of lien under the following circumstances (which is known as termination of right of lien):

- when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
- where the buyer or his agent lawfully obtains possession of the goods.
- where seller has waived the right of lien.
- by Estoppel i.e., where the seller so conducts himself that he leads third parties to believe that the lien does not exist.

For example, A sold a car to B for Rs. 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now, A cannot exercise the right of lien.

(b) Right of stoppage in transit

The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain the possession and to retain them till the full price is paid. When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer. This right is the extension of the right of lien because it entitles the seller to regain possession even when the seller has parted with the possession of the goods.



When right of stoppage of transit can be exercised

The right of stoppage in transit is exercised only when the following conditions are fulfilled.

- The seller must be unpaid.
- He must have parted with the possession of goods.
- The goods are in transit.
- The buyer has become insolvent.

Modes of stoppage in transit

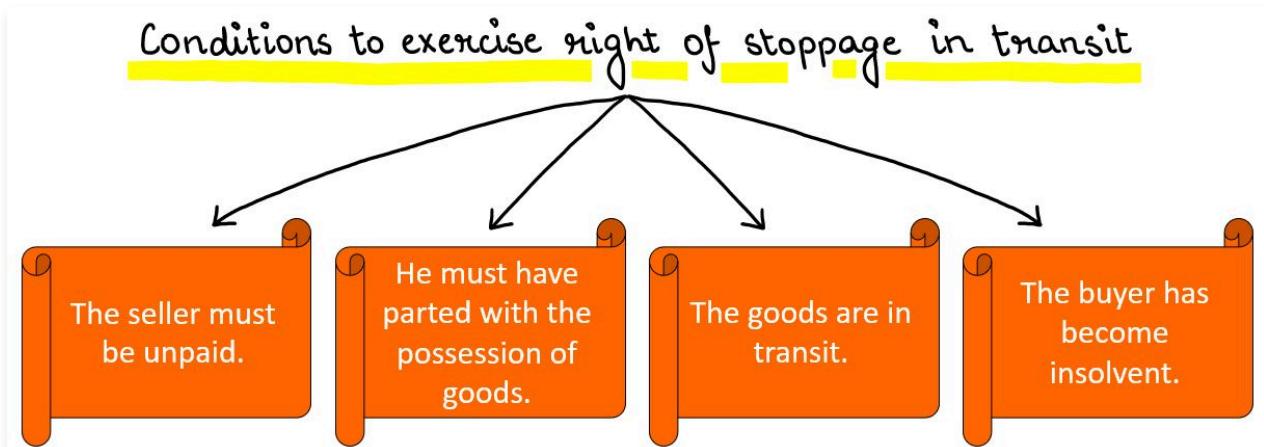
There are following 2 modes of stoppage in transit.

- By taking actual possession of goods, or
- By giving notice to the carrier not to deliver the goods.

Where the notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he (carrier or bailee) shall re-deliver the goods to, or according to the directions of the seller. The expenses of such re-delivery shall be borne by the seller.

When transit come to an end

The right of stoppage in transit is lost, when transit comes to an end.



Transit comes to an end in the following cases:

- when the buyer or other bailee obtains delivery.
- when buyer obtains delivery before the arrival of goods at destination.
- where the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods as soon as the goods are loaded on the ship, unless the seller has reserved the right of disposal of the goods.
- if the carrier wrongfully refuses to deliver the goods to the buyer.
- where goods are delivered to the carrier hired by the buyer, the transit comes to an end.
- where the part delivery of the goods has been made to the buyer, then the transit will come to an end for the remaining goods which are yet in the course of transmission.
- where the goods are delivered to a ship chartered by the buyer, the transit comes to an end.

(c) Right of re-sale

The unpaid seller can exercise the right to re-sell the goods under the following conditions.

- *Where the goods are of a perishable nature:* In such a case, the buyer need not be informed of the intention of resale.
- *Where he gives notice to the buyer of his intention to re-sell the goods:* If after the receipt of such notice, the buyer fails within a reasonable time to pay or tender the price, the seller may resell the goods.

It may be noted that in such cases, on the resale of the goods, the seller is also entitled to:

- (i) *recover the difference* between the contract price and resale price, from the original buyer, as damages.
- (ii) *retain the profit*, if the resale price is higher than the contract price.

It may also be noted that the seller can recover damages and retain the profits only when the goods are resold after giving the notice of resale to the buyer. Thus, if the goods are resold by the seller without giving any notice to the buyer, the seller cannot recover the loss suffered on resale. Moreover, in the absence of notice, if there is any profit on resale, he must return it to the original buyer, i.e., he cannot keep such surplus with him.

2. Where the property in goods has not passed to the buyer

The unpaid seller has, in addition to his remedies, a right of withholding delivery (i.e., refusal to deliver) of the goods. This right is similar to lien and is called "quasi-lien".

16. Rights of an Unpaid Seller

The rights of an unpaid seller against the buyer are as follows.

*Rights
against Buyer*

Sue for price upon breach if property passes

Sue for price if payable on specific day

Sue for damages for non-acceptance

Treat contract as rescinded for anticipating breach

Recover interest

- An unpaid seller may sue the buyer for the price of the goods, in case of breach of contract where the property in the goods has passed on to the buyer and he has wrongfully refused to pay the price according to the terms of the contract.
- The seller may sue the buyer even if the property in the goods has not passed, where the price is payable on a certain day.
- The seller may sue the buyer for damages for non-acceptance, where the buyer wrongfully neglects or refuses to accept and pay for the goods.
- Where the buyer repudiates the contract before the date of delivery, the seller may treat the contract as rescinded and sue damages for the breach. This is known as the 'rule of anticipatory breach of contract'.
- Where there is specific agreement between the seller and the buyer as to interest on the price of the goods from the due date of payment of price, the seller may recover interest from the buyer. However, in absence of any such specific agreement, the seller may charge interest on the price, when it becomes due from such day as he may notify to the buyer.

17. Rights of Buyer

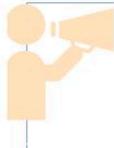
Rights of Buyer



Damages for non-delivery



Suit for specific performance



Suit for breach of warranty



Repudiation of contract before the due date



Suit for interest

If the seller commits a breach of contract, the buyer gets the following rights against the seller.

1. He has the right to have delivery of goods as per the contract.
2. If the seller does not send, as per the contract, the right quantity of goods to the buyer, the buyer can reject the goods.
3. The buyer has a right not to accept delivery of the goods in instalments by the seller.
4. If the goods are sent by sea route by the seller, the buyer has a right to be informed by the seller, so that he may get the goods insured.
5. The buyer has a right to examine the goods which he has not seen earlier before giving his acceptance for the same.
6. If the seller wrongfully refuses to deliver the goods to the buyer as per the contract, the buyer may sue the seller for damages for non-delivery. The amount of damages will be the difference between the contract price and the market price of the goods.
7. If the buyer has already paid the price and the seller has not delivered the goods as per the contract, the buyer can recover the amount paid.
8. If the contract is for the sale of specific or ascertained goods, the buyer may sue the seller for the specific performance of the contract in case of breach of contract by the latter.
9. The buyer may sue the seller for damages for the breach of any implied warranty as per the provisions of the Act.

1. Introduction

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. This is an Act to define and amend the law relating to **promissory notes, bills of exchange and cheques**.

The Act was last amended via Negotiable Instruments (Amendment) Act, 2018, effective from 1st September, 2018. The Amendment Act 2018 contains two significant changes – the introduction of Section 143A and Section 148. These sections provide for interim compensation during the pendency of the criminal complaint and the criminal appeal.

2. Definitions

The Act provides the definitions of following important terms.

Banker

Banker includes any person acting as a banker and any post office savings bank.

Drawee in case of need

When in the Bill or in any endorsement thereon, the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a "drawee in case of need".

Holder of a promissory note, bill of exchange or cheque

The holder of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

Holder in due course

Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, before maturity, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (i.e., in good faith).

Thus, according to the above definition, a holder in due course is one who receives the instrument:

- for consideration;
- without notice as to the defect in the title of the transferor; i.e. in good faith and
- before maturity.

Note that a holder in due course acquires a good title irrespective of any defect in a previous holder's title.

Payment in due course

Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

In other words, payment in due course refers to making a payment according to the clear terms of the instrument, done in good faith and without negligence, to a person who holds the instrument. This should happen under circumstances that do not give a reasonable reason to believe that the person is not entitled to receive the specified amount.

Maturity of a promissory note or bill of exchange

Maturity of a promissory note or bill of exchange is the date at which it falls due.

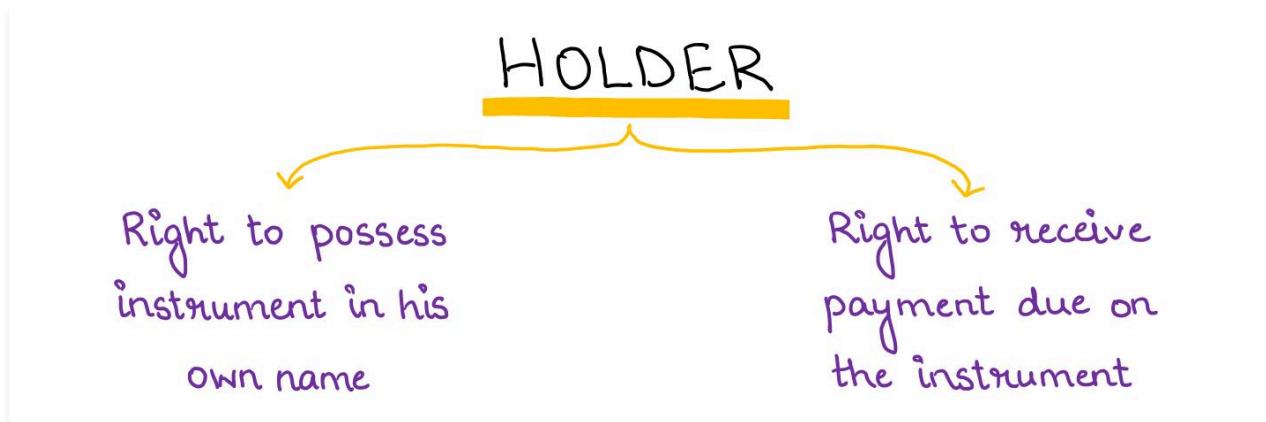
Days of grace

Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment is at maturity on the 3rd day after the day on which it is expressed to be payable.

2. Definitions

The law makes a clear distinction between ordinary holder (or just 'holder') and holder in due course (HIDC). HIDC enjoys certain privileges as compared to ordinary holder. The concept of ordinary holder, HIDC and his privileges are given below.

Meaning of 'Holder'



A person is said to be holder of negotiable instrument, if he satisfies the following 2 conditions:

- (i) He should be entitled to possess the instrument in his own name e.g., legal custody of an instrument.
- (ii) He should have a right to receive or recover the amount due on the instrument from the party liable to pay.

However, it is not necessary that the instrument must be in his possession. Rather, to be a holder, he is required to have a right to possession under some valid and legal title. Thus, the holder should be de-jure holder (holder in law).

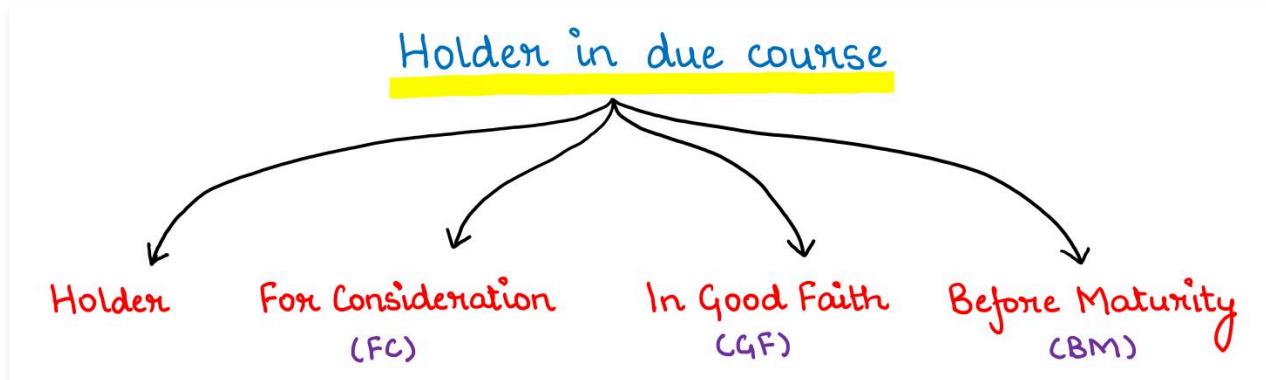
To be a holder, the person must be named in the instrument as the payee or the endorsee or he must be the bearer thereof. The legal representative of the holder may also become the holder of instrument, by operation of law i.e., on obtaining certificate of succession.

Where the person, is in possession of negotiable instrument without having a right to possess it, he cannot be considered as a holder. A person who has obtained the possession of instrument by theft or under forged instrument is not a holder.

Also, to become holder, it is not enough to have lawful possession of the instrument. But the person must also have right to receive or recover the amount from the party liable to pay.

Meaning of 'Holder in Due Course'

The holder in due course occupies key position in the instrument with regard to his relation with other parties of an instrument.



Before a person can claim to be a holder in due course, he must satisfy the following conditions:

1. He must be a **holder**, i.e., right to possess instrument in his own name and right to recover or receive payment thereon.
2. He must have become the **holder for consideration**. In other words, the holder must have given lawful consideration to acquire the instrument. In case, if someone gets a cheque as a gift, he cannot become holder in due course of that cheque.

3. He must have obtained the possession of negotiable instrument **before maturity**. In case he acquires the instrument after the date of maturity, he will not get better title than that of transferor.

4. He must have obtained the negotiable instrument **in good faith** i.e., without a sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. The circumstances leading to suspicion may be related to blank acceptance, incomplete bill, torn pieces of the bill pasted together and improper indorsement etc. In all such cases, he must exercise reasonable care and due caution as to be on safe side.

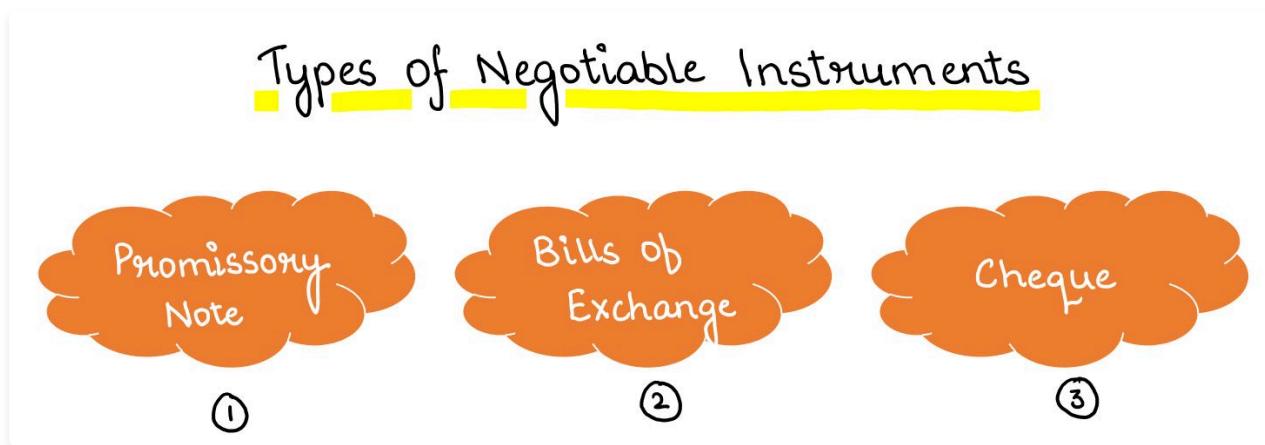
Privileges of a holder in due course

A holder in due course, is in a privileged position. He gets many special rights which are generally not available to an ordinary holder. He enjoys the following privileges:

1. **Defect-Free Title:** HIDC receive the instrument with a title free from any defects.
 2. **No Burden of Proof:** The holder in due course is not required to prove their title. Once the instrument is in their possession, it is considered clean and defect-free.
 3. **Liability of Prior Parties:** Anyone who was involved with the instrument before the holder in due course can be held responsible.
 4. **Transfer of Rights:** If someone acquires the instrument from a holder in due course, they enjoy the same rights as the original holder in due course.
 5. **No Defense Without Consideration:** Prior parties cannot claim that the instrument was drawn, made, or endorsed without any consideration.
 6. **Defense Against Fraud or Unlawful Acts:** Prior parties cannot defend themselves by stating that the instrument was lost, obtained through an offense, fraud, or for an unlawful consideration. A holder in due course obtains a valid title even if the transferor's title was defective.
-

3. Negotiable Instrument

Negotiable Instrument is an instrument (the word instrument means a document) which is freely transferable (by customs of trade) from one person to another by mere delivery or by endorsement and delivery. The property in such an instrument passes to a bona fide transferee for value.



The Act does not define the term 'Negotiable Instruments'. However, Section 13 of the Act provides for only 3 kinds of negotiable instruments namely, bills of exchange, promissory notes and cheques, payable either to order or bearer.

When is Negotiable Instrument payable to order

A negotiable instrument is payable to order:

1. which is payable to a particular person.
2. which is payable to a particular person or his order.
3. which is payable to the order of a particular person.

For example, a promissory note that states, "Pay to the order of Rama Dhingra."

When is Negotiable Instrument payable to bearer

A negotiable instrument is payable to bearer when:

1. it is expressed to be payable to bearer.
2. the last endorsement is in blank.

For example, a cheque with the payee left blank (not specified) or with the endorsement in blank, allowing it to be transferred to anyone by delivery.

Note that a promissory note cannot be made payable to bearer. The bill of exchange cannot be made payable to bearer on demand.

3. Negotiable Instrument

Essential features of Negotiable Instruments

In writing

Signed

Freely transferable

Holder's title free from defects

Transferred infinite times

Unconditional promise or order to pay

Delivery

Payable either to order or to bearer

Certainty of sum payable, time of payment & payee

Following are the essential characteristics of Negotiable Instruments.

1. It is necessarily **in writing**.
2. It should be **signed**.
3. It is **freely transferable** from one person to another.
4. **Holder's title is free from defects**.
5. It can be transferred **any number of times** till its satisfaction.
6. Every negotiable instrument must contain an **unconditional promise or order to pay** money. The promise or order to pay must consist of money only.
7. The **sum payable, the time of payment, the payee, must be certain**.
8. The instrument **should be delivered**. Mere drawing of instrument does not create liability.
9. Negotiable instrument **must be payable either to order or to bearer**.

3. Negotiable Instrument

Section 118 of the Act establishes presumptions regarding negotiable instruments. These presumptions can be challenged with opposing evidence.

1. { • As to consideration
2. { • As to date
3. { • As to time of acceptance
4. { • As to time of transfer
5. { • As to order of indorsements
6. { • As to stamp
7. { • As to holder

Presumptions as to
Negotiable Instruments

In simpler terms, unless proven otherwise, the following assumptions will be considered valid.

1. **Presumption as to consideration:** Every negotiable instrument was made or drawn for consideration. In other words, the law assumes that every promissory note carries a consideration unless proven otherwise.
2. **Presumption as to date:** Every negotiable instrument bearing a date was made or drawn on such date.
3. **Presumption as to time of acceptance:** Every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity.
4. **Presumption as to time of transfer:** Every transfer of a negotiable instrument was made before its maturity.
5. **Presumption as to order of indorsements:** Indorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.
6. **Presumption as to stamp:** Lost promissory note, bill of exchange or cheque was duly stamped.
7. **Presumption as to holder:** The holder of a negotiable instrument is a holder in due course.

4. Promissory Note

According to Section 4 of the Act, "A promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument".

Specimen of Promissory Note

Rs. 5,000	Delhi Oct 01, 2002
Three months after date, I promise to pay Sh. Deepak (payee) on order the sum of Rupees Five Thousand, for value received.	
To, Sh. Deepak Address of Payee	Stamp Sd/- Amit Kumar (Maker)

Parties to Promissory Note

There are following 2 parties to Promissory Note:

1. **Maker:** The person who makes the promise to pay is called the 'Maker'. He is the debtor and must sign the instrument.
2. **Payee:** Payee is the person to whom the amount on the note is payable.

4. Promissory Note



Essential Features
Of
Promissory Note

Following are the essential characteristics of a Promissory Note.

1. It should be **in writing**, therefore, an oral promise to pay is not sufficient.
2. There must be an **express promise to pay**. Mere acknowledgement of debt is insufficient.

For example, I owe you Rs. 3,000, is a mere acknowledgement of debt, but not a promise to pay.

3. The **promise to pay should be definite and unconditional**. Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event, are not promissory notes. However, the promise to pay may be subject to a condition, which is bound to happen.

For example, I promise to pay B Rs. 5,000 on D's death, is a valid promissory note, as death of D is certain.

4. A promissory note **must be signed by the maker**, otherwise it is incomplete and ineffective.
5. There should be a **promise to pay certain sum of money only**.

For example, I promise to pay Rs. 5,000 and all other sums which shall be due to him, is an invalid promissory note, as the amount payable is not certain.

6. The **maker and payee must be certain, definite and different persons**.
7. A promissory note **cannot be made payable to the bearer** (Section 31 of RBI Act). Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.
8. A promissory note **must be properly stamped** in accordance with the provisions of the Indian Stamp Act and such stamp must be duly cancelled by maker's signatures or initials or otherwise.

5. Bill of Exchange

A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

Specimen of Bills of Exchange

Rs. 10,000	Mr. A (Drawer) Address of Drawer March 01, 2021
Three months after date, pay to Mr. B (Payee) the sum of Rupees Ten Thousand, for value received.	
Stamp Signature Mr. A	
To, Mr. C (Drawee) Address Sd/- (Signed & accepted by drawee)	

Parties to a bill of exchange

There are following 3 parties to a bill of exchange.

1. **Drawer:** The maker of a bill of exchange.
2. **Drawee:** The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.
3. **Payee:** The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid. The payee may be the drawer himself or a third party.

5. Bill of Exchange

**Essential features
of
Bills of Exchange**



Following are the essential characteristics of a bill of exchange.

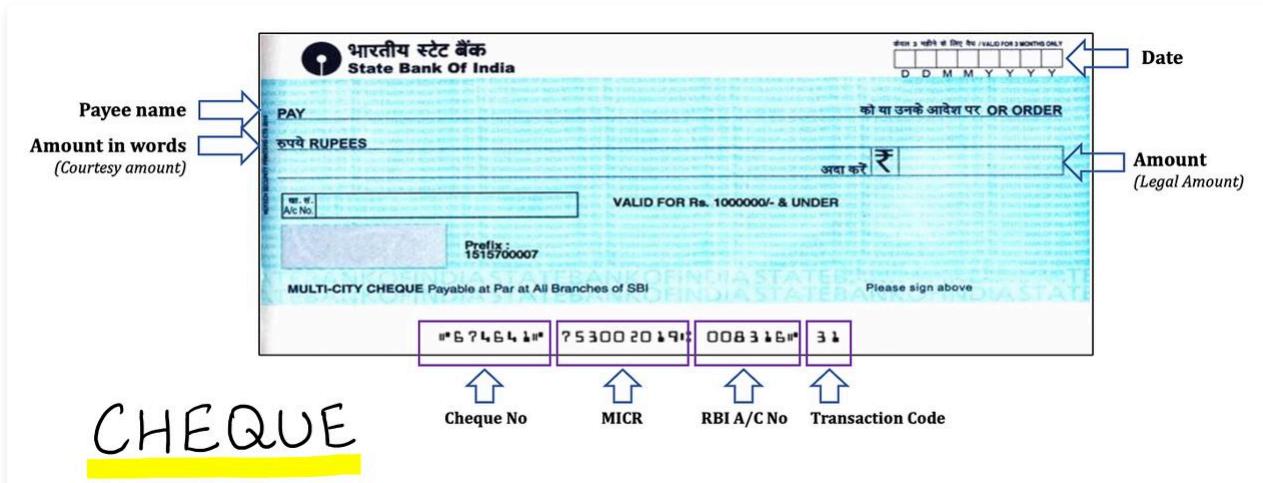
1. It must be **in writing**.
2. It **must contain an express order to pay**.
3. The **order to pay must be definite and unconditional**.
4. The **drawer must sign the instrument**.
5. **Drawer, drawee and payee must be certain**. All these three parties may not necessarily be three different persons. One can play the role of two. But, there must be two distinct persons in any case.
6. As per Section 31 of RBI Act, 1934, a bill of exchange **cannot be made payable to bearer on demand**.
7. The **sum must be certain**.
8. The **order must be to pay money only**.
9. It **must be stamped**.

5. Bill of Exchange

The difference between Promissory Note and Bills of Exchange are as follows.

Basis	Promissory Note	Bill of Exchange
Definition	It is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	It is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.
Nature of Instrument	There is a promise to pay.	There is an order for making payment.
Parties	Two parties, namely, the maker and the payee.	Three parties, namely, the drawer, the drawee and the payee.
Acceptance	It does not require any acceptance, as it is signed by the person who is liable to pay.	It needs an acceptance from the drawee.
Payable to bearer	A promissory note cannot be made payable to bearer.	It can be drawn payable to bearer. However, it cannot be payable to bearer on demand.

6. Cheque



A 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a 'truncated cheque' and a 'cheque in the electronic form'. The term 'Payable on demand' means it should be payable whenever the holder chooses to present it to the drawee (the banker).

It is important to note that a bill of exchange is a negotiable instrument in writing containing an instruction to a third party to pay a stated sum of money at a designated future date or on demand. Whereas, a cheque is also a bill of exchange, but is drawn on a banker and payable on demand.

Parties to a Cheque

There are following 3 parties to a Cheque.

- Drawer:** The person who draws a cheque i.e. makes the cheque. His liability is primary and conditional.
- Drawee:** The specific bank on whom cheque is drawn. He makes the payment of the cheque. In case of cheque, drawee is always a banker.
- Payee:** The person named in the instrument (i.e. the person in whose favour cheque is issued), to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee. The payee may be the drawer himself or a third party.

6. Cheque

Essential features of Cheque

- ↳ Bill of Exchange
- ↳ Drawn on specified banker
- ↳ Payable on demand

According to the definition of cheque under Section 6 of the Act, a cheque is a species of bill of exchange.

Therefore, a cheque:

1. should fulfil all the essential characteristics of a bill of exchange.
2. must be drawn on a specified banker.
3. must be payable on demand.

Thus, it can also be concluded from the above characteristics, that all cheques are bills, while all bills are not cheques.